Post-election update: Financial crime and the Tories

May 22 2015 Patrick Rappo and Alexandra Melia

Following the slim Tory majority won in the general election on May 7, it remains to be seen how resilient the new government will be and whether it will need to act in collaboration with the minor parties to strengthen its position. In the light of the election result, what does the future hold for the enforcement of money laundering and anti-corruption issues in the UK? And, in particular, what are the likely ramifications for financial services firms?

The UK published its first Anti-Corruption Plan (AC Plan) under the coalition government six months before the recent election. The AC Plan followed hot on the heels of two thematic reviews published by the Financial Conduct Authority (FCA), on the management of bribery and corruption risk in commercial insurance broking (ABC Review) and on the management of money laundering and sanctions risk by small banks (AML/Sanctions Review).

The AC Plan, which is the UK's first government-wide plan to tackle corruption, places an increased focus on collaborative working both nationally and internationally, coupled with a desire to raise awareness of corruption and to increase the number of public/private partnerships tackling corruption risk.

The AC Plan seeks to ensure that current tools available to UK regulators, such as the Proceeds of Crime Act 2002, the UK Bribery Act 2010 and deferred prosecution agreements are better used and enhanced, for example, by targeting professional gatekeepers, improving suspicious activity reporting and focussing on increasing the recovery of criminal assets.

Overall, the AC Plan articulates 66 action points. While the AC Plan makes little mention of the Serious Fraud Office (SFO), leading some commentators to speculate as to the agency's future, the reality is that financial crime and anti-corruption are high on the UK government's agenda.

The Tory manifesto also articulated a continued focus on financial crime. Among other things, the manifesto contained a promise to tackle tax evasion and aggressive tax avoidance by making global companies pay their fair share in tax and by increasing annual tax charges for "non-doms." Moreover, the focus on financial crime appeared to go much further than the AC Plan.

Of particular relevance for compliance professionals in the financial services sector are the Tory manifesto promises to introduce "full transparency on who really owns companies" and to "mak[e] it a crime if companies fail to put in place measures to stop economic crime such as tax evasion," which were accompanied by an ominous warning that promised "penalties...large enough to punish and deter".

The latter measure, in particular, seems to go further than the commitment made in the AC Plan to look at whether to introduce a new offence of failure to prevent economic crime.

Although there has been a change of government, the main players remain the same and pursuit of the keystone themes of cooperation, transparency and accountability is likely to continue unabated. UK firms, and FCA-authorised firms in particular, will be impacted by the implementation of the proposals contained in the AC Plan and the revised FCA guidance on financial crime, as well as by the SFO's prosecutorial approach. Firms wishing to stay ahead of the curve should review their internal compliance measures, implement more effective procedures and regularly monitor the effectiveness of their compliance programmes.

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THE ANTI-CORRUPTION PLAN

The AC Plan published in December 2014 introduced a number of initiatives that will likely have an impact on financial services firms. One initiative tasks the Ministry of Justice with looking into the merits of making it easier for companies to be found guilty of crimes committed by their directors and/or employees by re-defining corporate criminal liability.

Although this issue has been considered numerous times over the years by the Law Commission and others, the financial crisis and the benchmark rigging scandals appear to have forged a greater appetite for change on this occasion. Any such change would have seismic consequences for all firms across the UK, drastically increasing the risk of criminal prosecution.

Allied to the exploration of corporate criminal liability, the AC Plan also tasks the Ministry of Justice with considering the introduction of a new corporate criminal offence of "failure to prevent economic crime", paralleling the Bribery Act's section 7 corporate offence of "failure to prevent bribery and corruption." This proposed change in the law was heralded by the Attorney General last year and, as he and the government remain in power, it is only a matter of time before this offence is enshrined in the statute books.

The impact of such a change on firms would be huge. Companies would be held strictly liable for economic crimes committed by their employees, which would massively increase the risk not only of criminal prosecution, but also of regulatory intervention focussed on assessing the adequacy of the company's systems and controls (assuming the availability of a defence of "adequate procedures," as the Bribery Act provides). As such, firms should consider reviewing the systems and controls that they currently have in place to ascertain how "adequately" those measures prevent against the firm's employees and agents committing economic crimes.

The AC Plan also addresses the challenges "politically exposed persons" (PEPs) pose to the financial services sector. In particular, the Treasury has been tasked with assessing the financial sectors' vulnerability to corrupt PEPs and with encouraging a risk-based approach toward supervision and compliance by financial firms that is in line with the Fourth EU Money Laundering Directive, which will be implemented in the UK once it enters into force.

