# Financial Crime Best Practice Guide

**Version 1.4**

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## About TISA

**The Investing and Saving Alliance (TISA)** is a unique, rapidly growing membership organisation for UK financial services.

**Our ambition is to improve the financial wellbeing of all UK consumers.** We do this by focusing the convening the power of our broad industry membership base around the key issues to deliver practical solutions and devise innovative, evidence-based strategic proposals for government, policy makers and regulators that address major consumer issues.

TISA membership is representative of **all sectors of the financial services industry.** We have **over 200-member firms involved in the supply and distribution of savings, investment products and associated services**, including the UK's major investment managers, retail banks, online platforms, insurance companies, pension providers, distributors, building societies, wealth managers, third party administrators, Fintech businesses, financial consultants, financial advisers, industry infrastructure providers and stockbrokers.

As consumers, the financial services industry and the economy react to and recover from the effects of the pandemic, the importance of the three key pillars of work that TISA prioritises has never been more apparent:

- **Strategic policy initiatives that influence policymakers** regarding the financial wellbeing of UK consumers & thereby enhancing the environment within which the industry operates in the key areas of **consumer guidance, retirement planning, later lifetime lending, vulnerable customers, financial education, savings and investments**.
- TISA is recognised for the **expert technical support provided to members** on a range of operational and regulatory issues targeted at improving infrastructure and processes, establishing standards of good practice and the interpretation and implementation of new and existing rules and regulations covering **Financial Crime prevention, CASS, ESG/RSI, operational resilience, Governance, Conduct and Culture** and a range of other areas.
- **Digital transformation initiatives** that are driving ground-breaking innovation and the development of industry infrastructure for greater operational effectiveness and revenue promoting opportunity for firms. TISA has become a major industry delivery organisation for consumer focused, digital industry infrastructure initiatives – **TISAtech** (a digital marketplace that brings together financial institutions and FinTechs for greater collaboration and innovation) and **TURN** (TISA Universal Reporting Network – a digital platform providing a secure data exchange for financial services using blockchain technology) – alongside projects **Digital ID** and **Open Savings, Investment & Pensions**. This reflects TISA's commitment to open standards and independent governance.

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# 1. Introduction

The TISA Financial Crime Risk Best Practice Group, consisting of representatives from a wide range of firm types, has produced this Guide in the form of a number of separate documents, on discrete topics. Each document was written by one or more members of the group and reviewed by all members of the group, to provide a balanced view of each key area relating to the prevention of financial crime and managing financial crimes risks.

The purpose of this document is not to cover every aspect of financial crime prevention, but to focus on specific areas that the working group consider is not adequately covered within existing regulation or guidance, including those issued by FCA or the UK Joint Money Laundering Steering Group ("JMLSG").

Please remember that the information contained within these statements is for informational purposes only and is not intended as a substitute for the need of each firm to understand the financial crime risks that relate to its business model and determine its own financial crime prevention policies and procedures that are relevant to its business. The information contained is for general guidance only, is not exhaustive and may change from time to time.

## 2. Investment Fraud and Impersonation

### 2.1 Introduction

Scams have become increasingly prevalent, even more so during the disruption and uncertainty caused by the Covid-19 pandemic. Over the course of 2020, Action Fraud received over 300,000 separate reports of fraud, with over £2bn reported to have been lost by consumers in the UK.

This has led to one body, The Royal United Services Institute (RUSI) to demand that the Government treat fraud as a national security threat.

A recent common trend in scams has been an increase in firm impersonation or 'cloned firm' fraud.

This sees a fraudster establish fake websites, email domains and documentation which have similar brand identity to that of regulated financial services firms and household brands. In addition to the traditional out-of-the-blue contact usually experienced from these scammers; an investment opportunity will be advertised and identified by the consumer via an internet search. Potential investor information will be requested and will need to be submitted on the website. The potential investor will then be contacted by telephone by a fraudster pertaining to represent the regulated firm. The fraudster will then provide information about the investment opportunity, usually with a limited time period to invest, and focusing on the 'fact' that the investment is covered by the FCA. Should the investor be interested they will send an application by email. The documents will look like the regulated firm's brand and may be a mixture of 'true' and fake documentation. Once complete the investor will submit the application and pay funds into the fraudster's bank account. Due to the original type of investment being advertised as a long-term investment, it may not be until months have passed and the investor has not received any investment return payments that they contact the 'real' regulated firm, and the fraud is identified.

