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31 August 2006

Dear Martin

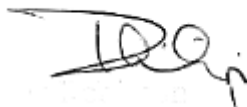
Fighting money laundering and terrorist finance: moving forward over the risk-based approach – our supervisory expectations

I wrote to Ian Mullen, as the then Chairman of the JMLSG, on 10 April setting out the FSA's expectations of firms under the new AML/CTF regime that comes into force on 1 September. In that letter I stressed the FSA's commitment to supervising in ways that promote the risk-based approach, and described how we have been investing in an extensive programme to retrain our supervisors to help deliver this. As part of this programme I will be circulating the enclosed material to our supervisors and firm-facing staff. As you will see, the key messages are essentially the same as those in my earlier letter, namely that we expect firms, under the leadership of their senior managers:

- to deliver high AML/CTF standards,
- to assess where their risks lie and manage them appropriately, and
- to have regard to the content of your Guidance in designing, implementing and monitoring their AML/CTF systems and controls.

We hope too that firms will be willing to shift resources into the areas of greatest vulnerability and (where the law allows this) away from activity that adds less value to their AML/CTF effort; although of course, ultimately, as long as firms are managing all their higher risks effectively it is their choice as to whether to refocus their AML/CTF activity in this way.

I am conscious that one reason why firms may feel inhibited about acting in a more risk-based way is concern as to how their supervisors will react. I hope that publicising the attached material will help firms understand their supervisors' expectations. With this in mind I will be posting this letter today on the FSA website and circulating it widely, and would be grateful if you could also cascade it to your members.

Yours sincerely


Philip Robinson
Financial Crime Sector Leader
Encs

To: All supervisors and other firm-facing staff Date: 31 August 2006

From: Philip Robinson cc:

Financial Crime Sector Leader

Ref:

Subject: **Changing the way we supervise anti-money laundering**

The FSA is committed to being more risk-based in the ways we supervise firms' anti-money laundering (AML) and counter-terrorist finance (CTF) systems and controls. This is of course part of our general commitment to better regulation. But it also reflects the fact that the FSA and HM Treasury are seen internationally as being among those pioneering a more risk-based approach to fighting money laundering and terrorist finance.

Supervisors and front-line staff are crucial to helping firms deliver a more risk-based approach to AML/CTF – it is through you that the FSA will achieve success. This note, and the material that accompanies it, is:

- to brief you on the major developments that are happening over a more risk-based approach to AML/CTF;
- to explore what these mean for you in your dealings with firms, in terms of the philosophy of your approach and what you do in practice; and
- to provide you with resources to assist you to supervise AML/CTF in a more risk-based way.

Formal changes to the AML/CTF regime

The change to a more risk-based approach can be seen in the reform of our Handbook provisions on money laundering. From tomorrow, the ML Sourcebook will be withdrawn in its entirety and replaced with high level provisions in the SYSC Sourcebook (SYSC 3.2.6A R – SYSC 3.2.6J G) intended to drive a more effective, risk-based approach. At the same time, radically revised Guidance from the Joint Money Laundering Steering Group (JMLSG), promoting a more risk-based approach, will also come fully into effect.

Changes to our approach

We need to ensure that our expectations of how firms should be managing their money laundering and terrorist finance (ML/TF) risks help provide the fertile ground in which a more risk-based approach can take root. In particular we need to be sure that firms:

- are systematically identifying and managing their ML/TF risks (in ways that are proportionate to the firms' circumstances);
- have strong senior management engagement with AML/CTF;
- use the right AML/CTF tools for the job; and
- keep their focus throughout on outcomes rather than inputs.

In other words, we are much more concerned about firms having in place systems which prevent and detect crime than matters like the number of documents and utility bills collected at customer take-on. The note below sets out some of the key issues in the way we need to supervise AML/CTF. It also reinforces the importance of the JMLSG Guidance and underlines the increased flexibility that firms have over their AML/CTF defences. We will shortly deliver to you all a laminated copy.

[Note from Philip Robinson](#)

How AML/CTF fits into ARROW II

We have been working on how AML/CTF fits best into the new ARROW methodology, to ensure that the subject gets the attention that it deserves and that you have resources that support the new style of AML/CTF supervision needed.

Different aspects of ML/TF risk fall within several risk elements including:

- institutional client/counterparty characteristics;
- retail customer characteristics;
- institutional product/market characteristics;
- accepting customers;
- post-sale handling of customers;
- people risk;
- HR controls; and
- compliance monitoring and guidance.

Guidance on the type of AML/CTF questions you should be asking your firms will be included in the relevant risk element guidance. However, for ease of reference, we will be providing you a laminated copy of consolidated AML/CTF guidance to assist you when preparing ARROW visits

Training for supervisors

Given the significance of the new approach to AML/CTF, we have invested substantially over recent months in a new training programme:

- our computer-based financial crime package, which we rolled out late last year. All staff should by now have completed this training, and new staff should do so as soon as possible after joining;

- the day-long workshops run by PWC on financial crime in the sectors you supervise, which are continuing; and
- the workshops, run by relevant trade associations and practitioners, on Part II of the new JMLSG Guidance - the sector-specific material - which will be rolled out later this year. The Financial Crime Sector Team will let you have details shortly.

Joint Money Laundering Steering Group (JMLSG) Guidance – 2006 edition

Every supervision team in the FSA will also shortly be provided with an up to date hard copy of the general material in the new JMLSG Guidance (Part I). You should destroy any old versions of the JMLSG Guidance that you have, as they are now out of date.

