

HM TREASURY: REVIEW OF THE MONEY LAUNDERING REGULATIONS 2007

RESPONSE FROM THE ASSOCIATION OF PRIVATE CLIENT INVESTMENT MANAGERS AND STOCKBROKERS (APCIMS)

Questions about the Regulations

- **To what extent is the scope of the Regulations and their application to business activity appropriately risk-based?**

The Money Laundering Regulations (MLRs) are applied in the regulated financial sector in large part through rules promulgated by the UK Financial Services Authority (FSA). The FSA's Systems and Controls, or SYSC, Handbook on Financial Crime (SYSC 6.3.1-6.3.10¹) is designed on a risk-based approach and states that systems and controls (including policies and procedures) must be firm specific and based on the particular money laundering risks that a firm is faced with.

SYSC 6.3.1 sets the overall framework:

- SYSC 6.3.1 R 01/04/2009:

“A firm must ensure the policies and procedures established under SYSC 6.1.1 R include systems and controls that:

- (1) enable it to identify, assess, monitor and manage money laundering risk; and
- (2) are comprehensive and proportionate to the nature, scale and complexity of its activities.”

We are however concerned at the low quality of implementation of these policies by FSA staff undertaking the supervision of firms. In practice, they seldom adopt a risk based approach during an inspection. As a membership based body APCIMS receives substantial information from its member firms. The larger of these are relationship managed by the FSA under the ARROW system. They have made it plain to us over a period of time that FSA supervisors mostly lack sufficient industry knowledge, or knowledge about APCIMS' firms' business models, to understand how the risk based approach can be appropriately applied to them. This includes the application of policies and rules relating to money laundering. Our smaller firms are not visited by FSA supervisors and so do not have the experience of interaction from which to comment on this issue.

¹ <http://fsahandbook.info/FSA/html/handbook/SYSC/6/3>

As regards definitions, scope, and activities covered by the MLRs, our views on aspects of these are made clear in the responses to individual questions below. As we indicate, APCIMS is a member of the Joint Money Laundering Steering Group and supports any comments made by that body on these issues.

- **To what extent are the Customer Due Diligence (CDD) requirements set out in the Regulations a proportionate response to the threat from money laundering?**

CDD: We consider that, broadly speaking, the CDD requirements set out in the MLRs are proportionate to the threat from money laundering, and that the permissions and requirements given for SDD and EDD are appropriate. But in making this general observation it is important to recognise that the different business models of different firms have different risks associated with them and that there are consequent differences in the way due diligence procedures are carried out.

Costs and SDD: The way that costs drive the choice of diligence process should also be noted: firms need to set up systems to handle the processes required and where SDD may be possible CDD is often done anyway because it is faster and cheaper to use existing mechanisms in all cases rather than go to the lengths of determining a situation in which a simplified approach may be desirable and then applying a bespoke but lengthy and costly exceptional process. This situation means that SDD is in effect often a redundant category.

EDD and PEPs: While we agree that EDD measures should in principle be applied to managing the risks presented by PEPs, we note that there is little guidance given on how or how often PEPs should be adequately verified and monitored. APCIMS' firms in general feel that this lack should be rectified. They are for example unsure about how far up the chain it is necessary to go to verify individuals and their relevant "associations", and about how to interpret some of the PEP definitions such as "associations" and the family members of those in the political office. They are also concerned about the time taken to obtain information on PEPs in order to be sure that they have covered all angles. Better guidance could alleviate these burdens.

Small Firms and Verification: Smaller firms do not have the in-house capacity to undertake verification to the same degree as their larger colleagues. But the costs of buying client screening services via an outsourcing arrangement is high and not all such anti-money laundering service suppliers are guaranteed to ensure that PEP checks are performed. For a small to medium firm to buy in a SARS solution the cheapest package from a vendor is between £70,000-£100,000 as a one-off cost with on-going costs ranging from £15,000-£20,000 per annum. For smaller firms developing their in-house verification systems costs will include not only the considerable time of staff who in a small enterprise typically wear a number of hats and cannot be dedicated to a single task, but also the costs system hardware and software which run to several tens of thousands of pounds. The downstream task of regularly updating the status of PEPs without having a supplier client database is also onerous. For all the above reasons it is almost impossible to ensure that every PEP is identified.

