



Financial Services Authority

Financial services firms' approach to UK financial sanctions

Financial Crime and Intelligence Division (FCID)

Foreword by Philip Robinson, Director of FCID

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The use of financial sanctions to deliver public policy objectives has risen rapidly up the political agenda in the UK, elsewhere in the European Union and at the United Nations. In February 2007 the Government issued its new anti-money laundering and terrorist finance strategy. As part of this, in October 2007 the Treasury set up a dedicated Asset Freezing Unit, which has increased the expertise and operational focus that the Government is able to bring to bear on asset freezing. In addition, as part of this strategy the Government said it would further enhance the UK's asset freezing regime by continuing to strengthen further the linkages between asset freezing and the Government's wider counter-terrorism framework, and would work with regulators and other bodies to ensure a robust and proportionate approach to compliance with and enforcement of financial sanctions.

It is important that firms understand these changes, and recognise how having systems and controls relating to financial sanctions is an integral part of complying with our requirements on financial crime.

This review highlights areas where there is significant scope across the industry for improvement in firms' systems and controls. Some firms have robust systems in place that are appropriate to their business needs, but others, including some major firms, are struggling with integrating legacy systems or have inappropriate systems for their business. In small firms we found a widespread lack of awareness of the UK financial sanctions regime.

This report provides some examples of good practice observed at firms that others could usefully learn from, examples of poor practice, common misconceptions held by firms, and the challenges that all firms face.

As there has been interest from the industry to understand what is expected in this area, I would encourage all firms to use this report to increase their awareness of the regime, to draw on the examples of good practice we found in some firms, and to use this report to benchmark their own systems and controls in order to make improvements where necessary.





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1. Executive Summary

1.1 Introduction

This report sets out our findings of firms' performance in meeting our financial crime requirements in relation to UK financial sanctions. It does not report on firms' compliance with the UK financial sanctions regime: this is a matter for the government. Nor does it constitute formal guidance from the FSA. However, we expect firms to consider our findings and examples of good and poor practice and, where appropriate, to translate them into a more effective risk assessment and implement more effective systems and controls. As in any other area of their business, firms should take a proportionate, risk-based approach to preventing financial crime, including financial sanctions breaches by the firm. Small firms should consider the factsheet that we will make available on our website to help them comply with our requirements in relation to UK financial sanctions. We will advise small firms through our 'regulation round-up' email when this is available.

1. The UK financial sanctions regime plays an important part in delivering the Government's foreign policy objectives. It is also used by the government to prevent and suppress the financing of terrorism and terrorist acts. In 2007 the Government issued its new anti-money laundering and terrorist finance strategy, and HM Treasury set up a dedicated Asset Freezing Unit, which has increased the expertise and operational focus that the Government is able to bring to bear on asset freezing.
2. The UK financial sanctions regime lists individuals and entities that are subject to financial sanctions. These can be based in the UK, elsewhere in the EU or the rest of the world. In general terms, the law requires firms not to provide funds or, in the case of the Terrorism Order, financial services, to those on the list, unless a licence is obtained from HMT (Her Majesty's Treasury).
3. A failure to comply with these obligations can carry serious consequences. For example, it carries the risk of criminal penalties being sought by the government against the firm and, in certain circumstances, against the management of the firm. A breach of the regime may also result in terrorists being better able to finance their activities or a criminal offence being committed, as well as leading to reputational damage to firms.
4. The government oversees the UK's financial sanctions regime. HMT is responsible for implementing, administering and enforcing compliance with UK financial sanctions. It maintains the list of sanctioned parties in the UK (the HMT list), which currently includes approximately 1,400 individuals, about 50 of whom are UK residents, and 500 entities, 12 of which are based in the UK.
5. Reducing the extent to which it is possible for a business to be used for a purpose connected with financial crime is one of our statutory objectives. The provision of funds



or, in the case of the Terrorism Order, financial services, to those on the HMT list comes within the financial crime objective. Our Handbook, in particular Principle 3 and SYSC 3.2.6R, places specific responsibilities on firms regarding financial crime. Consequently, authorised firms are also subject to regulatory requirements relating to the UK's financial sanctions regime.

“A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems”.

Principle 3: Management and control

“A firm must take reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements and standards under the regulatory system and for countering the risk that the firm might be used to further financial crime”.

SYSC 3.2.6R

6. This review was conducted by our Financial Crime and Intelligence Division (FCID). The main purpose was to assess current industry practice, identify examples of good and poor practice, and share our findings with the industry. Our review did not cover systems and controls relating to financial sanctions regimes in other jurisdictions. However, we are aware that many firms operating in a range of jurisdictions apply a global approach in meeting their obligations.
7. We obtained our information using an electronic survey of 228 firms. We interviewed 25 of the firms surveyed and had discussions with relevant stakeholders to obtain further information on industry practice and the challenges firms face. We would like to thank the firms who took part in this review and the stakeholders who contributed to our research.

1.2 Findings

8. Our review has led us to conclude that there are inadequacies in firms' systems and controls to reduce the risk of a breach of UK financial sanctions in all size of firms across all financial sectors. Many firms need to enhance their systems and controls and small firms in particular should improve their awareness of the UK financial sanctions regime. Our main findings are set out here.



Risk assessment

9. All major financial groups surveyed had assessed the probability of their customer base containing persons on the HMT list. The majority assessed the inherent risk of dealing with an individual or entity on the HMT list to be high. When their systems and controls were taken into account, most deemed the residual risk of dealing with a listed individual or entity to be low. However, such a risk assessment holds well only if it is based on a good understanding of the UK financial sanctions regime (see paragraph 12).
10. We found that two thirds of medium-sized firms had carried out a risk assessment in relation to UK financial sanctions. Just over half of small firms stated in the survey that they had conducted a risk assessment, but our visits suggested that the proportion of small firms that had actually carried out a risk assessment was significantly lower.
11. Disappointingly, we encountered a range of misconceptions of the UK financial sanctions regime among our sample. These included the following.
 - Firms who believed they were somehow exempt from the financial sanctions regime if they processed only low value transactions – there is no minimum limit.
 - Firms who believed that individuals and entities on the list were all based overseas. There are some individuals and entities on the list that are UK-based.
 - Firms, particularly small firms, who believed financial sanctions screening was not necessary as they did not hold client money, did not make payments or dealt in products they assessed as low risk for financial crime. This is not the case. Firms are reminded that under the Terrorism Order the prohibition extends to financial services as well as funds. Firms need to be careful when including product risk in their risk-based approach.
 - Firms, including one major retail firm, that failed to understand the difference between financial sanctions targets and politically exposed persons (PEPs). Most PEPs are not the subject of financial sanctions (although they may be).
 - Firms who believed that insurance is a no or low risk area for financial sanctions and others who believed that UK financial sanctions did not apply to insurance. However, as explained above the Terrorism Order prohibits the provision of financial services, including insurance, to a target on the HMT list. HMT also administers a licensing regime.
12. It is essential that firms have a good understanding of the UK financial sanctions regime. Without this, risk assessments are likely to be inaccurate and consequently systems and controls put in place to prevent a breach of UK financial sanctions may not be sufficient.



