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# Anti-money laundering annual report

2013/14





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# Introduction

This report, which is the FCA's second Anti-Money Laundering Annual Report, sets out:

- changes in our responsibilities since 2012/13
- policy developments in the last year
- findings and outcomes from our recent specialist supervisory work
- our new anti-money laundering (AML) supervision strategy

It also discusses some current trends and risks we have observed or that have been brought to our attention by our partners, and how we cooperate with those partners, both at home and overseas.

# 1.

## Changes in our responsibilities

### **Consumer credit**

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- 1.1** On 1 April 2014 we took over the regulation of the consumer credit industry, which covers over 50,000 firms. We supervise most of these firms' compliance with their legal and regulatory financial crime obligations.
- 1.2** Under the Money Laundering Regulations we are responsible for the AML supervision of consumer credit lending. The minority of consumer credit firms (around 3,500) provide loans. The majority of firms providing consumer credit services other than lending will nevertheless have to meet the obligation in our handbook to have systems and controls in place to counter the risk that the firm might be used to further financial crime.
- 1.3** We are assessing the financial crime risk posed by weaknesses in consumer credit firms' financial crime systems and controls. To do this, we are drawing on information from law enforcement and working with others to establish a national network to share intelligence on consumer credit. We also plan to begin a thematic review to assess financial crime systems and controls in consumer credit firms later this year. This will help us form a better understanding of the key risks in this area, in particular how those firms subject to the Money Laundering Regulations are complying with their obligations.

## 2. Policy developments

### **Financial crime guidance**

- 2.1** We updated our Financial Crime Guide to include examples of good and poor practice that we identified in our 2013 thematic review of ‘Banks’ control of financial crime risk in trade finance’.
- 2.2** Our review found that banks generally had effective controls to ensure they were not dealing with sanctioned individuals or entities. But most banks we visited had inadequate systems and controls over ‘dual-use’ goods (that is, those that can be used for both military and civilian purposes), and their anti-money laundering policies and procedures were often weak.
- 2.3** Most respondents found our examples of good and poor practice useful. But some were concerned that they were too prescriptive, which they regarded as disproportionate and incompatible with our risk-based approach.
- 2.4** We used the publication of our final guidance to explain that we expect our Guide to be used in a risk-based and proportionate way. We provide guidance on our rules and principles and set out examples of good and poor practices that we observe in some firms to help others adopt more effective financial crime systems and controls. We have made it clear that our guidance is not binding, and that firms can meet their legal and regulatory obligations in other ways.
- 2.5** We will keep our Guide under review and continue to update it to reflect the findings of future thematic reviews, enforcement actions and other FCA publications.

### **Fourth Anti-Money Laundering Directive and Fund Transfers Regulation**

- 2.6** We continued to support the Treasury in the negotiation of the Fourth EU Anti-Money Laundering Directive and the Second Regulation on information accompanying transfers of funds. On 18 June 2014, the Committee of Member States’ Permanent Representatives to the EU reached a ‘general agreement’ on both texts, which will form the basis for future negotiations between the Commission, the Council and the European Parliament. Both the Directive and the Regulation are likely to be adopted later this year.
- The Fourth Anti-Money Laundering Directive**
- 2.7** In February 2013 the European Commission published a proposal for a new anti-money laundering Directive. Once adopted, this Directive will be transposed into UK legislation through new Money Laundering Regulations. These will replace the current Regulations, which date from 2007.

