

What's inside

1 Introduction

Anti-bribery and corruption systems and controls in investment banks

2 Enforcement cases

Banks' defences against investment fraud

Recent speeches

3 Financial crime supervision

Financial crime: a guide for firms

Sanctions reporting: the practicalities

Thematic work

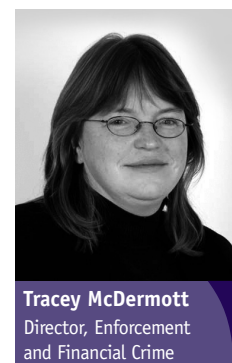
Safe custody

Welcome to Issue 16 of our Financial Crime newsletter. So far, 2012 has been particularly busy for us. We have published the findings of two significant pieces of thematic work, contacted over 75,000 potential victims of boiler room scams, and continued with our credible deterrence strategy, taking regulatory action against three financial institutions for financial crime failings and securing numerous criminal convictions for insider dealing.

Throughout the remaining life of the FSA, and continuing into the Financial Conduct Authority (FCA), we will focus on tackling key financial crime risks to our objectives. This newsletter confirms that we will be taking forward our intensive and intrusive work on anti-money laundering (AML), sanctions, counter-terrorist financing and anti-bribery and corruption (ABC) systems and controls in a number of very large banks. We also give more detail about our recent thematic reviews and enforcement cases.

Finally, it is vital during periods of change that we remain focused and committed in the fight against financial crime. I am delighted to be given the opportunity to lead our work in this area as director of the Enforcement and Financial Crime Division. I am also delighted to introduce the new Head of Department for our Financial Crime and Intelligence Department, Sharon Campbell. Sharon has been at the FSA for over seven years. Before this she was Head of Department in our Authorisation Division and she has over 20 years of industry experience. Sharon replaces Bob Ferguson, who has made a real contribution to countering financial crime and will be missed. He will be taking a few months career leave and returns in March to take up a new position in the FSA. Bob goes with all our thanks for his hard work over the years.

Tracey McDermott
Director, Enforcement and Financial Crime



Anti-bribery and corruption systems and controls in investment banks

In March 2012 we published a report on how investment banks and similar firms are managing the bribery and corruption risk in their business. We found that, although some had started work to identify and assess their bribery and corruption risks and factor them into their ABC controls, including policies, procedures and training and monitoring programmes, most had more work to do.

In particular:

- most firms had not properly taken account of our rules covering bribery and corruption, either before the implementation of the Bribery Act 2010 or after;

- nearly half the firms in our sample did not have an adequate ABC risk assessment;
- management information on ABC was poor, making it difficult for us to see how firms' senior management could provide effective oversight;
- only two firms had either started or carried out specific ABC internal audits;
- there were significant weaknesses in firms' dealings with third parties used to win or retain business; and
- many firms had recently tightened up their gifts, hospitality and expenses policies, but few had processes to ensure gifts and expenses in relation to particular clients/projects were reasonable.

We were pleased to see, however, that most firms used senior committees to drive the ABC agenda, and generally there was an appropriate level of senior management involvement in decision-making about new third-party relationships or transactions. Overall, the report concluded that the investment banking sector has been too slow and reactive in identifying, assessing and managing their bribery and corruption risk. In particular, the introduction of the Bribery Act and our visits were the main triggers for many firms in our sample to review, or consider for the first time, their approach to ABC.

Enforcement cases

Coutts

We fined Coutts & Company, a private bank and wealth management firm wholly owned by Royal Bank of Scotland (RBS), £8.75m in March 2012 for poor AML systems and controls. Coutts failed:

- to take reasonable care to establish and maintain effective AML systems and controls in relation to their high-risk customers;
- to assess adequately the level of money-laundering risk posed by prospective and existing high-risk customers, including failing to identify and record properly all politically exposed persons (PEPs); and
- to establish their PEP and high-risk customers' income or source of wealth, and to scrutinise appropriately the transactions of PEPs and other high risk customers.

These failings were serious, systemic and were allowed to persist for almost three years. They were particularly serious because Coutts is a high-profile bank with a leading position in the private banking market, and because the weaknesses resulted in an unacceptable risk of handling the proceeds of crime.

See our final notice for more information: www.fsa.gov.uk/static/pubs/final/coutts-mar12.pdf

Habib

In May 2012 we fined Habib Bank £525,000, and its Money Laundering Reporting Officer (MLRO) £17,500, for poor AML systems and controls. Habib did not:

- establish and maintain adequate procedures for assessing the level of money laundering risk posed by prospective and existing customers;
- conduct sufficient enhanced due diligence on higher risk customers;
- classify appropriately the risk posed by customers;
- undertake adequate levels of due diligence; and
- carry out adequate reviews of its AML systems and controls.

The MLRO was fined for failing to take adequate steps to ensure the establishment and maintenance of adequate risk management systems and controls, including training to address the shortcomings in the bank's AML practices, which he had himself identified.

The failings were particularly serious as a number of Habib's customers, holding the majority of its deposits, were based outside the UK and undertook transactions in higher risk jurisdictions. The bank's business therefore presented a higher risk of money laundering, so it was particularly important that Habib had effective systems and controls to prevent and detect money laundering.