Senior management responsibility and policies and procedures

13. We found that all major financial groups surveyed had policies and procedures in place to enable screening of the HMT list. However, we found some instances where country specific and/or business unit policies and procedures did not meet the minimum standards set out in the group wide policy.
14. Approximately three quarters of medium-sized firms and two thirds of small firms surveyed had formal written policies and procedures in place for financial sanctions screening. However, our visits to small firms indicated that only half of those who stated that they had written policies and procedures in place for financial sanctions screening actually had. This discrepancy arose primarily because many small firms thought that customer due diligence checks for anti-money laundering (AML) purposes were the same as screening against the HMT list.
15. Almost all firms with written policies and procedures in existence told us that senior management had approved them. However, it was disappointing to find that most firms had not conducted a review of financial sanctions procedures during internal audits, with one firm advising us that, although it had carried out an audit on its procedures for financial sanctions, the audit had not been conducted by an independent person in the firm.

Training and awareness

16. Our review identified that most of the major and medium-sized firms surveyed provided training to relevant staff on financial sanctions, which varied from the training being included in a wider programme of training on financial crime to stand-alone training on financial sanctions.
17. The individuals who had responsibility for the financial sanctions policies and procedures in the major financial groups reviewed varied in their understanding of financial sanctions. Staff at most of the medium-sized firms we visited generally displayed a good understanding of the UK financial sanctions regime, whereas staff at small firms generally displayed very low levels of awareness of the regime. For example, some firms thought the phrase ‘financial sanctions regime’ referred to financial penalties issued by the FSA.
18. Firms should take appropriate steps to ensure that the staff with responsibility for ensuring that UK financial sanctions are not breached understand exactly what they need to do to comply with the firm’s financial sanctions policy and procedures. Senior management have a key responsibility to ensure that all relevant staff understand and act in accordance with procedure.



19. We found that many small firms were very reliant on compliance consultants who often focused on AML requirements but did not cover financial sanctions requirements. We found some compliance consultants were providing small firms with inaccurate advice. Firms should ensure that they receive appropriate information and advice about financial sanctions and not just about AML requirements.

Screening clients

20. We found that most major financial groups were screening direct clients at the time of client take-on. We found that some medium-sized firms were screening clients retrospectively between a few days and several weeks rather than at the time of take-on. As a result of the lack of awareness of financial sanctions among the small firms we surveyed, very few were screening clients at all.
21. We identified a key general weakness among all major and medium-sized firms, when they dealt with customers who were already clients of other FSA-authorized firms. In those circumstances, many firms assumed that the first firm had screened the client against the HMT list but had taken no steps to verify that screening was actually taking place. This could have a significant effect on the overall risk to those larger firms and could mean that their risk assessments are inaccurate.
22. When another authorised firm refers a client, firms should satisfy themselves that the client has been screened against the HMT list. One firm's risk-based approach may not be suitable for another firm with a different risk profile, even if both firms are authorised by FSA. Firms should also consider if the client screened by the referring firm needs to be re-screened against the HMT list, as the list may have been updated since the original screening was performed.
23. We also identified weaknesses in major financial groups systems and controls, which made it difficult for them to comply with their policies in relation to UK financial sanctions. These weaknesses often arose from the difficulties of operating multiple legacy IT systems across the group. Some firms were in the process of devising or implementing a single firm-wide IT system to tackle these issues.
24. Weaknesses and issues we found repeatedly among the major financial groups and medium-sized firms surveyed included the following.
 - The failure to screen against the HMT list at the time of client take-on, with some firms screening only retrospectively. This led to firms providing a service before screening had taken place.
 - The inability to flag individuals and entities adequately on all of their systems meant that the risk of payments and services being provided to persons on the HMT list was not adequately mitigated in some parts of the business. Flags were often non-existent, did not work, or were not displayed prominently enough for staff in all parts of the group to realise that a target match had been identified in their firm. In some firms unauthorised staff were able to override blocked accounts.



- The failure to monitor the ongoing effectiveness of automated systems used for financial sanctions screening, including making sure that the calibration of screening rules remained appropriate and effective.
 - Reliance, particularly among major insurance firms, on small firms or other authorised firms to carry out screening against the HMT list. Firms should note that approximately three quarters of small firms surveyed did not screen the HMT list and, in general, small firms showed very low levels of awareness of the financial sanctions regime.
25. Overall, we found that medium-sized firms had more robust systems and controls for financial sanctions screening than other groups of firms. These firms had procedures in place to screen all clients and used a combination of automated and manual screening solutions bespoke to each business unit.
26. During the course of this review and in other discussions, firms have raised concerns with us and HMT about the quality of some ‘identifiers’ on the HMT list. ‘Identifiers’ are the personal identifying information on the HMT list used by firms to screen their customers. Identifiers, on the HMT list, that are too general make it difficult for firms to identify matches with their customers. They also increase compliance burdens significantly. While firms acknowledge there has been progress in this area, they remain concerned that some of the identifiers on the HMT list are too general. We would encourage HMT to continue their work to enhance the quality of identifiers.
27. Firms can improve the effectiveness of screening and reduce the amount of false positives by ensuring that their client data is kept up-to-date and is as complete as possible.

Ongoing screening

28. Most major financial groups surveyed had a method of screening their entire customer database periodically, ranging from daily to every three months. However, we found that the majority of the larger firms surveyed did not extend this to screening the directors and beneficial owners of corporate clients against the HMT list. This increases the risk that firms may inadvertently breach UK financial sanctions when changes of directors and beneficial owners are made but not included in the firm’s screening. Firms should consider covering changes to direct or indirect ownership in their overall risk-based approach.
29. We found that just over half of medium-sized firms surveyed carried out some form of ongoing periodic screening of their entire customer base. The majority of small firms surveyed and visited did not carry out periodic screening.

Treatment of potential target matches

30. All major financial groups surveyed said that they would conduct an internal investigation whenever a potential match on the HMT list was found, in order to



determine whether it was an actual match with a target on the HMT list or a false positive. In the event of the match being an actual target match, firms told us that they would notify HMT's Asset Freezing Unit and either decline to provide further services/carry out transactions for the client or, if appropriate, seek a licence from HMT.

31. We found that the majority of medium-sized firms surveyed said they would conduct an internal investigation when a potential target match was identified, in order to determine whether it was an actual target match. Of the small firms that were screening, approximately half said they would make an immediate report to the HMT's Asset Freezing Unit if a target match was identified, a quarter would refer the issue to their external compliance consultants for further investigation, while the remainder did not have procedures in place to deal with potential target matches. However, none of the small firms screening had ever identified a target match.

1.3 Conclusion

32. Firms should consider all the findings set out in this report, irrespective of the size of firm to which the finding applies. This review highlights areas where improvements are needed if firms are to ensure compliance with our financial crime requirements. To assist firms we have given examples of good and poor practice in Appendix 1 and included the main misconceptions about financial sanctions which we found during our review in Appendix 2.