- 2.8** The proposed Directive provides a common European legal basis for the implementation of the revised Recommendations of the Financial Action Task Force (FATF), which sets global AML standards on combating money laundering and terrorist financing (the 40 Recommendations). The draft Directive also strengthens the risk-based approach to anti-money laundering and countering terrorist financing (CTF) and aims to achieve the consistent application of provisions across Member States.
- 2.9** Importantly, the draft Directive proposes to delegate the responsibility for shaping important parts of Europe's AML/CTF regime to the European Supervisory Authorities (ESAs). The ESAs are asked, among other things, to:
- draft guidelines on key aspects of the Customer Due Diligence process and on the risk-based approach to supervision
  - draft regulatory technical standards on central contact points (a single point of contact for overseeing the AML/CTF compliance of agents of payments institutions and e-money institutions based in another country) and the measures firms should take where a third country's legislation does not permit the application of equivalent AML/CTF measures
  - provide an opinion on the money laundering (ML) and terrorist financing (TF) risks facing the internal market
  - collect, analyse and share information in relation to non-EU countries that have AML standards equivalent to those in the EU and those that do not.
- 2.10** The proposed Directive requires this work to be completed within two years of the Directive coming into force.
- 2.11** The ESAs' Joint Committee's AML sub-committee (AMLC) is taking this forward. We are closely engaged in this work. We provide the chair of the AMLC and are a member of the sub-committee. In addition, we are members of the AMLC's working groups that are responsible for drafting the guidelines and technical standards under the draft Directive. We also co-chair the AMLC's working group that will issue guidelines to AML supervisors and financial institutions on the factors firms should consider and the measures they should take when deciding whether simplified or enhanced due diligence would be appropriate.
- The Second Regulation on Information Accompanying Transfers of Funds**
- 2.12** In February 2013 the European Commission published a proposal for a new Regulation on Information Accompanying Transfers of Funds, which will replace Regulation 1781/2006 on information on the payer accompanying transfers of funds, often referred to as the Wire Transfers Regulation. The Regulation is likely to be adopted later this year. Once adopted, it will have direct effect in the UK.
- 2.13** The proposed Regulation provides a common European legal basis for the implementation of the FATF's Recommendation 16, which introduces requirements to provide information on the beneficiaries of payments as well as the originators. The draft Regulation specifies what payment service providers must do to ensure that transfers of funds are accompanied by meaningful information on both the payer and the payee, and what payment service providers must do where this information is missing or incomplete.
- 2.14** The Regulation will formally enter into force shortly after it is published in the Official Journal of the European Union. However, its application will be delayed to coincide with the date the Directive has to be transposed into the domestic legislation of all Member States.

**EU Data Protection proposals**

- 2.15** In January 2012 the European Commission published proposals for an overhaul of the legal framework protecting people's personal information. The aim of the proposals is to strengthen the rights of individuals and update the law so that it better reflects the globalised technology-driven world in which we live.
- 2.16** Many in the financial services industry are concerned that the proposals will have significant unintended consequences, including an impact on firms' ability to tackle financial crime. Negotiations over the proposals are still under way. We are feeding into the debate to ensure that new legislation captures the fact that data protection and protection from crime are both vitally important.

## 3. Findings and outcomes from our specialist supervision work

- 3.1** The quality of firms' AML systems and controls remains high on our agenda. Our financial crime specialist supervisors continue to carry out extensive AML work, including through our Systematic Anti-Money Laundering Programme and thematic reviews of particular financial crime risks and issues.

### **Systematic Anti-Money Laundering Programme and Thematic Reviews**

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- 3.2** We launched our Systematic AML Programme (SAMP) of 'deep dive' AML assessments in 2012. The SAMP covers 14 major retail and investment banks operating in the UK. So far we have completed six SAMP assessments and a seventh (which is the first also to cover anti-bribery and corruption (ABC) controls, as part of our plans for developing the programme) is well underway.
- 3.3** In October 2013, we published our thematic review of AML and ABC systems and controls in asset management and platform firms. We found that AML controls varied across the sector, and that standards were not consistently high. We also found there was still work for most firms to do to ensure bribery and corruption risks were appropriately mitigated.
- 3.4** Given our strong regulatory focus and previous publications on AML and ABC, we expected the firms we assessed in this review to have taken more action to ensure their controls reduced the risk of money laundering and bribery and corruption. We were especially concerned where the firms were part of major financial groups, which should be particularly well aware of our expectations. In some cases, the firms we visited were from groups that had been subject to previous regulatory attention, but we still found significant weaknesses.
- 3.5** We are currently working on a review of AML and sanctions controls in smaller banks. This is a follow up piece of work to our 2010/11 thematic review, *Banks' management of high money laundering risk situations*, to see whether firms had improved and taken into account the guidance we issued. Some of the banks in our sample were also part of our 2010/2011 thematic review. We plan to publish our findings from this review in the autumn.