Financial services firms should therefore consider reviewing their risk assessment procedures to ensure that they are sufficient to comply with these forthcoming changes.

Finally, a number of the AC Plan's recommendations are focussed on enhancing transparency. One initiative involves the production of a centralised, publicly accessible register that details the beneficial ownership of UK companies, which is intended to assist in the fight against corruption, tax evasion and money laundering by increasing transparency around the ultimate ownership and control of such companies. Support for this initiative also was expressed in the Tory manifesto.

Another initiative concerns the proposed abolition of so-called "bearer shares" (i.e., equity securities that are wholly owned by whoever holds the physical share certificate), which is intended to reduce money laundering risk by outlawing an instrument for which ownership is never recorded. In the light of these proposals for change, firms should consider the adequacy of their KYC and due diligence processes and assess their ability to correctly identify financial crime risks, such as money laundering, fraud, corruption and sanctions breaches.

FCA PRIORITIES AND CASES

In line with the UK government's focus on financial crime and corruption, the FCA's 2015/2016 business plan also highlights the importance of measures aimed at tackling financial crime, money laundering, corruption and sanctions breaches. In fact, financial crime is listed as one of 7 key areas of risk, posing "a significant threat to the realisation of our objective to promote and enhance the integrity of the UK financial system".

As such, it is clear that during the course of the next year there will be a renewed focus by the FCA on financial crime and on looking at the effectiveness of firms' systems and controls to prevent such crimes. In particular, the FCA likely will scrutinise whether firm's systems and controls are effective, proportionate and risk-based.

The FCA's business plan explicitly states that firms which fail to have adequate systems and controls are more vulnerable to being used to further financial crime and that "(d)uring 2015/16 we will continue to focus on both anti-money laundering (including terrorist financing and sanctions) and anti-bribery and corruption measures."

Moreover action will not just be aimed at firms, but increasingly at individuals within firms, as "individual accountability" is identified as a key priority.

These themes were emphasized by the FCA's director of investigations, Jamie Symington, in his remarks at an event in January this year, during which he stated that the FCA plans to target bribery and sanctions as part of its push against financial crime and in order to improve culture in the City.

He further stated that the FCA's focus will be on internal controls and the responsibility of senior management and approved persons for such controls, with potentially criminal matters being referred to organisations such as the Serious Fraud Office. This has already been visible over the course of the last two years with such referrals being made in the Libor, foreign exchange and Tesco's cases.

Likewise, international cooperation has improved markedly in the recent past with regulators and prosecutors across the globe working together on the same investigations.

If further warning signals are required to highlight the importance of financial crime systems and controls, both nationally and internationally, one need look no further than a recent plea agreement in the United States, where U.S. sanctions law violations by BNP Paribas S.A. led to an $8.97 billion penalty. In the UK, a number of recent enforcement actions have squarely focussed on failures to implement adequate compliance systems and controls. Coutts was fined £8.75 million for failing to take reasonable care to establish and maintain effective anti-money laundering systems and controls in 2012.

Similarly, Standard Bank PLC was fined £7.6 million for failings in the implementation of its anti-money laundering policies and procedures when establishing business relationships with corporate customers connected to PEPs. A number of UK

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enforcement actions also have focussed on failures with respect to anti-bribery and trade sanctions controls.

For example, RBS was fined £5.6 million for failing to have adequate systems and controls to prevent sanctions breaches in 2010, while JLT Specialty Ltd was fined £1.8 million in 2013 for failing to have appropriate checks and controls against bribery and corruption.

Willis was fined £6.8 million in 2011 for similar failings.

In April 2015, the FCA once again showed that it will continue to pursue transaction reporting failures and will increase fines if firms fail to take note of FCA guidance, by fining Merrill Lynch International (Merrill) nearly £13.3 million for incorrect transaction reports and failures to report. To date, this is the highest fine levied in the UK for such reporting failures. Notably, the fine was increased in the light of Merrill's failure to act on previous FCA guidance. The size of the fine was also intended to act as a deterrent to other firms.

An increased focus on bringing enforcement actions against individuals is also discernible from the FCA's recent activity. In March 2015, a former trader at Rabobank, Paul Robson was banned following his conviction in the United States for manipulating Libor submissions.

Similarly, in January 2015 the former CEO, David Caplin, and compliance officer, Jeremy Kraft, of Martin Brokers (UK) Ltd were banned and fined £210,000 and £105,000, respectively, for failing to ensure effective supervision and to remedy the firm's deficient systems and controls, which resulted in the making of misleading LIBOR submissions.