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2. Introduction

2.1 Background

33. This report is the result of a review carried out by FCID to examine the systems and controls that firms have in place to prevent a breach of UK financial sanctions and to comply with the financial crime requirements set out in our principles and rules. We have not previously carried out thematic work in this area.
34. This review has enabled us to benchmark firms' understanding of the financial sanctions requirements and the processes they have in place to meet them. It should assist firms in implementing appropriate and effective systems and controls to meet our financial crime requirements. The risk of UK financial sanctions being breached is most relevant to our financial crime objective, but it may also be relevant to our market confidence objective.

2.2 Legal requirements

35. Each financial sanctions order is set out in a statutory instrument and/or EC Regulation. These make up the HMT list. The relevant legislation will specify the services a firm may or may not provide.
36. While one of our statutory objectives is to reduce the extent to which it is possible for an authorised firm to be used for a purpose connected with financial crime, HMT is responsible for implementing, administering and enforcing compliance with UK financial sanctions.
37. Firms must inform HMT's Asset Freezing Unit as soon as practicable where it has identified an actual match with a person or entity on the HMT list, or where it knows or suspects that a customer or a person with whom the firm has had business dealings has committed a breach, and supply any information that would facilitate compliance.
38. HMT, or any person authorised by HMT, may request any person to supply it with any information in their possession or control that would enable the requesting authority to ensure compliance with, or detect evasion of, the UK financial sanctions regime.
39. The penalties for a breach of UK financial sanctions are set out in each Statutory Instrument. Any person guilty of an offence under the relevant Statutory Instrument is liable on conviction to imprisonment and/or a fine. The maximum term of imprisonment is currently seven years where the offence is imposed under the UK financial sanctions regime, or two years where imposed under the EC regime.

2.3 Our anti-financial crime requirements

40. Principle 3 of our Principles for Businesses provides that ‘*a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems*’.
41. Our Handbook rule SYSC 3.2.6R states that ‘a firm must take reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements and standards under the regulatory system and for countering the risk that the firm might be used to further financial crime’. Our Handbook also requires that firms’ relevant systems and controls must be ‘comprehensive and proportionate in nature, scale and complexity of its activities’.
42. Firms should therefore have proportionate systems and controls in place to reduce the risk of a breach of UK financial sanctions occurring.
43. Although there is no specific obligation in our Handbook requiring firms to notify us of a financial sanctions breach, Principle 11 requires firms to keep us advised of any relevant issues of which we would normally expect notice.

“A firm must deal with its regulators in an open and co-operative way, and must disclose to the FSA appropriately anything relating to the firm of which the FSA would normally expect notice”.

Principle 11: Relations with regulators

2.4 Methodology

44. We sought the views of 12 stakeholders, including HMT, professional firms, trade associations and providers of automated systems commonly used for screening.
45. We received 228 survey responses from a broad range of firms from across the financial services industry, ranging from small firms to major financial groups, both retail and wholesale. Our sample breaks down as follows.

	Total	Major financial groups	Medium-sized firms	Small Firms
Total surveys received	228	8	49	171
Total firms visited	25	3	13	9

46. Tailored surveys were sent to different types of firms to ensure that the questions were relevant to the nature and scale of the business of each firm. We then selected a sub-sample of 25 firms to visit to substantiate the findings from the surveys.
47. Our review was limited to an assessment of the financial sanctions systems and controls that firms have in place to meet our financial crime requirements.



3. Findings

3.1 Governance and senior management responsibility

48. Senior management involvement and responsibility are crucial in ensuring that effective and consistent systems and controls operate across the organisation and that adequate and appropriate resources are allocated. Senior management should be fully involved in the development and implementation of effective and appropriate financial crime policies and procedures. Firms should ensure that appropriate policies and procedures are in place across the organisation, the risk of dealing with a person on the HMT list is properly assessed and mitigated and staff understand their responsibilities and the firm's own procedures.
49. We examined whether there was adequate senior management involvement in devising and approving the procedures and policies for financial sanctions screening in the firm.
50. Our survey results indicated that, for firms with written policies and procedures in existence, almost all firms indicated that senior management had approved their policies and procedures. Some of the major financial groups surveyed also indicated that responsibility for compliance with the UK financial sanctions regime had been assigned to a board member as part of a wider anti-financial crime remit.

Senior management responsibility – examples of good practice

- Full senior management and/or board level involvement in approving and taking responsibility for policies and procedures.
- High level of senior management awareness of the firm's obligations regarding financial sanctions.
- Senior management involvement in cases where a potential target match cannot easily be verified.
- Adequate and appropriate resources allocated by senior management.
- Senior management notified of all actual matches and, if it should arise, all breaches of UK financial sanctions in an appropriate and timely manner.

Senior management responsibility – examples of poor practice

- No senior management involvement or understanding regarding the firm's obligations under the UK financial sanctions regime, or its systems and controls to comply with it.
- No, or insufficient, management oversight of the day-to-day operation of systems and controls.



- Failure to include assessments of the financial sanctions systems and controls as a normal part of internal audit programmes.
- No senior management involvement in cases where a potential target match cannot easily be verified.
- Senior management not being made aware of a target match for an existing customer.
- Inadequate or inappropriate resources allocated to financial sanctions compliance with our requirements.

3.2 Risk assessment

51. As with any other financial crime risks, we expect firms to take a proportionate, risk-based approach when assessing where and how financial sanctions breaches are likely to occur, and to focus resources and tailor systems and controls accordingly. Senior management should be involved in this process as appropriate.
52. We found that all major financial groups surveyed had conducted a risk assessment to assess the probability of their customer base, including individuals and entities on the HMT list. The majority assessed the inherent risk of dealing with an individual or entity on the HMT list to be high, though some assessed the risk to be low. When they took into account their systems and controls, most of the firms that assessed their inherent risk to be high then deemed the residual risk of dealing with a person on the HMT list to be low. However it should be noted that, when taking on customers referred by another authorised firm, major firms often assume that appropriate financial sanctions screening has been undertaken by the referring firm. Our findings show that this may well not be the case (see section 3.4). This may have a fundamental effect on the receiving firm's risk assessment.
53. Two thirds of medium-sized firms had carried out a risk assessment in relation to UK financial sanctions. Just over half of small firms surveyed stated that they had conducted a risk assessment, but the visits conducted to small firms indicated that most of these firms were referring to checks carried out for AML purposes rather than financial sanctions screening.
54. Firms reported that some factors they take into account when assessing the likelihood of a client being on the HMT list are as follows.
 - For individuals: place of residence, country of origin, citizenship, source of wealth, occupation, and countries to and from which transactions are to be made.
 - For entities: location of business, country in which the business is incorporated, nature of business, beneficial owners of the business, directors, countries from which transactions are made and entities with which the transactions are effected.