### **Event-driven supervision**

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- 3.6** In addition to our SAMP and thematic work, since July 2013 our specialist supervisors have considered around 70 requests for resources relating to money laundering systems and controls issues at regulated firms. In around two-thirds of these cases, we decided to allocate resource to these issues and take action. These actions included visiting firms to assess AML controls, conducting desk-based reviews of AML policies and procedures and assisting with interviews/vetting of individuals put forward by firms as Money Laundering Reporting Officers.

## Our findings

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- 3.7** Overall, the findings from our SAMP assessments, our thematic reviews and our general case work have been disappointing. Significant weaknesses have been identified in a number of firms, particularly in relation to the assessment and management of higher risk business – the focus of our reviews.
- 3.8** The most common issues we have found include:
- a.** inadequate governance and oversight of money laundering risk, especially historically
  - b.** inadequate risk assessment processes to identify high risk customers
  - c.** poor management of high risk customers and those who are Politically Exposed Persons (PEPs), particularly in relation to establishing the source of wealth and source of funds for PEPs
  - d.** inadequate due diligence on correspondent banks
  - e.** inadequate or poorly calibrated AML/sanctions-related IT systems
  - f.** weaknesses in handling of alerts relating to sanctions and/or transaction monitoring
  - g.** poor judgements or questionable decisions leading the firm to take on unacceptable money laundering risk
- 3.9** More positively, many banks, particularly large banks, now recognise AML as an issue requiring senior management attention and a strong tone from the top. Our thematic work on smaller banks has highlighted that private banks and wealth management firms are generally performing better on AML issues than retail and wholesale banks.
- 3.10** Some banks have started to review their AML frameworks and developed plans to address shortcomings. Many have significant remedial plans in place. We are encouraged to note that some firms with more effective AML controls have conducted gap analyses against our guidance and other relevant sources of information, such as the Joint Money Laundering Steering Group Guidance Notes. However large banks in particular still have a substantial amount of work to do on this, and in some cases will need significant investment. This will take several years to implement and there is often significant execution risk.
- 3.11** Our response to these findings has included:
- a.** Ensuring that firms took action to correct weaknesses in their AML framework and considered whether similar weaknesses also existed in areas of the firm that were not the focus of our review.
  - b.** Asking banks to nominate a senior manager to attest to this remedial work being completed and AML controls being effective.
  - c.** Referring two banks to Enforcement for AML weaknesses, including in relation to certain issues that we had highlighted to them previously.

## Early intervention

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- 3.12** Since our last report, we have obtained voluntary undertakings from six banks, including a large UK bank, that they will not enter into certain types of high risk relationships until AML control weaknesses have been corrected. We visited five of these banks during our thematic review of AML and sanctions controls in smaller banks. We take steps like this where we consider that the level of money laundering risk posed by the combination of the firm's business model and control weaknesses makes this a proportionate course of action.
- 3.13** We have seen some excellent results from our early intervention work. For example, in addition to the action we took during last year with a major bank (see paragraph 6.15 of our 2012/13 AML Annual Report<sup>1</sup>), we achieved a good outcome from similar work with a small bank with serious AML weaknesses. In that case, the bank gave a voluntary undertaking not to establish new high risk relationships while it corrected the weaknesses we had identified. In December 2013, the bank's Chief Executive gave us an attestation that remedial work on its high risk relationships had been carried out, and that it had decided to exit over 200 relationships where it could not satisfy itself that it could manage the risks these customers posed, including two where there appeared to be suspicious activity.

## Enforcement

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- 3.14** We have fined two banks in the past year for serious AML failings:
- In August 2013, we fined Guaranty Trust Bank (UK) Ltd £525,000 for failings in its anti-money laundering (AML) controls for high risk customers between May 2008 and June 2010, when we visited them as part of our 2010/11 AML thematic review. These failings were particularly serious as they affected customers based in countries associated with a higher risk of money laundering, bribery or corruption, including accounts held by PEPs.
  - In January 2014, we fined Standard Bank plc £7.6m for failings relating to its AML policies and procedures over corporate customers connected to PEPs. This was the first AML case we had brought that focused on commercial banking activity. It was also the first AML case to use the new penalty regime, which applies to breaches committed from 6 March 2010, under which larger fines are expected.
- 3.15** We are considering whether we should refer more cases to Enforcement later this year as a result of our AML specialist supervision work, in particular our thematic review of smaller banks' AML and sanctions controls.