Domestic PEPs: APCIMS does not think that UK domestic PEPs should be screened. We believe the current exclusion should remain in place and that the application of a risk-based approach leads to this conclusion.

PEP requirements and criminal sanctions: APCIMS adopts a neutral stance on the issue of whether or not criminal sanctions should be introduced in relation to non-compliance with PEP requirements provided that whatever sanctions are in place are proportionate and appropriate in both design and execution.

- **To what extent are Customer Due Diligence (CDD) requirements effective in the fight against money laundering?**

APCIMS' view is that the CDD requirements are very effective in anti-money laundering work and that the findings made possible by careful and thorough CDD activity assist with the detection and deterrence of money laundering, especially through the route of reporting suspicions. Our discussions with official agencies and others involved in this area suggests that the information discovered through CDD procedures can be of broader benefit in the fight against other crimes, including fraud.

There are however difficulties. Beneficial ownership in particular is often hard to ascertain, especially when trusts are located offshore and the beneficiaries are also abroad. There is a distinct unwillingness on the part of a number of key financial institutions to rely on information obtained from regulated firms in offshore jurisdictions and APCIMS' members are required in consequence to use lengthy, time-consuming and expensive methods of fact-finding to establish beneficial owners. This means that, as with SDD as noted above, reliance, while a well-intentioned part of the MLRs framework, is working sporadically and inefficiently and not achieving in full the objectives set out for it. More certain guidance about where reliance can be placed, and some reassurance about using it, may be necessary.

As regards the 25% figure, we believe this should remain a percentage formulation rather than be recast as a monetary amount, as calculating this figure accurately and credibly in some instances – for example in relation to investment trusts – would be difficult and thus hazardous for the agency responsible for producing it.

- **To what extent do the record keeping and policy and procedural requirements upon Regulated Firms support their anti-money laundering efforts?**

Documentation and other information kept in compliance with these requirements assist firms in their own work to detect suspicious activities and persons and report them, and are invaluable for anti-money laundering investigations. We are aware that authorities such as FSA and SOCA welcome such information from firms. We believe that the current 5-year time limit and reliance provisions are appropriate and note that any changes would be at cost to firms, which in the case of APCIMS' members would be passed on to retail clients but for no necessary gain in anti-money laundering ability or investor protection. Any policy and procedural changes would also have to meet data protection requirements.

We have no comment on the non-EEA member state issue mentioned in the second bullet point of this question. In general, APCIMS' members do not have such branches and subsidiaries.

- **To what extent do the Regulations provide Supervisors with appropriate compliance monitoring and enforcement powers and penalties to deter non-compliance?**

APCIMS' members essentially deal with the compliance monitoring and enforcement powers implemented by the FSA.

We have mentioned above our concerns regarding the implementation of supervisory responsibilities in relation to anti-money laundering and other issues by FSA personnel. More attention should be paid to what it means to carry out inspections in a risk-based manner. As part of this, APCIMS' believes it imperative for supervisors to understand the industry they are supervising and to have adequate knowledge of the business models of regulated firms. This would help to make the supervisory process both credible and meaningful. In this context we note the inconsistency between the supervision of larger ARROW relationship-managed firms by the FSA, in which inspections can be lengthy and detailed, as opposed to the smaller firms with whom the FSA has negligible communication. Such discrepancies do not encourage the view that the FSA knows the APCIMS' sector well.

We consider that the duties of supervisors in relation to compliance monitoring on anti-money laundering issues should be made much clearer to them and that greater proportionality of action would derive from better adoption of a risk-based approach. A "one size fits all" attitude to firms should be avoided, especially with regard to dealing with larger and smaller firms. We think that practical concerns such as these are the issue rather than the quantity of duties.

As regards enforcement and penalties for misdemeanours, we note that FSA penalties are due to increase in spring 2010 when the enforcement regime changes and believe that this development will support the FSA in achieving its goal of credible deterrence.

- **To what extent do the Regulations provide for a suitable system of registration and 'fit and proper' testing to be established and carried out on a risk basis?**

APCIMS considers the FIT² sourcebook within the FSA Handbook to be a suitable system of registration (authorisation) and of fit and proper testing for all in the regulated sector. The risk-based nature of the process means that only the more senior individuals are expected to follow it in full. FSA's additional guidance on its website about these issues is also helpful to firms.