See our final notice for more information:

www.fsa.gov.uk/static/pubs/final/habib-bank.pdf

www.fsa.gov.uk/static/pubs/final/syed-hussain.pdf

Turkish Bank (UK) Ltd

We fined Turkish Bank (UK) Ltd (TBUK) £294,000 for breaching the Money Laundering Regulations 2007 in relation to correspondent banking, which led to an unacceptable risk that TBUK could have been used to launder money. TBUK's breaches included failing to:

- establish and maintain appropriate and risk-sensitive AML policies and procedures for its correspondent banking relationships;
- carry out due diligence on, and ongoing monitoring of, the respondent banks it dealt with and failing to reconsider these relationships when this was not possible; and
- maintain adequate records relating to the above.

The failings were more serious because we had previously warned TBUK of deficiencies in its approach to AML controls over correspondent banking.

Banks' defences against investment fraud

In June 2012 we published our report on banks' defences against investment fraud. Our review found individual staff members had a strong commitment to protecting customers, but we saw little governance of the specific issue of investment fraud. We also found that:

- resource allocation was not based on risk assessments that explicitly considered the risk of investment fraud, so resources available were not the result of informed decision-making by senior management;
- it was not clear to us that the banks we visited had fulfilled their regulatory obligation to assess investment fraud risks appropriately and counter the risk that the bank might be used to further financial crime;
- banks' ability to detect where their customers might be complicit in investment fraud was disappointing; and
- ongoing monitoring of customers was often the responsibility of customer-facing staff with many other responsibilities, who often lacked the experience or knowledge to identify investment fraud.

More positively, we saw a range of transaction-monitoring technologies. Some banks had used these successfully to prevent customers falling victim to investment fraud. We also saw good examples of banks maintaining intelligence on investment fraudsters, although measures were not consistent across the industry.

Recent speeches

Tracey McDermott's speech to the BBA's Financial Crime Conference on 26 September 2012.

Bob Ferguson's speech at the ABI Financial Crime Conference on 13 September 2012.

Financial crime supervision

The FCA will continue to use many of the tools it does today to ensure financial institutions are meeting their regulatory obligations in relation to financial crime.

In addition to these tools, we have been developing a programme of intensive and intrusive supervision of some key financial crime risks in a group of very large banks. We highlighted the development and pilot of this programme, formerly referred to as the 'Core Financial Crime Programme', in our previous newsletter (Issue 15). This programme will focus on the anti-money laundering, countering terrorist finance (AML/CTF) and financial sanctions risks of a group of the highest impact banks in the UK. We now propose to include anti-bribery and corruption (ABC) risks in this programme from the middle of next year.

We have piloted the programme successfully, and it will now be rolled out across the group of banks selected. Continuing with our intensive and intrusive approach to supervision, we will be focusing on the inherent risks in each bank's business model. Once we have undertaken an initial assessment of each bank, we expect there to be a four-year rolling cycle for the programme, where each institution will have two business units, plus any associated central functions, examined at each cycle.

The programme will help the FSA, and in future the FCA, to carry out its financial crime mandate effectively; and assist us in assessing regulated firms' compliance with UK legislation on AML, wire transfers, terrorist finance, sanctions regimes, and bribery and corruption.

Safe custody

On 17 July 2012 the government published its response to the 2011 consultation on changes to the Money Laundering Regulations 2007. The response document can be found using the link below. One of the questions posed by the consultation was whether the term 'safe custody services' should be more clearly defined for the purposes of the Regulations. The Treasury worked closely with us and other key stakeholders to agree the following definition, which will be applied by us as the regulator of safe custody services. It has not resulted in a change to the Regulations:

'A safe custody service offers safety deposit boxes or other secure storage suitable for high-value physical items like jewellery, precious metals or documents of title. For the sake of clarity, a business solely offering the following services would not be considered by the FSA to be a safe custody service:

- the storage of goods such as luggage, household items or motor vehicles;
- the storage of non-physical property like computer data;
- the secure transportation of high value items;

- offering safe custody on an occasional or very limited basis, such as hotels providing a safe for use by guests; and
- legal professionals storing legal documents.'

Many different types of business offer storage services, so we agreed to provide a rationale for this definition of 'safe custody service'. The answer stems from the origin of the term 'safe custody service'. This can be found in Annex I to the Banking Consolidation Directive, which lists some activities banks perform that complement their main business of taking deposits.

We have concluded that, when a business offers a service that is similar to a service available from the banking sector, it is performing the activities set out on that list. So, while banks offer safe deposit boxes to their customers, they do not, for example, provide facilities for storing furniture or suitcases. Consequently, we decided that non-bank safe deposit box providers do offer 'safe custody services', but other types of storage provider do not.

www.hm-treasury.gov.uk/d/condoc_responses_changes_to_money_laundering_regs2007.pdf

Financial crime: a guide for firms

We have consulted twice this year on changes to the Financial Crime Guide regarding proposed guidance arising from our thematic reviews. We continue to encourage firms to engage constructively in this process.

A revised version of the Financial Crime Guide, incorporating final guidance from both reviews, will be published on 1 November 2012.

Sanctions reporting: the practicalities

Firms are required to tell the Treasury's Asset Freezing Unit if they hold money for a person or body on the UK's consolidated list of financial sanctions targets.

If the firm also has suspicions that those funds are the proceeds of crime, it is also necessary to file a Suspicious Activity Report with the Serious Organised Crime Agency (SOCA).

While this may look like 'dual reporting', the law allows information passed to SOCA to be shared with overseas partners more widely than data received by the Asset Freezing Unit. Telling SOCA gives the UK authorities more scope for ensuring assets are returned to their rightful owners.

Thematic work

Our next round of thematic reviews will focus on:

1. money laundering, terrorist financing and sanctions risks in trade finance; and
2. anti-money laundering and anti-bribery and corruption systems and controls in asset management firms.

We expect to publish both reports by Q3 2013.