To combat this ever-growing threat, the TISA Financial Crime Working group have compiled this guidance document for members. Following this guidance, member firms can be assured that they are well positioned to counter the activities of these fraudsters and the inclusion of an informational tool designed for consumers ensures a proactive and joined up response.

### 2.2 Legal & Regulatory Background

Since 2008 City of London Police have been the National lead police force for fraud. This is a broad role that encompasses many aspects of the volume economic crime landscape, from investigating some of the country's most complex frauds to hosting the National fraud and cybercrime reporting centre, Action Fraud.

Action Fraud is the only national crime reporting system in the UK. All frauds and a majority of cybercrime in England, Wales and Northern Ireland are reported to Action Fraud. These reports are then analysed by the National Fraud Intelligence Bureau (NFIB), also hosted by City of London Police, and then either sent on to the police force where the suspect resides or retained within the NFIB to inform disruption and warning activity.

For those members based in Scotland, frauds are usually investigated by the Police Service of Scotland, which has regional specialist units within its Specialist Crime Division to deal with complex economic crime cases. Serious and complex fraud and other economic crimes are investigated under

the direction of the Economic Crime Unit, part of the Serious Organised Crime Division of the Crown Office and Procurator Fiscal Service (COPFS) which is Scotland's prosecution service.

The Financial Conduct Authority has as one of its statutory objectives the reduction of financial crime, which includes fraud. Regulated firms must have adequate policies and procedures in place to counter the risk that they may be used to further financial crime. Individuals authorised by the FCA must act with integrity in carrying out their accountable functions. The FCA is empowered to enforce against firms and individuals for breaches of the relevant rules. The Prudential Regulation Authority (PRA), which is responsible for the prudential regulation and supervision of various financial institutions, has similar rules and means of enforcement to the FCA.

The FCA's 2021 Financial Crime Guide provides guidance to firms on steps they can take to reduce their financial crime risk across several areas, including fraud. The guidance is non-binding but is an indicator of the FCA's expectations and provides examples of good and poor practice.

## 2.3 Harms we are seeking to prevent

The ability for a consumer to lose their money to fraudsters is sadly quite high. Being a victim to a scam can have a devastating effect on the individual's financial and mental wellbeing. Once an individual has become a victim to a scam, history has demonstrated that they are contacted by fraudsters again.

Cloned firm impersonation fraud sees the consumers access scam websites since they can feature in search engine results. As of June 2021, current legislation fails to ensure that search engine providers have a duty not to enable fraudsters to advertise scam websites in their results.

By removing these results, consumers would have less opportunity and be less likely to discover scam websites and therefore become victims of fraud.

Cloned firms are not likely to be legally liable for any losses suffered by victims to this type of scam, but there may be other negative impacts, such as reputational damage and reduced investor confidence in this sector.

## 2.4 Recommendations for Firms

The existence of investment and impersonation fraud takes advantage of unsuspecting innocent parties and can drastically impact the victims both financially and emotionally. It is therefore important that firms provide guidance to their customers on how to spot and avoid such scams.

By producing such guidance this can help to increase understanding across our customers and support the ongoing process of disrupting such fraudulent activity using a program of continual awareness.

Key to disrupting such behaviour is helping customers to recognise the various approaches used by criminals to undertake the scam by:

- convincing the customer that something is genuine by impersonating an individual, firm/well-known brand;
- using fraudulent advertising and or a website; and
- taking advantage of situations (e.g. COVID-19)

Scams take many forms and are continually changing. Therefore, if firms can explain to their customers the steps to follow to establish if something is genuine this will help greatly to minimise the potential of someone falling victim to such scams.

Below outlines industry guidance that a firm should consider following when dealing with and taking action on such reports. When discussing any of the information with the customer throughout the investigations, the customer should be kept informed. Given time is of the essence in a lot of cases, it is advised that telephone conversation is the first port of call when gathering information from the customer. A follow up written communication would then suffice to confirm discussions and advice.