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<sup>1</sup> [www.fca.org.uk/your-fca/documents/anti-money-laundering-report](http://www.fca.org.uk/your-fca/documents/anti-money-laundering-report)

## 4.

# New AML supervision strategy

- 4.1** In addition to our work on major banks covered by the SAML and our thematic supervisory work, we have always undertaken supervisory work on individual firms where AML issues have arisen, aiming to deal quickly and decisively with any problems through remedial work or enforcement action as necessary.
- 4.2** We recognise that much of our specialist resource has so far been dedicated to AML work in the biggest banks, while money laundering risk is not necessarily correlated with the size of a firm. So this year we have also developed a new strategy to enable us to use our specialist financial crime resources more effectively by targeting more resource at firms that potentially pose a higher money laundering risk.
- 4.3** We are doing this initially by classifying all regulated firms subject to the Money Laundering Regulations 2007 into four risk bands, very much as we have previously put firms into different categories to reflect the overall risk they present to our objectives. We have done this by considering a number of factors, such as the nature of the firm's business and the jurisdictions where it is located or operates. We will use this approach to allocate our specialist AML resources most effectively. This will help us improve our mitigation of money laundering risks to our objectives. Over time we expect to refine our approach by drawing on our increased knowledge of money laundering risks in firms.
- 4.4** This classification of firms in relation to their financial crime risk will not affect any firm's conduct risk classification (i.e. C1-C4). However, it may result in a firm in a low conduct risk category receiving relatively more supervisory attention from a financial crime perspective.
- 4.5** Firms covered by the SAML will continue to be subject to the most intensive AML supervision. Firms in the category below that will be subject to a regular inspection programme, consisting of two or three day on-site visits. We expect the full cycle for these visits to last around 24 months. At the end of each cycle we plan to look again at the categorisation of these firms, to decide whether they should remain in this category, or be moved up or down.
- 4.6** We will continue to use thematic reviews and event-driven reactive supervision for all firms, including those subject to the SAML or the new inspection programme. Thematic reviews and event-driven reactive supervision will be the primary supervisory methods we use for firms in the lowest two categories of money laundering risk.

## 5.

# Emerging risks and current trends

### **Types of money laundering issues we see**

- 5.1** Financial services firms are at risk of being abused by those seeking to launder the proceeds of crime or to finance terrorism. Many of the risks that they face are threats that are well known, for example corrupt politicians attempting to move their money offshore, or the use of corporate vehicles and shell companies to move the proceeds of crime. Alongside these risks we see developments beginning to emerge of which firms need to be mindful. Firms should take appropriate and proportionate steps to manage such risks effectively, including exiting a relationship where they identify potential money laundering or terrorist financing.

#### **Mobile banking**

- 5.2** The use of mobile banking to pay overseas remittances from the UK is still at relatively low levels compared with the popularity of these services in other parts of the world, such as Africa, particularly East Africa. Mobile banking products and services are developing rapidly, so it is important for firms to keep money laundering risks under review.
- 5.3** Our specialist supervisors have contributed to our wide-ranging thematic review of mobile banking to assess how firms offering these products are managing financial crime risks.

#### **Virtual currencies**

- 5.4** Virtual, or digital, currencies are not currently regulated for AML purposes in the UK or elsewhere in the EU. In the last year or so there have been a number of high profile examples of how digital currencies may be abused for criminal purposes, including the currency exchange Liberty Reserve which is alleged to have laundered \$6bn of criminal funds. A number of digital currency websites have also suffered from repeated attacks from online hackers, in the process losing millions of pounds worth of customers' assets.
- 5.5** The EBA published an opinion on 4 July on virtual currencies<sup>2</sup> and the FATF published a paper on 27 June covering key definitions and potential AML/CTF risks of virtual currencies.<sup>3</sup> We will continue to monitor the development of virtual currencies and to work with other regulators and with our partners in Government to understand the nature of the financial crime and other risks virtual currencies may pose, as well as their potential competition advantages for consumers.