Most recently, the FCA fined the Bank of Beirut, a UK subsidiary of a Lebanese parent, £2.1 million (which included a 30 percent early settlement discount) for repeatedly providing it with inaccurate and misleading information about the status of efforts to remediate serious deficiencies in the bank's implementation of anti-money laundering and financial crime procedures identified by the FCA. It is particularly notable that the FCA also brought the bank's compliance officer and internal auditor to book for their roles in the matter, even though they were following orders from senior managers.

Respectively, these individuals were fined £19,600 and £9,900 (which also included a 30 percent early settlement discount). This case demonstrates: (i) that it is critically important to verify the truthfulness of any assurances before making them to the regulator; (ii) that approved persons have independent regulatory obligations that take priority over senior management pressure; and (iii) that personal accountability as well as a company's systems and controls are increasingly coming under regulatory scrutiny.

GOOD PRACTICE RECOMMENDATIONS FOR FINANCIAL SERVICES FIRMS

So, in view of this focus on financial crime, what good practice takeaways can be gleaned? Well there is no better place to start than the guidance contained in the FCA's Financial Crime: a guide for firms, which is relevant to all FCA regulated firms.

The guidance recently was amended to incorporate a number of good practice recommendations for the management of financial crime risk identified during the FCA's ABC Review and AML/Sanctions Review. Failing that, the following "Top 10" takeaways are a good start:

1. Financial services firms should consider conducting a gap analysis of their systems and controls, which addresses fraud, bribery and corruption, money laundering, and sanctions risk as well as pertinent FSA/FCA Final Notices to assess whether existing policies and procedures are compliant with current FCA requirements and forthcoming legal changes.

2. Any gaps identified by a gap analysis should result in amendments to a firms' policies and procedures to tackle financial crime and include an effective implementation and continuing monitoring plan.

3. Tone from the top – Firms should consider nominating board level champions responsible for tackling financial crime. They should also consider appointing financial crime officers (e.g., an anti-corruption officer or other senior manager) with responsibility for managing bribery and corruption risk. Formal bodies, such as a "financial crime committee," may also assist in propagating an appropriate "tone from the top" and in involving senior management in anti-money laundering decision-making.

4. Culture – When placing emphasis on improving culture or implementing a compliance culture, firms should undertake an "awareness raising" effort to increase knowledge of financial crime risk among employees. Consideration also should be given to implementing mechanisms that incentivise or remunerate good behaviours as part of the appraisal process for staff.

5. Training – Tailored, risk-based training that is focussed on identifying and mitigating financial crime risk and "red flags" is essential. Such training should cover the board and non-executives, down to staff and agents in outlying jurisdictions.

6. Risk assessments – Firms need to perform business-wide and customer/individual relationship risk assessments regularly that incorporate a matrix of risk factors (e.g., jurisdiction, distribution chain, recruitment, hospitality, donations). The identified risks should then be aggregated to arrive at an overall risk ranking.

7. Due diligence – Firms also need to ensure that their due diligence builds on the business-wide and customer/individual relationship risk assessments mentioned above. Bearing in mind the likely changes to be brought in by the Fourth EU Money Laundering Directive, due diligence will need to include detailed checks on directors, controllers, ultimate beneficial owners, sources of wealth/funds as well as PEP, sanctions, and adverse media screening.

8. Senior management approval of high risk relationships and for high risk payments – Such approvals ensure that high risk issues are appropriately escalated and considered. This is required to minimise the money laundering and corruption risk such relationships and payments pose and should always be supported by a full audit trail outlining the reasons for approval being granted.

9. Continuing monitoring and review – As with the Bribery Act, a policy that sits on the shelf gathering dust is never adequate. Regular periodic review, as recommended in the FCA guidance, is required to make sure that the policy is working and to act as a feedback loop that facilitates the implementation of appropriate updates and changes to the policy. Such reviews should look at CDD and EDD, including updating of the PEP, sanctions, and adverse media screening conducted, as well as incorporating elements of bribery, corruption and fraud risk review, for example, on transactions and payments.

   And last, but by no means least…

10. Management information – Compliance officers or risk specialists need to regularly provide senior management and the board with sufficient information to enable them to understand the financial crime risks to which the firm is exposed. Not only does this increase awareness of risk and raise the prospects of better risk mitigation strategies being implemented, it also evidences that approved persons and others are complying with their regulatory obligations, and therefore acts as protective shield for such officers.

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