55. We encountered firms with a poor understanding of the UK financial sanctions regime. This is likely to impact on the quality of their risk assessments. Some misconceptions amongst our sample included the following:
- Firms who believed they were somehow exempt from the financial sanctions regime if they only processed low-value transactions. In fact there is no minimum financial limit.
 - Firms who believed that individuals and entities on the list were all based overseas. There are some individuals and entities on the list that are UK-based.
 - Firms, particularly small firms, who believed financial sanctions screening was not necessary as they did not hold client money, did not make payments or dealt in products they assessed as low risk for financial crime. Firms are reminded that under the Terrorism Order the prohibition extends to financial services as well as funds. Firms need to be careful when including product risk in their risk-based approach.
 - Firms, including one major retail firm, that failed to understand the difference between financial sanctions targets and politically exposed persons (PEPs). Most PEPs are not the subject of financial sanctions (although they may be).
 - Firms who believed that insurance is a no or low risk area for financial sanctions, and others who believed that UK financial sanctions did not apply to insurance. However, the Terrorism Order prohibits the provision of financial services, including insurance, to a target on the HMT list. HMT also administers a licensing regime.
56. It is essential that firms have a good understanding of the UK financial sanctions regime. Without this, risk assessments are likely to be inaccurate and controls put in place to mitigate the risk of dealing with a person on the HMT list may not be sufficient.
57. Firms may well use a risk-based approach to screening. If so, they should be able to demonstrate why the approach taken is appropriate and sufficient.

Risk assessment – examples of good practice

- Conducting a comprehensive risk assessment, based on a good understanding of the financial sanctions regime, covering the risks that may be posed by clients, transactions, services, products and jurisdictions.
- Taking into account associated parties, such as directors and beneficial owners.
- A formal documented risk assessment with a clearly documented rationale for the approach.



Risk assessment – examples of poor practice

- Not assessing the risks that the firm may face of breaching financial sanctions.
- Risk assessments that are based on misconceptions – see Appendix 2 for some examples of the misconceptions we found.

3.3 Policies and procedures

58. If a firm is taking reasonable steps to reduce the risk of breaching UK financial sanctions, it should have in place up-to-date policies and procedures appropriate to its business that are readily accessible and well understood by all relevant staff.

An absence of written policies and procedures may lead to different interpretations of the firm's approach to financial sanctions and consequently an increased risk of a financial sanctions breach occurring in some parts of the firm.

59. Our survey revealed that all major financial groups and approximately three quarters of the medium-sized firms in our sample had formal written procedures in place for financial sanctions screening. Approximately two thirds of the small firms surveyed declared that they had in place written policies and procedures for financial sanctions screening. However, visits to a sub-sample of the small firms surveyed revealed that only half had policies and procedures in place, as some firms thought that AML checks would cover the possibility of the client being a target on the HMT list.

Standard AML customer due-diligence does not usually include screening against the HMT list and therefore does not reduce the risk of a breach of UK financial sanctions. Screening against the HMT list needs to be specifically carried out, in addition to checks done for AML purposes.

60. Some firms had good high-level policies in place, but did not have detailed procedures that explained how to comply with them. Some firms had good policies and procedures in place, but staff had a poor understanding of them and/or how to comply with them in practice.
61. Where firms operate in a number of countries, a consistent group-wide policy is likely to assist local business units in ensuring that their local procedures meet minimum group requirements. Three quarters of the major financial groups surveyed indicated that they had in place the same systems and controls for screening the HMT list in their non-UK business units as they had in the UK. However, our review found some larger firms with country specific business unit policies and procedures in place, which did not meet the minimum group-wide standards.
62. Where firms use automated processes for screening, it is good practice to review screening rules to ensure that they remain up-to-date and appropriate for the firm's needs. We found that, once systems are set up, some firms failed to understand how the system generates potential matches and the criteria used, and some also failed to monitor the ongoing effectiveness of the system.



One firm suffered a partial systems failure, resulting in a substantial drop in the number of potential matches. The firm did not investigate why the number of matches had suddenly dropped. Three months later it was discovered that three of five relevant IT platforms were not functioning and consequently some of the firm's clients were not being screened. The firm had failed to monitor its systems adequately.

Internal audit

63. In order to manage risk effectively, firms should ensure that procedures remain up-to-date and fit for purpose in a changing environment. It is good practice for an independent review of procedures to be carried out periodically by staff who are not involved in overseeing the firm's systems and controls for financial sanctions.
64. We found that approximately three quarters of the major financial groups and half of medium sized firms surveyed had included a review of financial sanctions procedures during internal audits.

One major financial group had never included a review of the financial sanctions screening process in its internal audit programme. In addition, the person responsible for overseeing the financial sanctions screening process advised that any audit of the process would be done by them. It is good practice for an internal audit to be carried out by someone who is independent of the process.

Policies and procedures – examples of good practice

- Documented policies and procedures in place that clearly set out a firm's approach to complying with its legal and regulatory requirements in this area.
- Group wide policies for UK financial sanctions screening across the group to ensure that business unit specific policies and procedures reflect, at the very least, the minimum standard set out in group policy.
- Effective procedures to screen against the HMT List that are appropriate for the business, covering customers, transactions and services across all products and business lines.
- Clear, simple and well-understood escalation procedures to enable staff to raise financial sanctions concerns with management.
- Regular review and update of policies and procedures.
- Regular reviews of the effectiveness of policies, procedures, systems and controls by the firm's internal audit function or another independent party.
- Procedures that include ongoing monitoring/screening of clients.



Policies and procedures – examples of poor practice

- No policies or procedures in place for complying with the legal and regulatory requirements of the UK financial sanctions regime.
- Internal audits of procedures carried out by persons with responsibility for the oversight of financial sanctions procedures, rather than an independent party.

3.4 Staff training and awareness

65. We found a concerning lack of awareness of the UK financial sanctions regime, particularly among small firms.
66. The effectiveness of systems and controls in this area depends on good awareness of financial sanctions among relevant staff. It is good practice for firms to give specialised training on the UK financial sanctions regime to relevant staff and, if appropriate, to provide more general training to other staff.
67. Our survey revealed that most major financial groups and medium-sized firms provided training to staff on financial sanctions. This varied from training being incorporated within wider general financial crime training to dedicated training on financial sanctions directed at staff involved in client take-on and monitoring.
68. Small firms generally displayed very low levels of awareness of the UK financial sanctions regime. For example, some were so unaware of the ‘financial sanctions regime’ that they thought the phrase referred to financial penalties issued by the FSA. Many small firms relied on compliance consultants to provide training, but this tended to be AML focused and generally did not include specific training on UK financial sanctions.
69. Firms should consider implementing effective arrangements to ensure that:
 - Training, appropriate for different groups of staff, is accessible and routinely provided;
 - Refresher training is included to ensure that knowledge remains current and up-to-date;
 - Staff are tested, as appropriate, to ensure that they have understood the training;
 - Reference material containing the firm’s financial sanctions policies and procedures is readily available and simple to understand.



Training and awareness – examples of good practice

- Regularly updated training and awareness programmes that are relevant and appropriate for employees' particular roles.
- Testing to ensure that employees have a good understanding of financial sanctions risks and procedures.
- Ongoing monitoring of employees' work to ensure they understand the financial sanctions procedures and are adhering to them.
- Training provided to each business unit covering both the group-wide and business unit-specific policies on financial sanctions.

Training and awareness – examples of poor practice

- No training on financial sanctions.
- Relevant staff unaware of the firm's policies and procedures to comply with the UK financial sanctions regime.
- Changes to the financial sanctions policies, procedures, systems and controls are not communicated to relevant staff.