#### **Derisking**

- 5.6** We are aware of suggestions that some banks are withdrawing from offering financial services to certain customers in light of a perceived increase in the cost of compliance and their own decreasing risk appetite. This process of 'derisking' began some years ago. We are working closely on this issue with the Treasury and others, in particular through the Cross Border Remittance Action Group,<sup>4</sup> on the issue of providing banking services to money transmitters.

<sup>2</sup> <https://www.eba.europa.eu/documents/10180/657547/EBA-Op-2014-08+Opinion+on+Virtual+Currencies.pdf>

<sup>3</sup> <http://www.fatf-gafi.org/topics/methodsandtrends/documents/virtual-currency-definitions-aml-cft-risk.html>

<sup>4</sup> <https://www.gov.uk/government/policies/helping-developing-countries-economies-to-grow/supporting-pages/enabling-the-continued-flow-of-remittances>

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- 5.7** We require firms to put in place and maintain policies and procedures to counter financial crime risk. These policies and procedures must include systems and controls to assess and manage money laundering risk. Where a firm does not believe that it can manage financial crime risk effectively, it should not enter into, or maintain, that business relationship. However we have seen examples where firms are able to manage the financial crime risk presented by higher risk customers effectively without exiting the relationship.
  - 5.8** Any decisions firms take to derisk their business should not unduly impede legitimate access to financial services or financial inclusion.

## 6.

# Whistleblowing and money laundering

- 6.1** Under the Public Interest Disclosure Act 1998 (PIDA), the FCA is a 'prescribed body'. That means that a whistleblower in a firm we regulate who prefers not to report internally can make a disclosure to us and still benefit from the protection that PIDA gives.
- 6.2** We are receiving increasing amounts of valuable intelligence from whistleblowers. Both the number and quality of the disclosures we receive have risen in recent years. In 2013/14 we opened 1,035 new whistleblowing cases, nearly twice as many as in 2011/12. Over the past year we have received a steady stream of reports (between one and two per cent of the total) related purely to money laundering concerns. In addition, we receive reports from whistleblowers relating to other types of crime, but where money laundering may also have occurred. Calls received by our whistleblowing unit often respond to news stories, so we might expect a major successful money laundering prosecution to result in a spike in calls about money laundering.
- 6.3** We think it is also important for us to support whistleblowers and provide feedback to them, within the constraints of the confidentiality requirements in UK and European law. To achieve this, we have recently increased the size of our dedicated whistleblowing unit to five employees, and revised our processes for responding to whistleblowers, including more face-to-face debriefs, and ensuring we capture how we use every piece of information we receive.
- 6.4** Over the last eighteen months we have reviewed our approach to our handling of the whistleblowing disclosures we receive, taking into account the recommendations of the Parliamentary Commission on Banking Standards. We have been improving our processes so that we can capture and analyse better how different crime types may arise in the whistleblowing cases with which we deal. We will continue to develop and refine our approach, aiming to provide a better service for whistleblowers and making the most of their unique contribution to our understanding of the regulated sector and the discharge of our statutory functions.
- 6.5** We will publish a report on whistleblowing later this year. This will include analysis of the trends and gaps we have identified, including how financial crime types feature in whistleblowing cases.

## 7.

# Our cooperation with others

### Law enforcement

- 7.1** The launch of the National Crime Agency in October 2013 and the establishment of its Economic Crime Command (ECC) marked the increasing emphasis placed by the Government on the fight against economic crime. The ECC oversees the national response to economic crime by working closely with partners across law enforcement, the public and private sectors. We have worked closely with the ECC throughout its development and in its initial phase. Our engagement with the NCA ranges from the strategic to the tactical level, so we provide intelligence, expertise on the regulated sector and operational support.
- 7.2** Money laundering and criminal finance are recognised in the NCA's Economic Crime Control Strategy as key enablers of many types of organised crime. The steering body of the ECC, the Economic Crime Strategic Governance Group (on which we sit), leads the cross-cutting response to those criminal groups that benefit from money laundering and criminal finance.
- 7.3** The table below sets out our growing involvement with the NCA across serious and organised crime policy and operational decision-making bodies.

