Money laundering update

FSA policy approach confirmed

Earlier this year, the UK's Financial Services Authority (FSA) added substance to the commonly held belief that it was more concerned about anti-money laundering controls than about the offence itself, when it fined Bank of Ireland (BoI) £375,000 ($696,605) for issuing a series of bank drafts disguising the identity of the beneficial owner of the cash. While there was no suggestion that any offence had taken place, FSA notice comments that the circumstances in which the drafts were issued resulted in an investigation by appropriate law enforcement agencies.

This latest fine sits uncomfortably with the £1,250,000 fine handed out to Bank of Scotland (BoS) at the beginning of the year, and the £2,300,000 fine which Abbey National received at the end of 2003, for their self confessed failures in customer identity verification and other anti-money laundering procedures.

The two cases highlight the continuing regulatory pressure by FSA on those they regulate to undertake identity verification when establishing a client relationship. It also shows that unlike every other area of FSA rule making, it does not apply a risk based approach to its enforcement policy. In the cases of Abbey and BoS, there was no suggestion by FSA that their failings had given rise to any risk of money laundering yet they received a harsher regulatory sanction than BoI, where the risk of financial crime was arguably much greater.

Current position

Client identity verification is an area which causes problems for everyone. FSA members complain it imposes an administrative burden, which is disproportionate to any benefit derived from clients' proving they are who they say they are.

Matters are made worse by the confused state of regulatory guidance. The current position is that we are operating under the Money Laundering Regulations 2003, which were introduced in accordance with the Money Laundering Directive 2001. These updated the 1993 Regulations which implemented the original Money Laundering Directive of 1991.

The 2003 Regulations had some impact on the regulated sector, however, the greater impact fell largely on lawyers, accountants, casinos, dealers in high value goods and others who came within the extended ambit of anti-money laundering legislation.

For the regulated sector, the Regulations are implemented through the FSA rules and guidance, which require identity verification to be obtained and retained. The Regulations and FSA rules are in turn underpinned by guidance detailing how this is to be done issued by the Joint Money Laundering Steering Group (JMLSG), which is an industry-wide group charged with the responsibility for drawing up this guidance. The current lengthy edition of the guidance was published in 2003, but was written to reflect the 1993 Regulations. Guidance from the JMLSG on the 2003 Regulations has to be approved by the Treasury, which I predicted at the time would be a long time coming. This still remains the case. No date has been set for finalising the revised guidance on the 2003 Regulations, but the earliest we are likely to see anything is the end of 2005.

Just to complicate matters, the European Commission is proposing a third Money Laundering Directive but, fortunately, this is some way off.

FSA policy initiative

The current JMLSG guidance has many deficiencies – it is not comprehensive, it is complex and in many respects it relies on outmoded practices.

FSA has recognised and responded to industry concerns about the problems of identity verification and launched its own initiative to address these concerns, headed by ex-LCH man turned regulator, Philip Robinson, financial crime sector leader at FSA. In October, he released a progress report, *ID – defusing the issue*.

The Report details the progress made by a working group set up in May 2004, with the aim of working together to deal with the ID issue ahead of the rewrite of the JMLSG guidance. It reiterates that identity verification is a legal requirement and part of the FSA's statutory objective to combat financial crime and, as such, it will remain a requirement for the regulated sector. FSA believes that not only does it help the fight against financial crime, it is also part of a firm's due diligence in taking on a new client and managing their relationship with that client.

According to the Report's notes, there are three main strands to the ID issue:

1. Customer experience
2. Value for money
3. FSA's supervisory approach.

Customer experience

Not only is the industry upset by identity verification requirements clients are also upset and have shared their unhappiness with politicians and FSA. In addition, there are particular concerns that socially disadvantaged groups are often those who find it most difficult to provide standard forms of identity verification. This must be difficult for a government which is looking to move away from cash payments for benefit claimants towards a direct credit to their bank account.