- **Are the requirements of the money laundering Regulations compatible with and complementary to the requirements of a) other aspects of the UK's anti-money laundering regime/legislation and b) international standards and practices?**

- In our view there are discrepancies between the requirements of the MLRs and other aspects of the UK's broader anti-money laundering regime and legislation, especially where different definitions of terms are used. Difficulties arise because of contradictions in the system. For example, it would be practical to ensure that Counter Terrorism and anti-money laundering legislation are fully aligned. The absence of a consolidated central data source for firms to access makes the verification process more time consuming and resource intensive. And at an implementation level APCIMS is concerned about the time lag between the submission of a suspicious activity report to SOCA and the formal response. Firms are not able to act for the client until approval is received and if the gap is too great it may deter a legitimate client from engaging a firm's services, leading to loss of business.

² <http://fsahandbook.info/FSA/html/handbook/FIT>

- We support work to keep the MLRs compatible with and complementary to international standards/practices and are aware that the UK in practice takes the fight against financial crime more seriously than many other nations, including a number of EU member states. The 3L3 Compendium Paper³ for example stated that the current status of EU Member States' implementation of the 3MLD as at 15 October 2009 was varied and that there remained member states who had not implemented, or fully implemented, the legislation by that time. Discrepancies of this kind create an unlevel playing field for UK firms and undermine fair competition. We have also noted European Commission statistics about the huge differences in the numbers of suspicious transaction reports submitted in different member states to the end of 2008: in the UK the figure was over 8,000 while no other member state recorded over 100. In relation to the USA there are also difficulties: those APCIMS firms subject to the US Qualified Intermediary (QI) regime have to document the Know Your Customer (KYC) process twice. This double due diligence is resource intensive, expensive and onerous, as well as being unnecessary in terms of investor protection and money laundering requirements. APCIMS has submitted to HM Treasury information about our concerns with regard to US legislation in this area.

8. How well does HMT engage with you in developing the Regulations and are the requirements of the Regulations clearly communicated?

APCIMS was pleased to be included in the stakeholder engagement process with HM Treasury regarding the Call for Evidence on the operation of the MLRs and is keen to maintain an ongoing dialogue with HMT on this and other matters. APCIMS' Financial Crime Committee, comprising a number of our key member firms in this area, assists in formulating our policy on anti-financial crime and anti-fraud measures and has twice in the last year been addressed by HMT staff. We also connect with the broader membership on these issues through our monthly Update electronic journal, which is very widely read. Our Financial Crime Conference in November 2009 assisted in engaging a substantial grouping of members with those presenting on money laundering and other financial crime matters, including representatives of HMT. As a member of the Joint Money Laundering Steering Group (JMLSG) APCIMS is fully involved in a collective interpretation process on behalf of its members regarding the MLRs and other anti-money laundering regulations and is party to the publication of the outcome. All these mechanisms enable APCIMS and its members to ensure discussion, interpretation and information flow regarding the MLRs and to maintain a productive relationship with HMT. However, APCIMS takes the view that a 9 week consultation period for evidence gathering is too short and that a longer period would encourage a more meaningful and valuable review. This echoes the absence of consultation on CTA Schedule 7, which was also of considerable concern to us and we hope was a one-off event.

Questions about Guidance

9. To what extent does Guidance promote both an effective and proportionate approach to anti-money laundering?

We believe that both the FSA's SYSC rules and the JMLSG Guidance promote an effective and proportionate approach to anti-money laundering in the UK.

³ The 3 Level 3 Committees Compendium Paper on the supervisory implementation practices of the Third Money Laundering Directive

The Call for Evidence asks whether “it is beneficial that Guidance is legally enforceable in the UK, and that compliance with its provisions can be used as a defence against prosecution for non-compliance with the Regulations.” It is important to contrast this statement with the FSA’s own explanations of Guidance aimed at assisting regulated firms in their use of it:

“Guidance and supporting material are not binding on those to whom the FSA’s rules apply. Rather, such materials are intended to illustrate ways (but not the only ways) in which a person can comply with the relevant rules”

The FSA goes on to say that Guidance may be taken into account in enforcement work:

“FSA guidance and supporting material are potentially relevant to an enforcement case, for example to help assess whether it could reasonably have been understood or predicted at the time that the conduct in question fell below the standards required by the Principles or rules. The extent to which we may take guidance and supporting material into account when considering a matter will depend on all the circumstances of the case.”⁴

APCIMS’ firms are familiar with Guidance being considered in the manner described by the FSA and use it as a means of ensuring they are in compliance with the Regulations, not as a method of justifying getting around them. The Treasury statement is somewhat misleading in this respect. One desirable result of the current review of the application of the MLRs would be absolute clarity about the function of Guidance in the UK’s financial sector.