### Serious and Organised Crime landscape and FCA involvement

Serious and Organised Crime Committees	Purpose
Ministerial Serious and Organised Crime meeting [MSOC]	Chaired by the Home Secretary, this meeting sets the direction of serious and organised crime policy in the UK <i>We are involved in economic crime themes including money laundering and criminal finance.</i>
Serious and Organised Crime Strategy Board [SOC]	Chaired by the Director General, Office for Security and Counter-Terrorism, Home Office, this is a senior level Board shaping SOC strategy and response, ensuring: efficient and effective LEA response to serious and organised crime; agreement on the Strategic Assessment and setting a National Control strategy <i>We are engaged at senior level.</i>
Economic Crime Strategic Governance Group [EC SGG]	Chaired by the Economic Crime Director, this group develops strategic action plans for mitigating the threat contained and co-ordinates the multi-agency response by setting operational objectives for partners <i>We are engaged at senior level.</i>
Threat Groups [TG]	Chaired by NCA partners (including the FCA) these groups ensure multi-agency delivery against their Strategic Action Plan and capture the impact of multi-agency activities on economic crime threats. <i>We are engaged at senior level.</i>

## National Risk Assessment

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- 7.4** As part of the UK's compliance with the revised FATF 40 Recommendations, the Treasury and the Home Office are leading work across government, and with law enforcement, regulators and the private sector, to produce a National Risk Assessment (NRA) on money laundering and terrorist finance. This will provide an evidence base to help the Government assess both how effective and proportionate current UK requirements are, and the application of the risk-based approach by regulators and firms.
- 7.5** The NRA will also help shape future priorities and ensure that the UK has the right level of expertise and resources targeted at these risks in both the public and private sectors, and will support further policy development. We have seconded a member of FCA staff to the Treasury to assist with this work.
- 7.6** The UK will be evaluated against the NRA and other FATF requirements through the FATF Mutual Evaluation of the UK's anti-money laundering and combating finance of terrorism regime.

## International

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- 7.7** We continued to provide expert support to the Treasury, who lead the UK delegation at the FATF.
- 7.8** On behalf of the UK, we co-chaired the FATF's working group on evaluations and compliance, which oversees the development and implementation of the FATF's approach to mutual evaluations. As mentioned above, the UK's compliance with the FATF's 40 Recommendations and the effectiveness of its AML regime will be assessed as part of the FATF's fourth round of mutual evaluations. Work is underway, including in the FCA, to prepare for this.
- 7.9** We are also providing the UK co-chair of an FATF working group which will review and update the FATF's guidance on the risk-based approach to AML controls. The first guidance document, which addresses banks and banking supervisors, is expected to be adopted in October 2014.
- 7.10** We are also members of the AML Expert Group (AMLEG) of the Basel Committee on Banking Supervision. In January 2014, the AMLEG published guidelines setting out how banks should include the management of ML/TF risks in their overall risk management framework. AMLEG continues to provide supervisory input into the FATF's standard-setting process.

## 8. Conclusions

- 8.1** Since the FCA was created in 2013 we have made important progress to deliver our anti-money laundering agenda. We have worked closely with our partners in Government and law enforcement to support the fight against economic crime. We are developing and broadening our AML supervision strategy, in ways that are consistent with our overall supervision strategy and apply our risk-based approach to AML. And we have made significant contributions to AML policy developments, both in the UK and abroad.
- 8.2** As part of our operational objective to protect and enhance the integrity of the UK financial system, we will take this work further, making judgements, intervening early and encouraging firms to use their resources most effectively to mitigate the biggest money laundering risks they take. We will also continue to work with Government, law enforcement and the industry to increase our common understanding of the risks our society faces from criminals seeking to misuse our financial system.