FSA is soon expected to publish an independent survey of customer attitudes which the Report reveals will (unsurprisingly) show that a large proportion of respondents have no problem with being asked to prove their identity and being able to provide that proof.

Vincent Mercer* provides an update on some encouraging initiatives by the UK's FSA, which may ease the process of identity verification going forward

The Report goes on to imply that not only do customers not have any problems with identity verification in issuing its fact sheet on identity checks in May 2004, FSA has dealt with every client's understanding of the need for these checks. The reality is probably that it is still left to those regulated by FSA not only to undertake identity verification but also to explain why it is necessary.

Value for money

The Report does not address the issue of value for money directly but indicates that FSA recognises that identity verification alone is responsible for a significant proportion of a firm's compliance costs. It also indicates a move towards a less complex arrangement, away from the current, gold standard, which assumes client identity verification is done face to face with every client providing two separate items of verification (one for the individual and one for their address).

The Report highlights a number of steps which firms can take to reduce the costs and burden of identity verification.

The current JMLSG guidance allows the use of electronic identity verification. Given that many client relationships are now created remotely on line it gives firms the opportunity to verify identity through one of the growing number of credit reference and similar agencies. The Report notes that these agencies compile data from a number of sources which should in most cases avoid the need to seek corroboration of the verification and avoid the inevitable delays and risks involved in sending original documents by post or the costs of insisting on certified copy documents.

The Report also questions the role utility bills play in identity verification, it notes that the corroborative value they add is limited and that any address may not remain current. It also highlights how many utility providers now generate bills electronically and that it is then left to the customer to print these bills, which inevitably leads to the possibility of manipulation. The Report shows that FSA is moving towards acceptance of a single document to satisfy identity verification and that this is also under active consideration by the JMLSG.

The Report also addresses introduction certificates and notes that both FSA rules and JMLSG guidance currently allow a firm to delegate responsibility for identity verification to another (but not the responsibility, which remains with the firm). It does not go beyond highlighting that there are sensitive issues involved in assigning responsibility for verification and liability if it proves to be inadequate. FSA accepts that a more widespread reliance on verification undertaken by others could bring significant cost benefits and this is another issue the Report indicates the JMLSG is considering.

FSA's supervisory approach

While making it clear that FSA's approach to enforcement of the new regime will be published at a later date (and giving the usual warnings that FSA will not compromise on the high standards it requires from those it regulates), the Report accepts that a firm's assessment of its anti-money laundering procedures can be risk based in order to bring it into line with FSA's practice in other areas. It notes that the enforcement actions brought by FSA have introduced a fear factor, which has lead to a conservative approach to identity verification which has in turn contributed to the current problems associated with it.

This is encouraging because, while the final rules and, particularly, the guidance on client identity verification are still a long way off, FSA at least seems to be responsive to industry and public concerns, so freeing hard-pressed compliance officers to deal with other more immediate concerns such as MiFID.

MiFID update

Last month I wrote about the progress of MiFID, the 70 Article European Directive scheduled to reach our desks in 2005. When the technical measures are added it is anticipated that MiFID will be some 300 pages of legislation changing everything from the way we do business with our clients to the way we organise trading.

I reported that CESR (Committee of European Securities Regulators) was planning a second consultation paper on its first set of mandates, with a possible public meeting in November. This has not happened; however, its consultation on the second set of mandates was issued in October on schedule (and is available at www.cesr-eu.org). An open meeting to discuss the second set of mandates has been scheduled for 19 November (after *FOW* went to press).

At the time of writing, there has been nothing official from CESR or the Commission. However, speaking at a trade conference on 5 November, both Callum McCarthy (FSA chairman) and David Wright (a senior Eurocrat driving these measures through), indicated that the Commission had been persuaded that the current pace towards implementation of the measures might be too fast and if there was sufficient industry support for a delay, implementation of MiFID would be delayed. ❑

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