3.5 Screening during client take-on

70. There is no legal obligation that requires firms to screen clients against the HMT list at the time of client take-on, but it would be difficult for a firm to know whether a client is on the list without screening. Retrospective screening (eg. not screening clients until several weeks after client take-on) carries the risk that the firm may carry out transactions or provide services in breach of financial sanctions.
71. Good reasons, which should be documented, would be needed to justify not screening some or all of a firm's clients. These reasons would need to be based on a good understanding of the financial sanctions regime and a robust risk assessment. Our review found weaknesses in both these areas, particularly among small firms.
72. We found that all the major financial groups and medium-sized firms surveyed routinely screened all new direct clients against the HMT list. However, they were not routinely screening referred clients (i.e. those referred by another authorised firm) against the HMT list at the time of client take-on.
73. Some small firms confused financial sanctions screening with checks being carried out for AML purposes. As a result, several small firms believed they were screening clients



for financial sanctions purposes when they were carrying out only AML checks. Only about a quarter of the small firms surveyed screened their customers against the HMT list. Of these, only a small proportion screened all new customers against the HMT list. The remainder screened only certain customers against the HMT list if they were concerned about the client. However, this judgement was generally based on misconceptions, such as the belief that no UK persons or entities were on the HMT list, rather than a robust risk assessment.

74. A widespread weakness identified was that most of the medium and large firms surveyed were not screening clients referred to them by another FSA-authorised firm. Most assumed that the clients were being screened and relied on the referring firm to have conducted adequate screening, without taking any steps to satisfy themselves that screening had taken place. Where firms rely on other firms to carry out financial sanctions screening, it is good practice for them to satisfy themselves that those firms do in fact screen in a way the receiving firm regards as acceptable.

We found some large firms were relying on intermediaries to screen clients they referred, without checking that they were in fact screening against the HMT list. In turn, the intermediaries were relying on small firms to carry out screening. In some cases, no screening was taking place at all.

75. Firms that assume other firms have screened clients against the HMT list are running the risk that they will inadvertently breach UK financial sanctions. Firms should remember that they cannot outsource their responsibility to meet either their legal obligation to ensure that UK financial sanctions are not breached, or our requirements to have in place effective systems and controls to prevent the firm being used for purposes connected with financial crime.

One firm sought confirmation from all its intermediaries that they screened all clients against the HMT list. As a result, some intermediaries put in place systems to screen clients against the HMT list and others improved their systems. The firm was then able to satisfy itself that the referring intermediaries were screening clients.

Use of automated screening systems

76. Some firms took the view that the implementation of an automated system was a total solution. However, implementing a system should only be the beginning of the financial sanctions screening process. Where firms use commercially available automated systems for screening, it is good practice to ensure that the systems are effective and appropriate for their firm and that the capabilities and limits of the system are fully understood. Where firms used ‘fuzzy matching’, we found some firms did not fully understand the ‘fuzzy matching’ rules contained in commercially available automated screening solutions.



77. Firms should carry out regular reviews of the appropriateness of the screening system to ensure that the system remains up-to-date and effective.

One firm stated that they had an abnormally large number of potential matches, investigation of which was time-consuming, resource intensive and resulted in a high number of false positives. It was discovered that most of the potential matches were generated because their search criteria included individuals other than those on the HMT list (such as PEPs) when the firm wanted to screen clients only against the targets on the HMT list. If the firm had a better understanding of how their systems worked and what their systems were picking up, this problem might not have occurred.

Calibration of automated screening rules and the use of ‘fuzzy matching’

78. The effectiveness of systems and controls to prevent breaches of UK financial sanctions depend on not only a firm’s policies and procedures, but also on the criteria it uses for screening the HMT list and the quality of the underlying data. Most medium and major financial groups used automated screening rules. We found some firms calibrated their screening rules too narrowly, e.g. they did not make use of the alternative identifiers on the HMT list, thereby increasing the risk that potential matches would not be picked up. Conversely some firms calibrated their screening rules too widely, which resulted in too many false positives being generated.
79. Where firms use automated systems for screening, they should consider whether the screening rules are calibrated appropriately for the nature of the firm’s business and client list. If they are not, there is a risk that potential matches will not be raised as alerts. As well as covering full name, date of birth and address, some firms were taking into account variables such as partial names, aliases, transliteration, different spellings of names, name reversal, insertion of a full stop or a space in a name, typing errors, digit rotation, shortened names for individuals, maiden names and abbreviations for names of entities (this list is illustrative, not exhaustive).
80. The process of searching for words or names that are likely to be relevant, even when search words and spellings may not match exactly, is known as ‘fuzzy matching’. Fuzzy matching searches produce lists of results based on possible relevance. Approximately half the major financial groups surveyed and a small number of medium-sized firms surveyed used fuzzy matching.
81. We consider the use of fuzzy matching to be good practice for firms using automated screening systems. However, if using fuzzy matching, firms should ensure that the matching criteria they use are relevant and appropriate for the size and nature of their business, in order to avoid a large number of false positives being generated.



Challenges for firms screening the HMT list

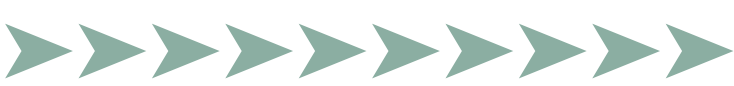
82. During the course of this review and in other discussions, firms have raised concerns with us and the HMT about the quality of some identifiers on the HMT list. Identifiers are the personal identifying information on the HMT list used by firms to screen their customers. Identifiers that are too general make it difficult for firms to identify matches with the HMT list and ensure that financial sanctions are applied quickly to the correct targets. They also increase compliance burdens significantly. While firms acknowledge progress in this area, they remain concerned that some of the identifiers on the HMT list are too general. We would encourage the HMT to continue their work to enhance the quality of identifiers.
83. Some firms operate a group-wide approach to financial sanctions and have expressed concerns about the differences between the UK and other financial sanction regimes. We note the challenges firms face in dealing with multiple financial sanctions regimes and would encourage firms to seek legal advice if any conflict between them arises.

“Where a firm has a US listing, or has activities in, or linked to, the USA, whether through a branch, subsidiary, associated company or correspondent banking relationship, there is a risk that the application of US AML/CTF and financial sanctions regimes may apply to the non-US activities of the firm. Senior management should take advice on the extent to which the firm’s activities may be affected in this way”.