**When being notified of a possible scam from a customer or member of the public, a firm should obtain the following key information for investigation, and provide certain information to the customer:**

- Full name and contact details of the caller.
- **Firstly, it is important to ask if they have sent any money – If they have, particularly if it is a recent payment, they need to report this to their bank immediately to understand if they can recall or reimburse the payment, and if there are any further protective measures the bank can take to secure the account.**
  Time is of the essence so consider insisting that the caller hangs up, contacts the bank and then rings back.
- Advise of the Authorised Push Payment code of practice and encourage them to make a claim against their bank, help and support with this is provided in the following link: https://www.which.co.uk/consumer-rights/advice/how-to-get-your-money-back-after-a-scam-amyJW6f0D2TJ
- Check if the caller is an existing customer and if they have provided any details to the fraudster about their holdings or account.
- Assess any potential vulnerability of the caller. Encourage them to speak with a trusted friend or family member for support or assistance if needed. A useful resource is the BSI Protecting customers from financial harm as a result of fraud or financial abuse. Code of practice PAS 17271.
- How they first came into contact with the fraudster (did they see something online, receive a cold call etc.).
- When they first made contact, together with dates and times of any contact they can recall.
- How the contact communicated was made- Email/Postal/Telephone.
- Details of any websites, social media pages, sales brochures, email addresses, phone numbers and names the fraudster used to contact the customer, as well as requesting any emails sent to them as part of the scam for further investigation - request that the emails be sent by attaching them to a new email (rather than simply forwarding), so that your information security team can see the domains behind the emails, in the metadata.
- The type of investment offered and how it was described to them.
- Bank details provided by the fraudsters (whether payment has been made or not).
- **If payment has been made:** Details of any payments made, include dates and amounts.
- Information the caller has provided to the fraudster, including personal information and documentation (such as passports, bank statements, utility bills etc.).
- Any other information they may be able to provide.
- **If the caller has NOT paid away funds** but is enquiring as to the legitimacy of this, then tell them this is a scam - gather the details as above and advise them to have no further contact with the individuals concerned.

**Advise the customer to take these next steps:**

- Report the matter to the UK National Reporting Centre for Fraud and Cyber Crime - Action Fraud on 0300 123 2040 or via www.actionfraud.police.uk
- Notify the FCA by telephoning their Consumer Helpline (0800 111 6768) or by filling in an online form (https://www.fca.org.uk/consumers/report-scam-unauthorised-firm )
- Visit the Financial Conduct Authority's ScamSmart information to learn more about investment scams and some useful tools to assist in avoiding such frauds www.fca.org.uk/consumers/protect-yourself-scams
- Consider whether any other financial accounts may be at risk and to get in touch with them as soon as possible to alert them of the situation. The firms may be able to take extra steps to ensure the security of their accounts.
- Forward suspicious **phishing emails** to the National Cyber Security Centre Suspicious Email Reporting Service (SERS)
- Forward spam texts to Ofcom using the number 7726.
- Contact CIFAS, a charity fraud prevention organisation, to affect a protective registration marker (https://www.cifas.org.uk/services/identity-protection/protective-registration), which will alert them of any unauthorised activity.
- Keep an eye on their credit file in case of any further activity (even if unsuccessful, many have parted with personal information). They can register (usually for free) with one of the credit reference agencies for a regular update on their credit report – e.g. https://www.creditkarma.co.uk/ , https://www.experian.co.uk/ , https://www.equifax.co.uk/
- In the coming weeks/months be very cautious of anyone other than their bank offering to recredit them with money, especially if they ask for a fee in order to proceed.

**Once the firm has been advised of the potential scam, it should seek to build a file in preparation for reporting to the relevant authorities by performing the following investigations:**

- Check the FCA website - Known Unauthorised Firms – remember though **if a firm is not on the list this does not mean they are bona fide.** You can also check the FCA register to see whether the firm is listed, or if there is a close match to a regulated firm.
- Check how long the website has been established – www.who.is. – A genuine company should have a few years internet presence and be clearly registered (rather than registered privately).
- Perform online searches on the company and/or investment – If the caller has been contacted by a scam, it is likely that others have too.
- Check to determine if the fake website has lifted text from other reputable sites and pasted onto their own.
- Check www.scamadviser.com – this site gives a breakdown of the website and what the details of it may indicate based on location, time active, ownership of site etc.
- Check the company is registered on the relevant 'Companies House' website for the country they claim to be operating. In addition, if they claim to be/appear to be a financial services firm they should be regulated by the appropriate regulatory authority. Use Companies House - Government Links and Regulatory Authorities by Country to help check registrations.
- Review any letters/emails that the customer may have been able to provide. Sometimes email addresses can appear suspect along with numerous grammatical and spelling errors which may be missed from the untrained eye.