The JMLSG will be updating their Guidance from time to time so you may wish to add the attached shortcut to the electronic version of the Guidance to your desktop (use cut-and-paste), to ensure that the version you are using is up to date.

[JMLSG Guidance](#)

Firms need to be confident about what the FSA expects of them over AML/CTF

Ultimately, as long as firms are managing all their higher risks effectively it is their choice as to whether to refocus their AML/CTF activity and act in a more risk-based way. But we hope that firms will have the confidence to take the new opportunities available to them and will shift resources into the areas of greatest vulnerability and (where the law allows this) away from activity that adds less value to their AML/CTF effort.

To help give firms greater confidence about our supervisory expectations, I have written to the Chairman of the Joint Money Laundering Steering Group, Martin Hall, with a copy of this note and its attachment. This letter has been posted on the FSA website and will be circulated widely.

Philip Robinson

**FSA supervision of firms' defences against
money laundering and terrorist finance**

**Six key issues:
note from**

Philip Robinson, Financial Crime Sector Leader

31 August 2006

The FSA has, over the last couple of years, been strongly encouraging firms to be more risk-based in the way they deploy their anti-money laundering (AML) and counter-terrorist finance (CTF) systems and controls. We need to ensure that our style of supervision helps support this approach. The withdrawal of the Money Laundering Sourcebook at the end of August, and its replacement with more high-level provisions in the SYSC Sourcebook, is an important stage in this process; as is the coming fully into force at the same time of the new edition of the Joint Money Laundering Steering Group (JMLSG) Guidance that advocates a more risk-based approach to AML/CTF. These changes have important implications for how we do AML/CTF supervision, and this note highlights six key issues.

1. AML/CTF matters as much as ever

The priority that we accord to AML/CTF is unchanged. Supervisors should continue to pay as much attention to AML/CTF issues as is appropriate given the risks presented to our regulatory objectives.

2. We expect high AML/CTF standards

We expect firms to be managing their money laundering and terrorist finance risks effectively and to be meeting their legal and Handbook obligations. A more risk-based approach means:

- more flexibility over the *how* – what firms do to manage their risks, in ways that are proportionate for them; but
- no flexibility over the *what* – they must deliver high AML/CTF standards (and comply with the law).

3. Significant changes of emphasis over AML/CTF

The new AML/CTF regime is more about significant changes of emphasis than radical changes to the techniques used. In particular under the new SYSC provisions we expect:

- strong senior management involvement (and under SYSC 3.2.6H R there is now an explicit requirement for a firm to allocate to one or more specific directors or senior managers - who may also be the MLRO - overall responsibility for the establishment and maintenance of effective AML/CTF systems and controls). This in turn implies good flows of management information to the person(s) with such overall responsibility;
- a more risk-based approach to the use of AML/CTF tools: monitoring procedures, for example, that pay more attention to high-risk customer/product combinations than they do to low-risk ones;

- a risk-management approach – identify, mitigate, monitor, review and document. Which is not to say that such an approach need always be elaborate – it will depend on the circumstances of the firm; and
- systems and controls that are proportionate to the risks the firm faces, and appropriate for the firm's particular circumstances (given the nature, scale and complexity of its activities).

Also more generally we expect a firm to regard AML/CTF tools as a means to an end. A firm will still need to identify its customers satisfactorily, deliver good training to its staff etc. But how it does so, and how much resource it should put into each area, should be determined by a sound judgement as to how best it can reduce its money laundering and terrorist finance risks. Ultimately, as long as firms are managing all their higher risks effectively it is their choice as to whether to refocus their AML/CTF activity and act in a more risk-based way. But we hope that firms will have the confidence to take the new opportunities available to them and will shift resources into the areas of greatest vulnerability and (where the law allows this) away from activity that adds less value to their AML/CTF effort.

4. A growing diversity of AML/CTF practice

Supervisors should expect to see a growing diversity of AML/CTF practice in firms, as the focus is now more on the result (adequate risk mitigation) and there is a wider range of ways to achieve this. So if, say, two firms doing similar business have very different ID regimes, provided that both firms are effectively managing their risks and complying with the law the difference in approach will not give cause for concern.

5. The importance of the JMLSG Guidance

Under SYSC 3.2.6E G we undertake when considering whether there has been a breach of our rules on AML/CTF systems and controls to 'have regard to' whether a firm has followed the JMLSG Guidance. So we expect firms either to be following the Guidance or to be doing something else that delivers the same standards of risk mitigation (and meets the firms' legal obligations). We would also be surprised if a firm was unaware of the contents of the Guidance.

6. Sensible and effective ID practices

Firms are obliged by law to verify the identities of their new customers and as part of good risk mitigation we also expect them where the risks warrant it to ensure that they have verified the identity of long-standing customers. Also under SYSC 3.2.6G(5) G we encourage firms to 'ensure that [their] systems and controls include ... appropriate measures to ensure that procedures for identification of new customers do not unreasonably deny access to [their] services to potential customers who cannot reasonably be expected to produce detailed evidence of identity'.

Generally we would expect firms:

- to be verifying the identity of customers effectively and to be keeping good records of this;
- to be using checks that are fit for purpose – with standards geared to the ML/TF risks presented; and
- to be taking advantage of the flexibility over financial exclusion set out in the guidance at SYSC 3.2.6G(5) G - using the other AML/CTF tools as necessary to deliver effective risk mitigation in these circumstances. ID should not be a significant barrier to financial inclusion.