

Chapter 5

Review of firms' implementation of a risk-based approach to anti-money laundering (AML) (2008)

5.1 Introduction

- 5.1.1** **Who should read this chapter?** This chapter is relevant, and its statements of good and poor practice apply, to all firms for whom we are the supervisory authority under the *Money Laundering Regulations*.
- 5.1.2** In March 2008 the *FSA* conducted a review of firms' implementation of a risk-based approach to anti-money laundering. This followed the move to a more principles-based regulatory strategy from August 2006, when we replaced the detailed rules contained in the Money Laundering sourcebook with high-level rules in the Senior Management Arrangements, Systems and Controls sourcebook (*SYSC*) of the *Handbook*.
- 5.1.3** The *FSA* visited 43 firms in total and gathered additional information from approximately 90 small firms with a survey. The report explored in depth a number of key areas that required improvement, including a review of staff training and the need to ensure staff are aware that it is a constant requirement to ensure AML policies and procedures are up to date and effective.
- 5.1.4** Due to the wide range of firms the *FSA* visited, there were a number of different findings. There were many examples of good practice, particularly in the way the larger firms had fully embraced the risk-based approach to AML and senior management's accountability for effective AML. The *FSA* also recognised that smaller firms, which generally represent lower risk, had fewer resources to devote to money laundering risk assessment and mitigation.
- 5.1.5** The contents of this report are reflected in ■ **FCG 2** (Financial crime systems and controls) and ■ **FCG 3** (Money laundering and terrorist financing).



5.2 The FSA’s findings

5.2.1

You can read the findings of the *FSA’s* thematic review here: http://www.fsa.gov.uk/pubs/other/jmlsg_guidance.pdf

5.3 Consolidated examples of good and poor practice

5.3.1

Firms' implementation of a risk-based approach to AML

Examples of good practice

- One large firm's procedures required it to undertake periodic Know Your Customer (KYC)/Customer Due Diligence (CDD) reviews of existing clients. The depth of the review is determined by the risk ranking assigned to the client. Clients rated A and B are reviewed every three years; Cs every two years; and Ds and Es are reviewed annually. For lower risk (A-C) clients, the review may amount to no more than refreshing the client's file to take account of: significant changes in ownership or capitalisation; changes in the client's line of business; addition of a Politically Exposed Person (PEP) to shareholders or senior management; or any negative news on the client's owners or senior managers. For high risk (D or E) clients, visits to the client are necessary to provide an extra layer of comfort. Such visits would typically cover: review of client's client take-on procedures; sample testing of KYC documentation on underlying clients; and, obtaining answers to outstanding queries on, e.g., annual AML certification, transaction queries, and potential PEP or sanctions hits.
- One building society undertook a comprehensive policy review following the publication of the 2006 JMLSG

Examples of poor practice

- Some firms did not have a robust approach to classifying the money laundering risk associated with their clients. For example, one wholesale small firm classified all its clients as low or medium risk, despite the fact that most of them were based in Eastern Europe, North Africa and the Middle East. Another firm's risk-assessment procedures provided that the Compliance Officer or MLRO (Money Laundering Reporting Officer. See FCG Annex 1 for common terms) would determine the risk category for each client and would record the basis of the assessment for each client. However, a file review showed no evidence that risk assessments had actually been carried out.
- Some small firms had produced inadequate annual MLRO reports, which failed to demonstrate to their gov-

(Joint Money Laundering Steering Group. See FCG Annex 1 for common terms) guidance, in order to identify which parts of the business were affected and what action was needed. It identified eight core business areas, which represented the key operational areas exposed to risk from money laundering. These business areas were ranked in order of risk and formed into workstreams. The local managers from each workstream business area were then trained by the Compliance Policy Team, using a series of presentations and individual workshops, to understand the impact of the risk-based approach, their individual responsibilities and the appropriate customer due diligence policies. These managers were then required to apply this awareness and their existing knowledge of their workstreams' business activities to create documented risk profiles covering customers, products, delivery channels and geography. The risk profiles were graded as Red, Amber and Green and customer due diligence and monitoring requirements set at appropriate levels.

- In response to the SYSC changes, one major bank decided to appoint the MLRO's line manager as the designated director with overarching responsibility for AML controls. This director was seen as the obvious choice for the role, given that his portfolio of responsibilities included fraud, risk and money laundering. The bank's decision formally to appoint a Board-level senior manager to this position was viewed as reinforcing the importance of having in place a robust AML control framework. Following his appointment, the director decided that the management information (MI) on AML

erning body and senior management that the firms' AML systems and controls were operating effectively. In one case, the MLRO stated categorically that there had been no perceived deficiencies in the suspicious activity reporting process. However, he was unable even to describe that process to us, so it was highly unlikely that he had ever reviewed the SAR (Suspicious Activity Report. See FCG Annex 1 for common terms) process for possible deficiencies.

- In one small firm, the MLRO was clearly not fully engaged in his role. For example, he was unaware that we had removed the Money Laundering sourcebook and he was still using an outdated (2003) edition of the JMLSG Guidance. It was not entirely clear whether this arose from a lack of interest in his MLRO function or from inadequate compliance resources at the firm, which left him with insufficient time to keep up to date with AML matters, or a combination of both.

issues he had hitherto received was too ad hoc and fragmented. So the SYSC/JMLSG changes proved to be a catalyst for the bank establishing more organised MI and a Group-level Financial Risk Committee to consider relevant issues. (In the past, various Risk Committees had considered such issues.) The new Committee's remit covered fraud, money laundering and sanctions issues; however, its primary focus was AML.

- One large bank judged that staff AML training and awareness were suitable for the development of a risk-based approach. It saw a need to differentiate between AML requirements in various business units, so that training could be adapted to the needs of the job. So in Retail, training had been re-designed to produce a more balanced package. Accordingly, staff were required to undertake one training module per quarter, with the emphasis on a different area in each module and a test taken every quarter. The aim was to see what impact this constant 'drip feed' of training had on suspicious activity reporting. At the time of the FSA's visit, this bank was also in the throes of merging its anti-fraud and AML training. The overall objective was to make it more difficult for criminals to do business with the bank undetected.
- We found some cases of medium-sized and smaller firms documenting their client take-on procedures but not regularly updating those procedures and not always following them. For example, one firm told us that CDD information on clients was refreshed every time clients applied for a new product or service. However, a file review showed no evidence that this had been done.
- A number of medium-sized and small firms were unaware that it was illegal for them to deal with individuals or entities named on the Treasury's Financial Sanctions list. As a result, no screening of clients or transactions was being undertaken against that list.
- One firm said that it did not routinely check the Financial Sanctions list, because it did not deal with the type of cli-

ent who might appear on the list.

- Some medium-sized and small firms admitted that staff AML training was an area where improvement was needed. One firm told us that training was delivered as part of an induction programme but not refreshed at regular intervals throughout the employee's career. Another firm said that it provided AML induction training only if a new joiner specifically requested it and no new employee had actually made such a request. The firm's MLRO took the view that most new employees came from the regulated sector, so should already be aware of their AML obligations. Such employees were merely required to sign a form to confirm that they were aware of the firm's AML procedures, but their understanding was never tested.