**Next steps for the firm to take:**

- Report the fraud to law enforcement - Action Fraud on 0300 123 2040 or via www.actionfraud.police.uk
- Consider whether, as a result of what has been learned, a Suspicious Activity Report (SAR) filing is appropriate – for instance if payments have been made and the details are known.
- Firms should remember that they can submit a 'vulnerable person' SAR, if this would be appropriate: https://www.nationalcrimeagency.gov.uk/who-we-are/publications/45-guidance-on-sars-reporting-routes-relating-to-vulnerable-persons/file
- If firms are aware that other firms have suffered from the same fraud then they may wish to submit a Super-SAR, under section 11 of the Criminal Finance Act 2017. This involves them, with the consent of the NCA, collecting information from other firms subject to the fraud, collating the information and submitting the consolidated intelligence report to the NCA.
- Consider the need to contact the FCA with details of the fraud. The FCA have pages dedicated to alerting members of the public about firms which have had their brand cloned along with the ability to add warnings.
- Firms should ensure that their contact centres are aware of current types of fraud, the red flags and receive training on how to deal with contact from those who have suffered such frauds. They should be aware of what to ask, and how to offer suitable help.
- Review the fraud section on the firm's website and update it if necessary. Consider whether a warning should be placed on the website to alert customers and other visitors.
- Consider communication initiatives for customer education.
- Fake adverts identified online should be reported to The Advertising Standards Agency (ASA) – their website has a section on reporting online scam adverts. Fake adverts on Social Media platforms can also be reported directly.

**If the firm has been cloned:**

- Take down any websites by contacting the site owner, law enforcement agencies, the internet service provider (ISP) or the domain registrar - Services such as WHOis can provide this information. Note that evidence of the fraud will be required by the ISP or registrar.
- Take detective steps to identify any fraudulent websites that may have been set up to appear legitimate using almost replicates of the real URL. DNS Twist is an example.
- Services such as URLCrazy enable you to take preventative steps through generating and testing domain variations to detect typo squatting, URL hijacking, phishing, and corporate espionage.
- If website take down is successful, try to prevent similar events from happening, consider making a complaint to the ISP or registry – use Nominet for UK domains and non-UK here.
- Notify the FCA who will be able to place a warning on their unauthorised firms list.
- If legitimate phone numbers have been spoofed by the fraudsters, consider protecting these numbers with Ofcom, who can add the number to their 'do not originate' list. Note however that this only applies to numbers which are only ever used to contact the firm, and from which no calls are ever made.

### 2.5 TISA Customer Guide:

The following section is intended as an information template for firms to publish to Customers either as TISA guidance, or to use as a basis to form their own branded document. Additional guidance can be found https://www.actionfraud.police.uk/a-z-of-fraud. If publishing as TISA guidance, no changes should be made to the wording:

# TISA Guide to Investment Fraud

## What is Investment Fraud?

There are many different types of investment fraud. They are often difficult to spot because they're designed to look like genuine investments and the scammers may have a professional looking website and documents.

It often involves criminals contacting people through cold calls and out-of-the-blue offering an opportunity to invest into a scheme, investment or product that is either worthless or doesn't exist – including offers for the victim to purchase historical shares that are no longer trading, or offers to purchase shares victims hold and an attractive price, for an advance fee. These types of scams often operate out of what is known as 'Boiler Rooms'.

For many fraudsters, it is a full-time job meaning they have the time to build a relationship with their victim and make them more vulnerable to their exploits. Their aim is to take the victim's money and convince them that they have invested into something worthwhile.

Once monies have been paid to the criminals, usually via bank transfer, it is unlikely they will be recovered and contact from the offenders is likely to cease.

## What is Impersonation/Clone Fraud?

Impersonation/clone fraud is an iteration of an investment scam. Impersonation fraud involves an imposter posing as an individual or legitimate firm with the aim to convince their victim to make payment or provide their personal or financial details.