The value of Guidance to APCIMS’ firms, which in the anti-money laundering context means in particular the JMLSG Guidance, lies in its role in interpreting and elaborating the MLRs in a manner that helps firms in their practical daily work to comply with them. It is therefore very important for the JMLSG material to be carefully considered and drafted and up to date, and to offer an approach to putting the MLRs into effect that is acceptable to all, including both HMT and the FSA. They must not offer a route around the MLRs or show alternative methods of compliance.

At present the JMLSG Guidance fulfils the appropriate purpose very well and is widely used by APCIMS firms to ensure they are complying with the MLRs. In being sector specific it assists understanding and supports risk-based implementation of the MLRs, and our firms regard it as containing invaluable information and as beneficial to their interests. As regards process for keeping it up to date the regular JMLSG meeting and review arrangements are effective and in the current major biannual assessment of the Guidance being conducted by the JMLSG our members have been consulted on concepts and drafts through the sorts of mechanisms outlined at Question 8 above.

It is of considerable help that the composition of the JMLSG Board and Editorial Panel allow APCIMS to participate as an active member and the picture could be different for those not in this position. It should also be noted that the JMLSG Guidance applies to the financial services sector and may be less useful for those outside it.

10. How clear and consistent is Guidance including whether Guidance is consistent for those sectors where more than one supervisor exists and generally across sectors?

⁴ http://www.fsa.gov.uk/pages/Library/Other_publications/Miscellaneous/2009/guidance.shtml

For APCIMS and its members both the FSA's SYSC 6.3 and the JMLSG Guidance are clear. We believe from discussions with colleagues, reading drafts prepared by different groupings, and anecdotal evidence that they function consistently across sectors, but our direct experience of this is limited since APCIMS firms themselves are mostly single sector operations.

11. In what ways does Guidance assist with a risk-based implementation of Customer Due Diligence (CDD) measures within your sector?

In our view the JMLSG Guidance supports the risk-based implementation of Customer Due Diligence (CDD) measures within our sector as it is structured to address the concerns of different types of investment business activity and to encourage firms to develop processes that take account of risks inherent specifically in their business models.

Our firms spend considerable resources on due diligence processes and in order to control costs while optimising compliance and anti-money laundering outcomes they systematise their processes as much as possible. This means that, even though SDD and EDD situations are explained adequately in the reference material, firms will whenever possible and justifiable in terms of compliance with Regulations use CDD procedures. In practice this means that EDD is implemented as necessary but that SDD is hardly ever used since as a bespoke activity it is more expensive but less efficacious than CDD.

The definitions of PEPs and EDD are appropriately and understandably set out but for further comments on these issues and that of verification please see our response to Question 2 above.

We would like here to draw attention to two further matters in this area. First, we would like there to be more specific Guidance about risk assessments where they incorporate material relevant to an anti-money laundering context or are generated to address money laundering risks. Such Guidance should clearly state that risk assessments should be firm specific and conditioned by firms' business models along the lines of "an evidential and appropriate risk assessment for your firm". Firms should be encouraged to document detailed information about their risk assessment processes, especially where such material may be read and have to be justified to external sources such as the FSA or other regulatory authority.

Second, we recommend that there should be greater clarity about reliance in relevant Guidance. Summary requests to APCIMS' firms from other jurisdictions (such as Ireland and Guernsey) are complex, time consuming and expensive to manage and comply with. In other cases regulatory bodies bombard APCIMS' firms with information requests, sometimes forcing them to deal with up to 5 or 6 such requests per day. On the other hand, many banks that APCIMS has to deal with through the operation of client accounts will not accept reliance for verification and diligence purposes on information from regulated firms in other jurisdictions, including local offshore centres. This compels APCIMS' firms to commission or undertake further due diligence themselves, almost always with the same result as they achieved through reliance yet at far greater expenditure of time and money. It would be very helpful if the UK authorities could prepare Guidance that would stop this wasteful, expensive and unnecessary duplication.

