

# FSA review of management of AML risk by Banks

The FSA's thematic review into how money laundering risk is managed by banks, published on 22 June 2011, generally concludes that there are serious weaknesses common to many banks in their AML systems and controls for managing higher-risk business relationships and situations. Commentary from the FSA notes 'troubling failings' in this area, and that many banks demonstrate weaknesses similar to those identified in the review of banks' handling of Abacha funds back in 2001. The FSA has indicated that the report produced is the product of a style of intensive, intrusive supervision that will be carried into the new Financial Conduct Authority, one of the two new agencies taking over from the FSA in early 2013.

The findings of the thematic review, published in the FSA's report "Banks' management of high money-laundering risk situations", are based on 35 visits by the FSA to 27 banking groups in the UK, comprising eight major banks and 19 medium-sized and smaller banks. The banks were chosen because they deal in products or with customers likely to give rise to high levels of inherent money laundering risk.

The report focuses on the high risk activities of high-risk customer (including Politically Exposed Persons or PEP) relationships, correspondent banking and wire transfers. It sets out a number of concerns and in some cases identifies good and bad practice observed. The report also notes areas where improvement is required.

The FSA is clear that it expects major improvements in banks' AML systems, controls and decision-making. Banks should consider reviewing their procedures against the findings of the review to meet this expectation.

## High-risk customers and PEPs

The report identifies a number of concerns in respect of high-risk customers, including:

- concerns around AML policies and procedures;
- concerns around risk assessment and the customer on-boarding process; and
- concerns around ongoing monitoring of high-risk and PEP relationships.

### *AML policies and procedures*

Some concerns were raised around policies and procedures, and in particular the extent to which they were up-to-date and continued to be updated to take account of developments. The need to implement policies and procedures effectively was examined, with findings that in some cases, while banks had good AML policies, these were not implemented or understood by key staff

## Key Issues

Thematic review of money laundering management by banks

FSA has serious concerns about weaknesses in AML systems and controls

Highlights banks' AML obligations in respect of high-risk relationships

If you would like to know more about the subjects covered in this publication or our services, please contact:

[Carlos Conceicao](mailto:Carlos.Conceicao@cliffordchance.com) +44 (0)20 7006 8281

[Kate Long](mailto:Kate.Long@cliffordchance.com) +44 (0)20 7006 2715

[Michael Lyons](mailto:Michael.Lyons@cliffordchance.com) +44 (0)20 7006 4317

[Ellen Lake](mailto:Ellen.Lake@cliffordchance.com) +44 (0) 20 7006 8345

To email one of the above, please use [firstname.lastname@cliffordchance.com](mailto:firstname.lastname@cliffordchance.com)

Clifford Chance LLP, 10 Upper Bank Street,  
London, E14 5JJ, UK  
[www.cliffordchance.com](http://www.cliffordchance.com)

members. Awareness and understanding of the application of policies to high risk clients is highlighted, with the report noting general AML training was carried out which rarely contained specific, detailed material on higher risk activities. The FSA noted that it expects firms to improve in this area, indicating that bespoke training for staff directly involved in dealing with high-risk customers is desirable.

#### *Risk assessment and identification of PEPs*

The importance of appropriate risk appetite when taking on high-risk customers, or considering exiting existing high-risk customers, is prominent. The review found that some banks appeared to be unwilling to turn away business relationships which could be highly profitable where there appeared to be an unacceptable risk of handling the proceeds of crime.

It also found some cases where, for customers who should have been classified as high-risk, some banks were allocating inappropriately low risk weightings, and therefore the enhanced due diligence (EDD) measures required for high-risk customers were not followed.

#### *Customer on-boarding*

The report discusses banks' obligations under the Money Laundering Regulations 2007 (the Regulations) to apply EDD measures to high-risk customers. The FSA found that over half of the banks visited had failed to apply 'meaningful' EDD measures which meant that adverse information about customers, or a customer's beneficial owner, was not identified or recorded. It was further considered that around a third of banks dismissed serious allegations about customers without adequate review. There is a clear obligation to ensure that EDD measures are carried out, but also a need to show that the results are adequately considered and the findings recorded so as to be able to show a clear reasoning behind the decisions being taken with respect to individual customers. Further, relying on intra-group introductions, particularly where underlying due diligence information is inaccessible due to jurisdictional constraints, is to be treated with caution, with the report stressing that banks must ensure they have access to underlying customer due diligence documentation at all times.

