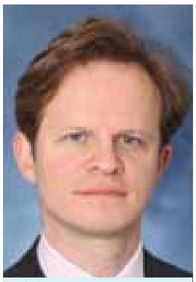
UK Asset Management Sector set for regulatory shake-up

William Yonge, Partner in the London Business and Finance Practice at global law firm Morgan Lewis, assesses the implications as the FCA concludes a review of anti-money laundering and anti-bribery and corruption systems and controls in the UK Regulated Asset Management Sector and explains why authorities are set to take action against the worst offenders.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The operational objectives of the UK Financial Conduct Authority (FCA) include protecting and enhancing the integrity of the UK financial system, hence its role in preventing financial crime. Regulated firms risk being used to facilitate financial crime in areas such as money laundering, bribery and corruption. They have legal and regulatory obligations to establish and maintain robust defences and risk management frameworks to identify and mitigate anti-money laundering (AML) and anti-bribery and corruption (ABC) risks that they face.

Regulatory action regarding anti-money laundering, anti-bribery and corruption systems and control failings has, historically, focused principally on banking and the insurance industry. It was thus inevitable that the asset management sector would eventually face the regulatory spotlight. In 2012, FCA predecessor, the Financial Services Authority, started to review the way 22 asset management, platform and fund administration firms managed AML and ABC risks. The FCA, which succeeded the FSA in April 2013, completed the review, publishing its findings last autumn (Anti-Money Laundering and Anti-Bribery and Corruption Systems and Controls: Asset Management and Platform Firms (TR13/9)).

The review identified "common weaknesses" within the sector, concluding that many firms' systems and controls for counteracting money laundering, bribery and corruption were inadequate. The FCA emphasised that although the review focused on the asset management sector, it expected "all firms to have appropriate systems and controls in place for AML and ABC".

Heightened vulnerability

In preparation for the review, the FCA identified key areas in which the risk of money laundering and bribery and corruption in the asset management sector is heightened: the selling of investment products (particularly where third parties are employed); firms' dealings with clients; and the accumulation of information to obtain competitive advantages. The FCA also noted a range of factors that could increase the risk of money laundering and bribery and corruption:

- non face-to-face business;
- customers from (or with links to) countries considered high risk from a money laundering and/or corruption perspective;
- high net worth and powerful clients, particularly those insisting on high degrees of confidentiality;
- the use of offshore trusts and shell companies to distance owners from funds;

- high value and/or unexpected transactions;
- payments or inducements to third parties without clear business rationale.

Common weaknesses

The FCA found that, although AML and ABC systems and controls varied across the sector, there were a number of common weaknesses, notably:

- some firms were unable to demonstrate the effectiveness of senior management supervision, and there was a "lack of rigour in following up on formal actions and issues raised";
- although most firms had "well-defined" governance arrangements, the FCA did not approve of the fact that in some instances, AML and ABC controls and systems were "managed in organisational 'silos'...that could have benefited from being more integrated";
- most firms did not have the proper systems in place to identify, assess and manage AML and ABC risks, and the frequency with which risk assessments were carried out was unsatisfactory; "assessments were sometimes not undertaken; not documented and lacked appropriate consideration of relevant risks";
- firms had AML policies that were dated or contained inaccurate references to regulations no longer in force;
- enhanced due diligence was not always carried out on high risk customers due to "incorrect, unclear, or inaccurate definitions used to identify potentially 'higher' risk customers";
- some firms considered a longstanding business relationship to be a substitute for maintaining up-to-date customer due diligence information. The FCA emphasised that "firms are required to conduct on-going monitoring of business relationships... throughout the course of the business relationship";
- some firms did not properly identify and document the ultimate owner of a customer, source of funds, and/or source of wealth;
- although most firms deployed AML and ABC training, the FCA called into question its efficiency, noting that a lack of effective training meant that most firms failed to recognise or effectively deal with potential risks;
- most firms failed to demonstrate adequate systems and controls for assessing ABC risks in relation to dealing with and monitoring third-party relationships (e.g. agents or introducers). The FCA noted that "procedures to identify and risk-assess the use of third parties were not clearly defined" and the extent of due diligence performed on third parties often "appeared insufficient". The FCA was particularly concerned that third party agreements did not invariably include audit rights or AML and ABC clauses.

Clearly disappointed

The FCA concluded the review by encouraging firms to carry out regular internal risk assessments, and ensure ABC and AML polices are constantly updated, emphasising the importance of tailored training programs. It was further recommended that staff training records should be kept by firms, and used to "test staff understanding and quality of training".

The FCA is clearly disappointed with the sector's approach to AML and ABC systems and controls, stating that it intends to take action against the worst offenders.

All businesses should ensure they give due consideration to potential AML and ABC risks. Each firm should assess risks frequently, and ensure systems and controls specific to the firm's size, customer base and risk factors are in place, and that staff are thoroughly trained.

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FCA takes action for inadequate ABC controls

On 19 December 2013, the FCA fined JLT Specialty Limited ("JLTSL") (a subsidiary of the JLT Group, one of London's largest insurance brokers) £1,876,000 (after a 30 per cent discount for early settlement) for breaching Principle 3 of the FCA Handbook by failing to ensure appropriate checks and controls were in place to safeguard against bribery or corruption when making payments to overseas third parties.

The infraction occurred when JLTSL made payments totalling over £11.7 million to overseas third parties who had assisted the firm in winning and retaining business. These payments accounted for roughly 57 per cent of brokerage earned, and created what the FCA called an "unacceptable risk", that overseas introducers could use payments made by JLTSL for corrupt purposes, including payment of bribes to people connected with insured clients and/or public officials.

Notably, the FCA determined that although JLTSL's procedures "appeared reasonably sound", including an Anti-Bribery and Corruption Policy, and detailed internal risk assessment/compliance manuals, the firm failed to issue guidance on practical steps required to comply with procedure and, therefore, had failed to properly implement its own stated policies.

Timely reminder

This decision should serve as a reminder for all firms involved in using overseas brokers and agents of the importance of maintaining robust procedures to prevent payments being made for corrupt purposes. It is not sufficient to merely have codified policies; all measures must be "living", and consistently implemented through training for all employees and third party representatives, and careful due diligence and monitoring of third party arrangements. The case also functions as a noteworthy aide memoire to the effect that the FCA is not required to prove beyond reasonable doubt that a bribe has taken place (within the meaning of the Bribery Act 2010) in order to initiate enforcement proceedings.

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