12. In what ways does Guidance assist and support Regulated Firms' anti-money laundering policies and procedures?

FSA Rules and Guidance direct APCIMS firms to the JMLSG Guidance as the authoritative source of sector-specific, detailed information on acting in compliance with the MLRs. As made clear above, the Guidance materially assists firms in the development of their risk-sensitive policies and procedures but it also includes information on training and record keeping and generally encourages high standards of practice to ensure compliance with regulatory requirements. It is of good quality, informative and very widely used. However, it is less certain in relation to the interaction of the MLRs with the requirements of POCA and TACT and we believe that work should be done here by HMT and perhaps the JMLSG to advise more clearly on where and what the key linkages are and the need for firms to address them. As a general point it is significant that at APCIMS the anti-money laundering regulatory queries we receive from our membership are almost exclusively about JMLSG Guidance, very seldom about the FSA, and almost never about the MLRs.

13. How is Guidance made accessible and are there opportunities to engage in its formulation?

We have made clear in Question 8 above the various methods we use to ensure that APCIMS' members are fully aware of the JMLSG Guidance and have the opportunity to engage in its formulation through commentaries on drafts. We also take note of comments and complaints we receive throughout the year about issues arising from use of the Guidance and bring these to the attention of the JMLSG for consideration.

We have also noted in Question 9 above the value we place on active full membership of the JMLSG and the engagement that permits both APCIMS and its members, as key stakeholders in anti-money laundering work, in the Guidance development and production processes. In our view the JMLSG Guidance owes its credibility to many factors, including inter alia its membership structure which reflects industry specifics and its transparent consultation processes which value input from industry stakeholders.

Our experience with FSA's formulation procedures in work which does not purport to be guidance but takes on its characteristics in practice ("non-guidance") has however been more patchy. Due process, including adequate Cost Benefit Analysis, is not always followed and disproportionate, inappropriate and occasionally confused results may arise in consequence. This is particularly awkward when supervisory teams undertaking inspections measure against reports or non-guidance as if they were rules and firms are uncertain about the status of documents for compliance purposes. We made the point about the need for clarity about the use of Guidance in Question 9 above and would repeat it here. APCIMS had to prepare internal guidance on data security for its members following an FSA report because of such confusion, while information on financial crime and anti-money laundering is also published on the small firms section of FSA's website without prior industry consultation or cost benefit analysis. APCIMS is concerned that this may present a regulatory risk since without discussion and information flow it is almost impossible to achieve a proportionate and risk based approach which provides sufficient certainty and clarity to the firms.

Questions about Supervision

14. To what extent does the supervisory framework support an effective, risk-based anti-money laundering regime and compliance with the Regulations?

APCIMS' member firms are overseen by a single supervisor (the FSA) and are not subject to a multi-supervisor arrangement. APCIMS considers that FSA policy and regulations support an effective, risk-based anti-money laundering régime and help to ensure compliance with the MLRs, but as previously stated in this response does not consider that the implementation of this policy is always evidenced in the supervisory process. We doubt whether FSA supervisors are mindful of the costs and benefits to firms of the anti-money laundering régime and they certainly do not offer ideas to minimize costs or to maximise benefits.

APCIMS' larger ARROW managed firms are concerned that supervisors do not take into account specific business models and associated risks. Firms have often reported to us that inapplicable standards that are neither rule nor regulation based are applied to them and that this is unfair. They have repeatedly called into question the competence and experience of supervisors and claim that many do not have adequate knowledge of the APCIMS sector.

APCIMS smaller firms do not directly engage with FSA. The feedback we receive is that most of APCIMS smaller firms have not seen the regulator since its inception. This is a cause for concern. Small firms are often left to their own devices when having to grapple with FSA rules and guidance and it is common for them to spend considerable amount of money and resources on external support.

The situation regarding supervision that is described above does not support an effective, risk-based anti-money laundering regime and compliance with the Regulations. APCIMS would welcome a better dialogue with FSA on emerging anti-money laundering and financial crime/ fraud trends in its sector.

15. In what ways do Supervisors communicate and engage with the firms they regulate to ensure a sound understanding of legal duties and responsibilities under the Regulations?

We have raised general concerns about supervision in our sector above.

In relation to communication from the Supervisor, APCIMS notes the FSA's range of devices such as online awareness campaigns, their annual Financial Crime Conference, written information and Guidance, and telephone help lines relating inter alia to financial crime. These are welcome elements in the armoury of devices that help to inform the regulated financial sector about anti-money laundering and other issues.