The Regulations require firms to take adequate measures to establish the source of wealth and source of funds for higher risk customers. The report states that it is essential banks obtain 'meaningful information', apply risk-sensitive measures to verify this information and challenge information where appropriate, particularly where the risk associated with the business relationship is increased. No guidance is given on what 'meaningful information' might comprise, but the report indicates that information provided by customers should not be accepted at face value and that undue reliance must not be placed on the word of customers or relationship managers. Banks should also ensure that how the source of wealth and funds has been established is adequately documented.

#### *Ongoing monitoring*

The Regulations require that banks conduct ongoing monitoring of customer relationships and enhanced monitoring for PEPs. At more than half of the banks visited, the FSA found failures to review regularly and, where necessary, update customer information. While nearly a third of banks did carry out customer annual reviews, the FSA found that there was often inadequate management oversight and challenge of the findings. Good practice identified includes regularly reviewing PEP relationships at a senior level, and implementing transaction monitoring which takes into account up-to-date customer due diligence information, including expected activity, source of wealth and source of funds.

#### **Correspondent banking**

Concerns raised in the review of correspondent banking relationships fall broadly into the same areas identified for high-risk customers above, including concerns around customer take-on, risk assessment of respondent banks, and ongoing monitoring of respondent accounts.

The review found that many banks' due diligence procedures comprised a 'paper gathering exercise' with no obvious assessment of the information collected. The report also points to an over-reliance on the Wolfsberg Group AML questionnaire, containing simple 'yes' or 'no' answers to basic AML questions, without use of the Wolfsberg Principles on correspondent banking. It calls for a more risk-based approach where PEPs own, direct or control respondent banks to avoid the risk that a bank's respondent could be influenced by allegedly corrupt PEPs.

The report noted that transaction monitoring of correspondent relationships can be challenging due to often erratic, yet legitimate, flows of funds. It recognised that banks rely on explanations given by the respondents of unusual transactions, and verification can be difficult, but found that in some cases, banks did not take adequate steps to corroborate such explanations. The report further indicates the need for evidence of assessment by internal audit of money-laundering risk in correspondent banking relationships.

### **Wire transfers**

The review found no major weaknesses in the measures taken by banks to ensure inter-bank payment messages complied with the Wire Transfer Regulations ('WTRs').

### **Implications**

The report concludes that a number of weaknesses identified by the review are the same as, or similar to, those identified back in 2001 when the FSA reviewed banks' handling of the funds of Nigeria's General Abacha, raising concerns that, despite changes in the legal and regulatory framework, there has been insufficient improvement in banks' AML systems and controls during this period.

Many of the concerns raised in the report highlight the need for strong record-keeping procedures to document the decisions being made throughout the relationship with the customer. At the on-boarding stage, banks must ensure that the assessment of risk-weighting of the customer and EDD measures taken are adequately recorded, so as to ensure a clear audit trail can be established in respect of concerns such as establishment of a customer's source of wealth and funds. Records must also document the ongoing relationship with the customer, in order to show compliance with the ongoing monitoring obligations in relation to high-risk customers and PEPs.

The FSA has commented that it has set money aside to undertake a follow-up thematic review if necessary.

### **Wider financial crime focus**

The findings of the thematic review are part of a wider focus on financial crime by the FSA, which was highlighted at the FSA's Financial Crime Conference on 22 June 2011, where publication of the thematic review was announced. Also published on the same day was a consultation paper (CP11/12), which proposes a new guide designed to help firms reduce the risk of their business being used to facilitate financial crime, and which will provide a one-stop guide for the FSA's publications and guidance on financial crime, including AML, aimed at improving firms' understanding of the FSA's expectations in this area.

From early 2013, the new Financial Conduct Authority will assume the FSA's responsibilities on financial crime, including AML. The FSA is clear that it expects major improvements in this area by banks, and that the new Financial Crime Authority will pursue the objectives of "keeping crooks out of finance, encouraging industry to strengthen its defenses, and educating and warning consumers about the dangers they may face."

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