Clone firm investment scams involve fraudsters using literature and websites that mirror the details of trusted and authorised organisations. They'll try to convince their victim that they work for a genuine company and use high-pressure selling tactics to get you to buy 'investments' which, of course will be worthless and often aren't even offered by the company they're pretending to be.

It is worth highlighting that in some, more recent, versions of this type of scam, fraudsters have obtained their victim's details via online comparison sites they have set up, or scam online adverts where individuals are searching for investment/savings opportunities into vehicles such as ISAs and bonds. The initial call or contact from the fraudsters is then essentially expected rather than the typical 'out-of-the-blue' contact usually experienced in investment scams.

Criminals may use a tactic called 'spoofing' to make their call or text appear genuine by cloning the number or sender ID which the organisation uses. Whilst legitimate firms do use texts as a part of their service to notify customers of certain activity, it is important to familiarise yourself with what a legitimate message would look like and what would be deemed a suspect message. Banks and other trusted institutions would never ask you to disclose any security credentials, personal or financial information this way.

Fraudsters are also creating fake social media accounts purporting to be the legitimate firm and communicating with victims in this way. Again, it is important to understand how a firm will legitimately communicate with you.

Clone scammers selling fake investment products pocketed over £78 million from UK citizens in 2020, with victims losing £45,242 on average.

## What are the Red Flags?

There are several ‘red flags’ that you should be aware of that may indicate that the investment opportunity may be fraudulent, these include:

- Involvement of unregulated/ unlicensed investment professionals.
- Investment offers found on social media or through internet searches.
- The promise of guaranteed returns.
- Being targeted by an aggressive seller who may provide exaggerated or even false credentials.
- Tempting offers that sound ‘too good to be true’ including saying things like “everyone is buying it”.
- The usage of language such as “risk-free" investment opportunities.
- The promises of great wealth and guaranteed returns.
- Pressure to invest right now, with sales needing to be concluded within a small time period to obtain the deal, including the use of couriers to bring or collect documents to your home.
- The usage of over-the-top or sensational reviews for investments.
- Cold calling / unsolicited emails seeking to obtain your personal information.
- Being asked to pay for investments by credit card, gift card, or sending money abroad or to a personal account.
- The investment is alleged to be ‘protected’ by the FCA rather than the FSCS.

## What to do If I have received contact from a scam?

Fraudsters will impersonate well known financial institutions with the intention of enticing you into sending money to them. These criminals are highly sophisticated and will create the impression of being genuine through means such as literature and websites.

Do not send any money as the likelihood is that any money sent will be lost.

Do not respond to any future communication from them including requests for personal information or money to be sent. Fraudsters will often try and use tactics to pressure you into sending information or money, such as advising that the offer is only available for a limited time to get you to make rash decisions or telling you there is little risk.

# Who do I contact if I have fallen victim?

## Speak to your bank

Any victim of investment fraud, including investment firm impersonation fraud, should speak to the bank they used to initiate the payment as soon as possible. The bank will have the full transaction details and may have the ability to notify the receiving bank of the fraud and potentially reclaim any fraudulently paid funds, depending on the circumstances of the transaction.

If the money sent cannot be reclaimed, the chief means of restitution which victims have reported benefiting from is the Contingent Reimbursement Model (CRM) Code for Authorised Push Payment (APP) scams. This is a voluntary code which a number of major banks have signed up to and sets out the circumstances of when a bank may compensate a customer who has fallen victim to a fraud, even where they authorised the payment.

It should be stressed that reimbursement is not a guarantee, and not all banks have signed up to the code; however, it is strongly recommended that victims who have suffered losses ask their bank to provide confirmation about whether the circumstances of the transaction(s) meet the grounds for reimbursement under the Authorised Push Payment Scam Code.

Before contacting the bank, you may also wish to refer to the following article for further information about reimbursement under the APP Scam Code: https://www.which.co.uk/consumer-rights/advice/what-to-do-if-youre-the-victim-of-a-bank-transfer-app-scam . The article also includes steps that you may take if your bank is not signed up to the APP Scam Code.

## Government fraud reporting organisations

Report your concerns to the FCA and Action Fraud for them to investigate further

FCA – Contact their consumer Helpline on 0800 111 6786 or report it online at https://www.fca.org.uk/consumers/report-scam-us

Action Fraud - www.actionfraud.police.uk or 0300 123 2040.