We are concerned however about the suitability of these approaches for smaller firms, which form the majority of APCIMS and indeed FSA's regulated population. Small firms with limited resources require more communication and engagement from the FSA in terms of education and outreach, not less, and the risk-based approach with its focus on systemic impact does not achieve this. Indeed, as noted in question 14 and elsewhere above small firms also lack the same kind of ARROW engagement that larger firms have and as a result do not have any contact at all with the FSA, their only regulator and supervisor.

APCIMS' view is that FSA should encourage more feedback from the firms they regulate and take more notice of the feedback they do receive. Although firms are obliged to report regularly to the regulator on a variety of issues, and the supervisory teams pick up information from the firms they visit, required information gathering of this kind does not constitute a constructive dialogue that illuminates the anti-money laundering situation for either side. Regulated firms would appreciate anti-money laundering intelligence from FSA and receive almost none. This reflects the fact that there is little communication beyond what is required by law and regulation and that the FSA does not provide the industry with feedback the other way on the findings of monitoring and supervisory work. Further to this, APCIMS is unaware of any sector analysis of APCIMS' firms' risks to the FSA in meeting its financial crime statutory objective and firms would be grateful for and interested in a debate about this. At the moment there is little if any flow of this sort.

In the absence of formal regulatory information of the kind outlined above for firms, many try to analyse FSA's enforcement documents such as Warning Notices or Final Notices once they are published in order to extrapolate supervisory themes and trends. This can however produce misleading results as often the full facts of the case are confidential and publicly available information limited. The Notices may also not be current as they may relate to investigations that took place some time, perhaps years, previously. Firms may also be seeking to learn lessons on a cross-sector basis which may lead to confusing or inappropriate outcomes. Firms are in consequence often unclear in practice what the lessons learned are from enforcement cases or how they should be applied to their situation.

In the light of this experience APCIMS does not favour the FSA approach of publishing enforcement cases and expecting firms to read across from them into their own circumstances. It does not necessarily lead to the cherry picking of best practice but rather to confusion and in some cases inadvisable outcomes which serve nobody's interests well.

There should instead be a regular and fluent dialogue between supervisor and industry. Membership associations such as APCIMS can play a major role in acting as an intermediary and conduit between firms and regulator for this purpose. We have excellent connections with all our members, can represent their regulatory and related interests, and the infrastructure for engaging them as stakeholders in the process is in place. In short, we form part of the solution to the problems described above, and APCIMS firms would welcome us playing a greater role in this area.

APCIMS notes the usefulness of SOCA and FATF reports in the communication flows about anti-money laundering matters.

16. How do Supervisors ensure that a consistent approach to compliance monitoring and enforcement is taken across the anti-money laundering regime?

We have no information on this issue but note that the FSA is not subject to any requirement to publish performance results or risk reviews for quality assurance purposes of its work and findings in the anti-money laundering area. It is therefore not possible for us to monitor the regulator's cross-régime consistency as implied by the question. This may be a gap that should be addressed by Treasury in its current MLRs review.

17. To what extent is Supervisors' monitoring of compliance targeted, proportionate and risk based?

We are not aware of any dedicated anti-money laundering FSA visits to our firms and for larger firms data gathering would in any case be made as part of the ARROW process. Smaller firms, as we have explained above, are in general not party to any routine information gathering through visits or otherwise. All this suggests to us that in relation to anti-money laundering issues the supervisor's monitoring is targeted on the larger sector but is not necessarily proportionate or risk based.

18. How effective and proportionate is the enforcement regime?

FSA's enforcement régime will change further in the spring of 2010 not least because until 2008, when some initial strengthening was introduced following the financial crisis and the introduction of the credible deterrence approach, it was considered insufficiently effective and as failing to send appropriate messages about intolerance of financial crime to the markets. However these changes do not relate specifically to money laundering but to financial crime more broadly. Beyond this it is impossible for APCIMS to comment as we are not party to required information.

19. In what ways could the registration process for Regulated Firms be improved?

No comment.

Questions about Industry Practice

20. Are there barriers to implementing risk-based policies in practice? If so, what are they?

Implementing risk based policies may in general be an unnerving experience for regulated firms as the element of judgment involved may create uncertainty about what approach is most clearly in compliance with what is required. Larger firms will normally obtain compliance assurance from the supervisor only when they are assessed and reviewed, while small firms have recourse primarily to the Small Firms Contact Centre. This is particularly pertinent for smaller firms whose only alternative option is to pay for costly external consultancy (see also Question 2 above).