JMLSG 2007 Part 1 Guidance, Chapter 1, paragraph 1.49

Screening during client take-on – examples of good practice

- An effective screening system appropriate to the nature, size and risk of the firm’s business.
- Screening against the HMT list at the time of client take-on, before providing any services or undertaking any transactions for a customer.
- Screening directors and beneficial owners of corporate customers.
- Screening third-party payees where adequate information is available.
- Where the firm’s procedures require dual control (e.g. a ‘four eyes’ check) to be used, having in place an effective process to ensure this happens.
- The use of ‘fuzzy matching’ where automated screening systems are used.
- Where a commercially available automated screening system is implemented, making sure that there is a full understanding of the capabilities and limits of the system



Screening during client take-on – examples of poor practice

- Screening retrospectively, rather than at the time of client take-on.
- Screening only on notification of a claim on an insurance policy, rather than during client take-on.
- Relying on other FSA-authorised firms and compliance consultants to screen clients against the HMT list without taking reasonable steps to ensure that they are doing so effectively.
- Assuming that AML customer due-diligence checks include screening against the HMT list.
- Failing to screen UK-based clients on the assumption that there are no UK-based persons or entities on the HMT list or failure to screen due to any other misconception.
- Large global institutions with millions of clients using manual screening, increasing the likelihood of human error leading to matches being missed.
- IT systems that cannot flag potential matches clearly and prominently.
- Firms calibrating their screening rules too narrowly or too widely so that they, for example, match only exact names with the HMT list or generate large numbers of resource intensive false positives.
- Regarding the implementation of a commercially available sanctions screening system as a panacea, with no further work required by the firm.
- Failing to adequately tailor a commercially available sanctions screening system to the firm's requirements.

3.6 Ongoing screening

84. It is difficult to see how firms can take reasonable steps to ensure that they are not breaching UK financial sanctions, without taking account of the fact that financial sanctions regimes change in the light of national and international political developments and names are therefore added (and removed from) the HMT list. Firms need to recognise this in the systems and controls they put in place in respect of ongoing screening. It is therefore good practice for firms to have procedures to ensure that their client database is screened within a reasonable time of changes being made to the HMT list.



‘All firms to whom this guidance applies, therefore, whether or not they are FSA regulated or subject to the ML Regulations, will need either:

- For manual checking: to register with the HM Treasury update service (directly or via a third party, such as a trade association); or
- If checking is automated, to ensure that relevant software includes checks against the relevant list and that this list is up-to-date.’

JMLSG Guidance 2007, paragraph 5.3.42

85. Our survey revealed that most major financial groups conducted ongoing screening, the frequency of which ranged from daily to quarterly. We also found that some firms varied the frequency of ongoing screening according to business line. We found that just over half of the medium-sized firms surveyed carried out periodic screening. Although approximately a third of small firms surveyed told us that they would conduct periodic screening, the confusion we found among small firms between financial sanctions screening and AML checks suggests that they were probably referring to ongoing Know Your Customer checks rather than financial sanctions screening.
86. The results of our survey also revealed that the majority of firms conducting ongoing screening only checked the names of persons and entities on the HMT list. They did not appear to cover directors and beneficial owners during ongoing screening. This gives rise to the risk that firms may inadvertently breach UK financial sanctions when there are changes of directors or beneficial owners. Firms should therefore consider covering changes of directors and beneficial owners in their overall risk-based approach towards screening.
87. It is good practice for firms to ensure that data on clients is kept up-to-date. If it is not, screening will not be as accurate as it could be and a firm may inadvertently breach UK financial sanctions. Data cleanliness was highlighted as an issue in our 2007 thematic review, Automated anti-money laundering transaction monitoring systems.
88. When screening existing clients, some major financial groups experienced problems because their flagging systems were not robust. The flags raised when a target match was made were not prominent enough to be clearly identified, giving rise to the risk that staff may miss the flag and process transactions or provide a service to a target on the HMT list.

At one firm, cashier staff received a ‘pop-up’ box asking them to contact compliance immediately before operating a flagged account. This was very effective. In contrast, at another firm, the cashier staff needed to check on page 4 of their screen to see if the account had been flagged. Where flags are not prominent there is a risk that staff may fail to see them.

89. Some firms had controls on IT systems for flagged individuals and entities that could be overridden by line management without referral to compliance. In contrast, other firms had controls that would not allow staff to deal with flagged individuals and entities unless authorised by compliance, thereby including a second line of defence that could not be overridden and reducing the risk of a breach of UK financial sanctions.



Ongoing screening – examples of good practice

- Screening of the entire client base within a reasonable time following updates to the HMT list.
- Ensuring that customer data used for ongoing screening is up-to-date and correct.
- Processes that include screening for indirect as well as direct customers and also third-party payees, wherever possible.
- Processes that include screening changes to corporate customers' data (e.g. when new directors are appointed or if there are changes to beneficial owners).
- Regular reviews of the calibration and rules of automated systems to ensure they are operating effectively.
- Screening systems calibrated in accordance with the firm's risk appetite, rather than the settings suggested by external software providers.
- Systems calibrated to include 'fuzzy matching', including name reversal, digit rotation and character manipulation.
- Flags on systems prominently and clearly identified.
- Controls that require referral to relevant compliance staff prior to dealing with flagged individuals or entities.

Ongoing screening– examples of poor practice

- No ongoing screening of customer databases or transactions.
- Failure to screen directors and beneficial owners of corporate customers and/or third-party payees where adequate information is available.
- Failure to review the calibration and rules of automated systems, or to set the calibration in accordance with the firm's risk appetite.
- Flags on systems that are dependent on staff looking for them.
- Controls on systems that can be overridden without referral to compliance.

3.7 Treatment of potential target matches

90. A match found during screening does not necessarily mean that the firm is dealing with an actual target on the HMT list. The HMT defines a target match as follows.



“A target match is where you are satisfied that the account held is that of the target of the financial sanctions. A name match is where you have matched the name of an account holder with the name of a target included on HM Treasury’s consolidated list. This does not necessarily mean that the account holder is one and the same as the target”.

www.hm-treasury.gov.uk./documents/financial_services/sanctions/faqs

91. HMT requires that, if a firm finds an actual target match or freezes an account as a result of suspicion that an individual or entity is acting on behalf of a listed individual or entity, the firm must report the matter, as soon as reasonably practicable, to HMT’s Asset Freezing Unit (AFU) at:

Asset Freezing Unit

HM Treasury

1 Horse Guards Road

London

SW1A 2HQ

assetfreezingunit@hm-treasury.gov.uk

92. Firms should therefore have appropriate systems and controls:
- To enable investigation of a potential target match to determine if it is a actual target on the HMT list; and
 - For freezing/blocking accounts.

Firms should also have clear internal and external reporting processes for reporting actual target matches to HMT as soon as reasonably practicable.

93. All major financial groups surveyed said that, if they identified a potential match, they would conduct an internal investigation to determine whether or not the individual or entity identified was an actual match with a target on the HMT list. They also told us that, if they identified an actual target match with a target on the HMT list, they would, as required by the relevant financial sanctions order, notify HMT’s AFU, freeze the account and, if appropriate, seek a licence. These firms showed an understanding of the sanctions regime and the obligations regarding matches.
94. The majority of medium-sized firms said they would conduct an internal investigation if a potential match were identified. No small firm surveyed had ever identified a target match. This is not surprising given the low levels of awareness, risk assessment and screening carried out by small firms in relation to UK financial sanctions.
95. In respect of potential matches that could not be clarified, we found differing approaches in our sample of major financial groups. Most said that they would notify HMT’s AFU



and seek consent to proceed with the service or the transaction. The remainder said that they would either proceed with the transaction or service on the grounds that an actual target match had not been found, or assume that the match was positive, not proceed with the transaction or service and report it to HMT's AFU. Some firms said that they would seek further information from the client to endeavour to determine whether the match was genuine.