Both the FCA and Action Fraud provide further information on Investment Scams and what action you can take to help prevent to help stop yourself becoming a victim of fraud.

To assist with their enquiries, try to provide the following information:

- How you were first made aware of the investment offer;
- If you were cold called, or further information was requested through routes such as internet comparison sites or social media;
- Copies of all correspondence with them that you can provide;
- Details of further communications you had with the fraudster;
- Details of any personal or confidential information you have sent to the fraudster, including any documents;
- Details of any money you have been asked to send. If so, the bank account details that money was sent to and what payments have been made;
- Confirmation of if you are willing for your contact details to be shared with the Police; and
- Any other details you think may be relevant.

## Other protective steps

If you think that the fraudsters have any of your personal details that could potentially be used for other fraudulent purposes, such as identity theft, then you may want to consider, for your own peace of mind, registering with the Credit Industry Fraud Avoidance Scheme. This enables financial organisations to be alerted to the fact that your details may have been compromised if any future account applications have been made in your name. They may respond by seeking additional identity information to ensure the application was genuine. Note that there is a small charge for this service. Further details can be found at www.cifas.org.uk .

It is also advisable to contact other financial organisations who you hold accounts with to let them know that your personal information has been obtained by scammers and you may be at a higher risk of fraud.

## Support agencies

Falling victim to fraud can have a huge emotional impact as well as being financially crippling. Victims can often feel embarrassed and don't want to tell people what's happened, even though they're not the ones to blame. As a result of what has happened, there is also an increased vulnerability to be targeted for further scam campaigns, such as fraud recovery scams suggesting they can help get any lost monies back.

There are a number of organisations available to offer their services to those who may be struggling with coming to terms with what has happened to them:

### Victim Support

An independent charity dedicated to supporting victims of crime and traumatic incidents in England and Wales. Can be contacted online or via their support line **0808 168 9111**.

### Think Jessica

A charity committed to protecting older people from fraud and scams. Visit: https://www.thinkjessica.com/ to find out more about the more common methods used by fraudsters to target the older generation, such as telephone scams, postal fraud and doorstep crime.

### The Samaritans

Can be contacted any time of the day or night and can offer the chance to speak to someone who understands, on **116 123**.

### Citizens Advice

If a scam has left a victim struggling financially, they can contact Citizens Advice. They can speak to an adviser to help find a way forward, via their Adviceline. They are available 9am to 5pm Monday to Friday. If in England call **0800 144 8848**. If in Wales call **0800 702 2020**.

### Citizens Advice Scotland

Citizens Advice Scotland runs a dedicated online scams advice service which offers free, confidential, impartial advice. The Scams Action Service also undertakes scams prevention work to identify, tackle and raise awareness of online scams. To report an online scam and seek advice, call the free helpline on **0808 250 5050** or get in touch with via the webchat option. Advisers can be contacted via either of these ways from Monday to Friday from 9am to 5pm

### Victim Support Scotland

Free, confidential help from Victim Support Scotland for individuals affected by a scam. Consumers can: call the Victim Support Scotland Helpline for free on **0800 160 1985** (Mon - Fri 8am-8pm)

# Beware of Fraud Recovery Fraud

Whenever someone falls victim to an investment fraud, or any type of scam where money has been lost, a key consideration should be the risk of future 'fraud recovery fraud'.

Sadly, fraudsters retain the details of their previous victims and will often target them again in the future for another scam. Fraud recovery fraud is a particular type of scam where the fraudsters falsely claim to be pursuing the perpetrators for the money lost to the investment fraud. They may convincingly pose as a financial institution's fraud team, a government agency, the police or a law firm. Ultimately, they require payment of a fee or trick the victim into disclosing banking information, allegedly to secure the reimbursement of the original money which was lost; however, this is simply a second stage to the original fraud.

Victims of an investment fraud should be extremely cautious of any future contact from someone purporting to be able to reclaim funds lost to a scam, as it is highly unlikely that an unfamiliar person will legitimately contact victims for this reason. The default assumption should be that this contact is likely to be from a fraudster. The victim should question where their contact details have been obtained from and should ensure they are able to authenticate that the contact is genuine by obtaining contact details for the organisation from an independent and reliable source.