The effect of this is to generate a view within some firms, especially smaller ones, that they would prefer the certainty and assurance that comes with prescriptive rule-based regulation in which they are required to do some things and not others and from which the element of judgment has been removed. This helps them to avoid the possibility that in implementing risk-based policies they may be assessed as non-compliant by the regulator. For example, we are aware that, in the context of anti-money laundering, some APCIMS firms are not sure whether they do enough to verify PEPS and how to define PEP categories

Cost is a common and significant constraint on all firms' implementation of regulatory policies and procedures, whether risk-based or not. Regulatory cost is commonly passed on to the client in the form of higher charges and can represent an important component of fees.

Even if a firm has discretion in the rules to apply a lower compliance standard (eg CDD/SDD) to a particular area of business they will not do so if this raises costs

unnecessarily. As noted at Question 2 it may be costly and disruptive for a firm to alter its internal systems and controls to meet different compliance levels. Firms generally would prefer to apply one rather than several compliance standards to a specific aspect (eg anti-money laundering) of its business.

As regards carrying out risk assessments, the rule of thumb is that the larger the firm the more likely it is that they will have the necessary skills, data, tools, and other resources to do so. It is also that case the cost and resource diversion required to undertake this kind of regulatory activity hits small firms disproportionately hard, especially if they have to buy in expertise. This differential in cost ratios should be taken into account in the cost-benefit analyses applied to proposed regulatory developments.

21. During the process of customer due diligence (CDD), how are risks (in terms of likelihood and impact) taken into account to decide the type of due diligence that will be undertaken?

The processes will vary from firm to firm.

We have commented above on the CDD/SDD relationship and use patterns as compelled by a mix of regulatory and cost requirements. We have also drawn attention to problems experienced by firms with the use of reliance on third party information.

We have referred to the difficulties of establishing beneficial ownership, especially when beneficial owners are overseas. In these circumstances the process can become complicated, time consuming and expensive and the rule of thumb is that the further removed the beneficial owner is from the business the more complicated the information chain that is created and the more difficult it is to find out what is required. This leads to the paradoxical situation that the more urgent it is to discover who the beneficial owners are the more difficult it is to do so. So diminishing effectiveness of process and greater disproportionality of burden (including costs) go hand-in-hand.

Against this background the ongoing monitoring of businesses in relation to CDD requirements is seen as important and continues. However, in view of the expense and time taken to establish initial processes these continue to be used and updating or review of process to ensure that correct and reliable information is being obtained is rarer. It is probably occasioned primarily when some flaw or difficulty comes to light and the situation needs to be re-examined.

We do not have data regarding the proportionality issues raised at the end of this question.

22. To what extent do the Regulations support or complement Regulated Firms' 'business as usual'?

APCIMS' firms have implemented internal systems and processes to comply with the MLRs and JMLSG Guidance. These have been in place for a minimum of two years now and have become integrated into the normal compliance work of regulated financial businesses. For most firms this means that actions to comply with the MLRs and JMLSG Guidance, such as CDD, have become part of their business as usual régime.

The degree of coherence with training and other aspects of a firm's business will vary between firms. Most firms, for example, will not manage training out of the compliance function where the money laundering reporting officer and responsibility for anti-money laundering policy and oversight normally rests, but from HR or a special training unit. So

there will need to be some coordination here. But that is part of normal business management and not exceptional.

Regardless of the efficiency of implementation and the degree of integration, however, all regulation comes at an incremental cost and the MLRs are no exception. So although we are unable to quantify how much additional cost for firms and investors is attributable to the MLRs, some will be.

Good anti-money laundering policy, procedures and practice which are seen to operate effectively in the interests of market integrity, investor protection and financial crime prevention enhance the reputation of a jurisdiction and make it easier for firms from there to win business. APCIMS and its members are aware of this and support the Treasury's anti-financial crime agenda which they see as being in their reputational and commercial interests.

23. Are “fit and proper” tests being conducted in an effective and proportionate manner?

Fit and proper tests have been a long standing requirement of the authorisation process for financial services firms in the UK's regulated sector. Procedures are well established and integrated into the business practices of all firms. Constant review and revision in line with evolution in the industry has kept them broadly coherent with modern business needs and practices. In general the fit and proper qualification is transportable provided nothing happens in a particular employment to dislodge it.