96. We found a similar approach to unsubstantiated target matches in our sample of medium-sized firms. Just over half of those surveyed said that they would notify HMT's AFU and seek consent to proceed with the provision of the service or the transaction. The rest said they would either proceed with the transaction or service on the grounds that an actual target match had not been found, or assume that the match was positive, report it to HMT's AFU and not proceed with the transaction or service. Those who took the second approach would also seek more information from the customer.
97. All the major financial groups and medium-sized firms surveyed advised us that they kept an audit trail of financial sanctions screening and all firms retained details of false positive matches. It is good practice for firms to ensure that there is a clear rationale for deciding that a potential target match is a false positive and that this is documented. Only half the small firms surveyed said they would keep an audit trail of a positive match.

Most listed individuals and entities are aware that they are on the HMT list, which is publicly available. The financial sanctions regime is legally distinct from the anti-money laundering regime established by POCA. As such, it is unlikely that freezing funds, subject to a financial sanctions order, would constitute tipping off. However, firms should be aware that in certain cases there may be some cross-over between the two regimes and they should seek legal advice if in any doubt as to whether tipping-off issues arise in any particular case.

Treatment of target matches – examples of good practice

- Procedures for investigating whether a potential match is an actual target match or a false positive.
- Procedures for freezing accounts where an actual target match is identified.
- Procedures for notifying HMT's AFU promptly of any confirmed matches.
- Procedures for notifying senior management of target matches and cases where the firm cannot determine whether a potential match is the actual target on the HMT list.
- A clear audit trail of the investigation of potential target matches and the decisions and actions taken, such as the rationale for deciding that a potential target match is a false positive.

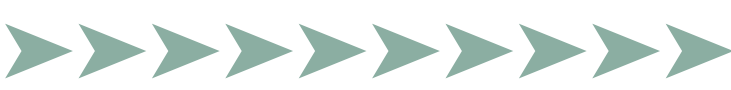


Treatment of target matches – examples of poor practice

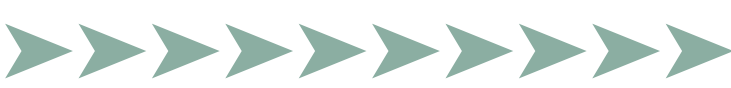
- No procedures in place for investigating potential matches with the HMT list.
- Discounting actual target matches incorrectly as false positives due to insufficient investigation.
- No audit trail of decisions where potential target matches are judged to be false positives.

Appendix 1: Consolidated examples of good and poor practice

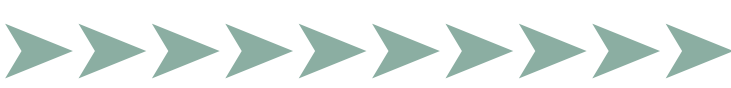
<i>Financial sanctions – consolidated examples of good and poor practice</i>	
Examples of good practice	Examples of poor practice
Senior management responsibility	
• Full senior management and/or board level involvement in approving and taking responsibility for policies and procedures. • High level of senior management awareness of the firms' obligations regarding financial sanctions. • Senior management involvement in cases where a potential target match cannot easily be verified. • Adequate and appropriate resources allocated by senior management. • Senior management notified of all actual matches and if it should arise, all breaches UK financial sanctions in an appropriate and timely manner.	• No senior management involvement or understanding regarding the firm's obligations under the UK financial sanctions regime, or its systems and controls to comply with it. • No or insufficient management oversight of the day-to-day operation of systems and controls. • Failure to include assessments of the financial sanctions systems and controls as a normal part of internal audit programmes. • No senior management involvement in cases where a potential target match cannot easily be verified. • Senior management not being made aware of a target match for an existing customer. • Inadequate or inappropriate resources allocated to financial sanctions compliance with our requirements.



<i>Financial sanctions – consolidated examples of good and poor practice</i>	
Examples of good practice	Examples of poor practice
Risk assessment	
• Conducting a comprehensive risk assessment, based on a good understanding of the financial sanctions regime, covering the risks that may be posed by clients, transactions, services, products and jurisdictions. • Taking into account associated parties, such as directors and beneficial owners. • A formal documented risk assessment with a clearly documented rationale for the approach.	• Not assessing the risks that the firm may face of breaching financial sanctions. • Risk assessments that are based on misconceptions – see Appendix 2 for some examples of the misconceptions we found.
Policies and procedures	
• Documented policies and procedures in place, which clearly set out a firm's approach to complying with its legal and regulatory requirements in this area. • Group-wide policies for UK financial sanctions screening across the group, to ensure that business unit specific policies and procedures reflect at the very least the minimum standard set out in group policy. • Effective procedures to screen against the HMT list that are appropriate for the business, covering customers, transactions and services across all products and business lines.	• No policies or procedures in place for complying with the legal and regulatory requirements of the UK financial sanctions regime. • Internal audits of procedures carried out by persons with responsibility for oversight of financial sanctions procedures, rather than an independent party.



<i>Financial sanctions – consolidated examples of good and poor practice</i>	
Examples of good practice	Examples of poor practice
• Clear, simple and well understood escalation procedures to enable staff to raise financial sanctions concerns with management. • Regular review and update of policies and procedures. • Regular reviews of the effectiveness of policies, procedures, systems and controls by the firm's internal audit function or another independent party. • Procedures that include ongoing monitoring/screening of clients.	
Staff training and awareness	
• Regularly updated training and awareness programmes that are relevant and appropriate for employees' particular roles. • Testing to ensure that employees have a good understanding of financial sanctions risks and procedures. • Ongoing monitoring of employees' work to ensure they understand the financial sanctions procedures and are adhering to them. • Training provided to each business unit covering both the group-wide and business unit-specific policies on financial sanctions.	• No training on financial sanctions. • Relevant staff unaware of the firm's policies and procedures to comply with the UK financial sanctions regime. • Changes to the financial sanctions policies, procedures, systems and controls are not communicated to relevant staff.



<i>Financial sanctions – consolidated examples of good and poor practice</i>		
Examples of good practice	Examples of poor practice	
Screening during client take-on		
• An effective screening system appropriate to the nature, size and risk of the firm's business. • Screening against the HMT list at the time of client take-on before providing any services or undertaking any transactions for a customer. • Screening directors and beneficial owners of corporate customers. • Screening third-party payees where adequate information is available. • Where the firm's procedures require dual control (e.g. a 'four eyes' check) to be used, having in place an effective process to ensure this happens. • The use of 'fuzzy matching' where automated screening systems are used. • Where a commercially available automated screening system is implemented, making sure that there is a full understanding of the capabilities and limits of the system.	• Screening retrospectively, rather than at the time of client take-on. • Screening only on notification of a claim on an insurance policy, rather than during client take-on. • Relying on other FSA-authorised firms and compliance consultants to screen clients against the HMT list without taking reasonable steps to ensure that they are doing so effectively. • Assuming that AML customer due diligence checks include screening against the HMT list. • Failing to screen UK-based clients on the assumption that there are no UK-based persons or entities on the HMT list or failure to screen due to any other misconception. • Large global institutions with millions of clients using manual screening, increasing the likelihood of human error and leading to matches being missed. • IT systems that cannot flag potential matches clearly and prominently.	



<i>Financial sanctions – consolidated examples of good and poor practice</i>	
Examples of good practice	Examples of poor practice
Screening during client take-on	
	- Firms calibrating their screening rules too narrowly or too widely so that they, for example, match only exact names with the HMT list or generate large numbers of resource intensive false positives. - Regarding the implementation of a commercially available sanctions screening system as a panacea, with no further work required by the firm. - Failing to tailor a commercially available sanctions screening system to the firm's requirements.
Ongoing screening	
- Screening of the entire client base within a reasonable time following updates to the HMT list. - Ensuring that customer data used for ongoing screening is up to date and correct. - Processes that include screening for indirect as well as direct customers and also third-party payees, wherever possible. - Processes that include screening changes to corporate customers' data (e.g. when new directors are appointed or if there are changes to beneficial owners). - Regular reviews of the calibration and rules of automated systems to ensure they are operating effectively.	- No ongoing screening of customer databases or transactions. - Failure to screen directors and beneficial owners of corporate customers and/or third-party payees where adequate information is available. - Failure to review the calibration and rules of automated systems, or to set the calibration in accordance with the firm's risk appetite. - Flags on systems that are dependent on staff looking for them. - Controls on systems that can be overridden without referral to compliance.

Financial sanctions – consolidated examples of good and poor practice

Examples of good practice	Examples of poor practice
Ongoing screening	
• Screening systems calibrated in accordance with the firm's risk appetite, rather than the settings suggested by external software providers. • Systems calibrated to include 'fuzzy matching', including name reversal, digit rotation and character manipulation. • Flags on systems prominently and clearly identified. • Controls that require referral to relevant compliance staff prior to dealing with flagged individuals or entities.	
Treatment of potential target matches	
• Procedures for investigating whether a potential match is an actual target match or a false positive. • Procedures for freezing accounts where an actual target match is identified. • Procedures for notifying HMT's AFU promptly of any confirmed matches. • Procedures for notifying senior management of target matches and cases where the firm cannot determine whether a potential match is the actual target on the HMT list. • A clear audit trail of the investigation of potential target matches and the decisions and actions taken, such as the rationale for deciding that a potential target match is a false positive.	• No procedures in place for investigating potential matches with the HMT list. • Discounting actual target matches incorrectly as false positives due to insufficient investigation. • No audit trail of decisions where potential target matches are judged to be false positives.



Appendix 2: Misconceptions

1. Firms who believed they were somehow exempt from the financial sanctions regime if they only processed low value transactions – there is no minimum limit.
2. Firms who believed that individuals and entities on the list were all based overseas. There are some individuals and entities on the list that are UK-based.
3. Firms, particularly small firms, who believed financial sanctions screening was not necessary as they did not hold client money, did not make payments or dealt in products they assessed as low risk for financial crime. This is not the case. Firms are reminded that under the Terrorism Order the prohibition extends to financial services as well as funds. Firms need to be careful when including product risk in their risk-based approach.
4. Firms, including one major retail firm, that failed to understand the difference between financial sanctions targets and politically exposed persons (PEPs). Most PEPs are not the subject of financial sanctions (although they may be).
5. Firms who believed that insurance is a no or low risk area for sanctions and others who believed that UK financial sanctions did not apply to insurance. However, the Terrorism Order prohibits the provision of financial services, including insurance, to a target on the HMT list. HMT also administers a licensing regime.
6. Firms who believed that the funds of sanctioned individuals cannot be frozen because it may constitute ‘tipping off’. Most listed individuals and entities are aware that they are on the HMT list, which is publicly available. The financial sanctions regime is legally distinct from the anti-money-laundering regime established by POCA. As such, it is unlikely that freezing funds subject to a financial sanctions order would constitute tipping off. However, firms should be aware that in certain cases there may be some cross-over between the two regimes, and should seek legal advice if in any doubt as to whether tipping-off issues arise in any particular case.
7. There is a misconception among some small firms that checks carried out for AML purposes will cover sanctions checks. Checking client identity will not ensure that the individual is not on the HMT list. Only screening against the HMT list will cover the possibility.
8. Some small firms who believed that Financial Sanctions was a form of FSA enforcement action. The UK Financial Sanctions regime is implemented, administered and enforced by HMT.

Appendix 3: Glossary

Term	Meaning
AFU	HMT's Asset Freezing Unit. The Asset Freezing Unit in the Treasury is responsible for implementing, administering and enforcing compliance with the UK financial sanctions regime.
False positives	Raised as a potential match with a target specified on the HMT list, but on investigation proves not to be an actual match.
Freezing of funds	"Preventing any move, transfer, alteration, use of, access to, or dealing with funds in any way that would result in any change in their volume, amount, location, ownership, possession, character, destination or other change that would enable funds to be used, including portfolio management": http://www.hm-treasury.gov.uk/fin_sanctions_definitions.htm .
Funds	The meaning of 'funds' is defined on HMT's website at: http://www.hm-treasury.gov.uk/fin_sanctions_definitions.htm .
Fuzzy matching	An IT technique that uses a variety of algorithms to identify additional potential matches e.g. if the search is for "Alastair" fuzzy matching may also pick up "Alasdair" or "Alistair" etc. Fuzzy matching can also be used to pick up other variations such as variations in punctuation e.g. US or U.S. USA or U.S.A can be picked up.
HMT	Her Majesty's Treasury.
HMT list	HMT's consolidated list of targets, which consists of the names of individuals and entities that are listed by UN Resolutions, EU Regulations and UK Statutory Instruments.
Licences	"A licence is a written authorisation from HM Treasury to allow an activity which would otherwise be prohibited. A licence may include associated reporting requirements or other conditions": http://www.hm-treasury.gov.uk/fin_sanctions_definitions.htm .
PEPs	Politically Exposed Persons. An individual who is or has, at any time in the preceding year, been entrusted with prominent public functions and an immediate family member, or a known close associate, of such a person" (JMLSG Guidance 2007, Part 1, 5.5.19).
POCA	Proceeds of Crime Act 2002
Potential target match	This is where there appears to be a match with an identifier on the HMT list, but further investigation is needed to determine if it is an actual match. HMT refers to this as a 'name match'.
Referred clients	Clients referred to a firm by another firm.
Referring firm	A firm that refers its clients to another firm.



Term	Meaning
Financial sanctions order	An EC regulation or an UK Statutory Instrument containing the name(s) of the target(s) against whom the order is made and sets out prohibitions applying against the target and the maximum penalty for a breach of the order.
SARs	Suspicious Activity Reports (which are reported to SOCA).
SOCA	Serious Organised Crime Agency.
SYSC	Systems and Controls sourcebook within the High Level Standards block of the FSA Handbook: http://fsahandbook.info/FSA/html/handbook/SYSC .
Target	The subject of the restrictions set out in a financial sanctions order.
Target match/Actual match	This is where the firm is satisfied that the potential match is an actual match with a target on the HMT list.

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