24. How easy or difficult is it to comply with reporting and record keeping obligations?

These can be onerous but become easier to meet once appropriate systems are in place and processes are fully automated. But setting up the systems is expensive, often difficult, and frequently time-consuming. It is most difficult and expensive of all when regulators keep changing their specifications and requirements, so constancy should be a keynote for those in authority over the industry.

25. What forms of communication and engagement take place with stakeholders, from government agencies through to customers?

We have dealt with much of the detail on this issue in our response to Question 8 and other Questions above. In addition to the points made there, APCIMS provides a regulatory policy function for our members whereby we represent their interests in consultation rounds, letters, meetings and discussions with a considerable range of authorities in the financial services and related sectors, especially at the national and European levels. This helps to ensure the engagement of our members in policy and guidance development and the provision of appropriate information to those who formulate law, regulation and rules. Any benefits of the MLRs in terms of effectiveness and outcomes are communicated to our members as soon as they are known.

Questions about Customer Experience

26. How proportionate do you believe the Regulations appear once they reach the customer?

The verification of non-face-to-face clients has been seen by some firms as disproportionate: and such clients have been increasingly concerned about sending their

personal details in the post. APCIMS' firms have noticed that their clients are becoming more concerned about the safety of their identification and associated identification risks and have as a result sought assurances from the firms about the security of information they pass over. This places greater onus inter alia on good data security policy and practice in the firms themselves.

27. Are you able to provide customers with access to information and resources to check what information is needed from them and why?

Yes, we can for example refer them to the JMLSG Guidance and firms generally have their own policies and procedures about ensuring that client needs for information are appropriately met.

Questions about the Régime

28. To what extent do the Regulations, the accompanying Guidance, the supervisory framework and industry practice (the Regime) provide an effective tool in the fight against money laundering?

APCIMS believes that the Regulations and the accompanying JMLSG Guidance are effective tools in the fight against money laundering. They do help to protect the integrity of the financial system and the reputation of UK business, as indicated in Question 22 above. They have some deterrent and detection value although we cannot quantify how much. As regards reporting they have had a clear impact as demonstrated by the reporting figures quoted at Question 7(b) above. This also shows how well the UK régime compares internationally, especially at the regional level where the UK appears to be the leading member state of the EU on anti-money laundering work. Indeed, the fact that 16 member states still had not implemented the 3rd Money Laundering Directive more than 6 months after 15 December 2007 supports the notion that anti-money laundering may be treated less seriously elsewhere in the EU.

It is hard to judge how well the régime identifies and responds to new and emerging risks. However, as noted in Question 8 above the experience with the development of CTA Schedule 7 was an unhappy one and does not suggest smooth handling and management of the response to new problems. Appropriate lessons should be learned.

29. To what extent are the Regulations, the accompanying Guidance, the supervisory framework and industry practice (the Regime) a proportionate response to the risk of money laundering in the UK?

On the whole the Régime is proportionate. However the UK has a reputation for being over-zealous in the implementation of new regulations and to go super-equivalent with relative ease. This may be a different way of viewing, for example, the 8,000 plus reports mentioned at 7(b) above. It is important in the light of this perception to maintain a sense of proportion in reviewing the régime and not to allow the process to lead to the development of an over-large and imprecisely targeted edifice that is expensive to run and disadvantages UK firms while offering no additional protection to markets and investors in the fight against financial crime.

30. Would you say that all relevant stakeholders are able to participate in the development of the Regime?

APCIMS' view is that all relevant stakeholders ought to be able to participate in the development of the Régime, but there is some variation in the extent to which they do, dependant partly on which part of the regime is being referred to. We have noted at the end of our response to paragraph 13 above, for example, a type of situation in which stakeholders participate less than perhaps they might in the development of non-guidance. Communication was also lacking in relation to CTA Schedule 7 until after it was there. However, participation and engagement in other ways, both with the Government and Regulator or through the JMLSG process and the work of associations to inform and involve their members, works well and should continue. On international partnership we think that standards of anti-money laundering work are being raised globally, but in a very sporadic and uneven way between territories and issues. There is a lot of work still to do in this regard within the EU itself as well as with offshore centres and other countries.

APCIMS, December 2009