Victims may refer to the following article for additional information on red flags for fraud recovery fraud: https://www.actionfraud.police.uk/a-z-of-fraud/fraud-recovery-fraud

## Other Online Safety Tips

### Choose secure passwords/pass-phrases

A secure password helps keep you safe online. It also helps identify you when you log in as part of a multi-factor authentication process. The key to your password being secure is its strength and memorability. If you are concerned about the security for any of your online accounts, please update your passwords immediately.

- Never use your PIN, name in any form (first, middle, last, maiden or nickname) and / or date of birth as your password.
- Putting together a few words or phrases makes a longer password that can be easier to remember.
- Use a combination of letters, numbers and special characters. Using less common special characters will help strengthen your password.
- Change your password regularly. There's no set rule on this, but the more frequent the better.
- Always use different passwords on key accounts that hold financial or personal information. This way, even if one password is compromised, your other accounts will remain protected.

### Visiting websites

If you have not visited a website before, spend some time investigating the 'About us' section. If it contains poorly written English this could be a red flag. You can also check a site's authenticity by researching it using a respected search engine or an established customer or business review site.

## Protect your computer:

Many of us see these vital tasks as being a bit of a pain. Yet they are essential to keeping individual's safe online. Here's how:

| Dos and Don'ts when using a computer | |
|---|---|
| **Do** | **Don'ts** |
| Keep your devices updated with the latest security patches and system software to guard against evolving threats. You can find out more from Microsoft† and Apple†. | Provide personal information into sites without first checking the FCA scam guidance https://www.fca.org.uk/scamsmart/warning-list. |
| Keep your antivirus software updated to reduce the risk of malicious software and viruses being installed on your computer. | Open attachments or download forms from an unsolicited email. |
| Your home Wi-Fi router is your online front door allowing your devices to connect to the internet, so it's really important that you keep this secure. One of the keyways to protect your router is to change the default admin password as the one set by the manufacturer can easily be discovered by attackers. | Assume that an advert on the internet is legitimate. Sadly, Google, Facebook/other social media platforms are used by fraudsters to target individuals. |

# 3. Cannabis related investment restrictions

## 3.1 Introduction

The risks surrounding cannabis related investment activity are complex and management of them depend upon each firm's own risk appetite and risk-based approach. There is, however, some useful regulatory and industry guidance available that can help firms identify the risks that they want to manage. This guidance document has been written for TISA members to support identification of risks, mitigating controls available and how to approach defence against money laundering under the Proceeds of Crime Act 2002 (POCA) in relation to cannabis investments. The guidance does not provide answers to which risks are acceptable or not. In the document there will be references made to higher risk and lower risk. If a risk is unacceptable will be up to each user to define.

The guidance is focused on UK based investment managers. International firms may need to consider relevant laws and regulations in their areas of operation and where their clients are located. To support the reader in terms of definitions around cannabis types and thresholds, a supporting cannabis taxonomy can be found in Appendix 1.

## 3.2 UK Legislative and Regulatory Landscape

*3.2.1 Recreational Cannabis*

Cannabis is a Class B drug and cultivation, possession or supply without a license is illegal. Under POCA, 'criminal property' is given a wide definition that includes property which represents a person's benefit from any conduct which would amount to a criminal offence in the UK if it were to occur in the UK. Profits made by an overseas recreational cannabis related business may therefore be regarded as 'criminal property', even if the firm is operating in a country where this business is legal. The Financial Conduct Authority (FCA) is the only government agency which has communicated a clear view on this subject, stating that "proceeds from recreational cannabis companies, even when they are located in those jurisdictions that have legalised it, are the proceeds of crime under POCA" (see https://www.fca.org.uk/news/statements/listings-cannabis-related-businesses).

A firm engaged in recreational cannabis cultivation is not admitted to listing on the Official List maintained by the FCA in its capacity as the UK Listings Authority in the UK.

*3.2.2 Medicinal Cannabis*

Medicinal cannabis cultivation and supply is legal in the UK since 2018 but only when operating with appropriate Home Office licences. Any firm engaged in cannabis related activities that does not hold such licence is committing a criminal offence. Cannabis related wellness products, such as CBD oils, may also be sold in the UK where the THC content does not exceed 1 milligram. The legal position of purely UK-based medicinal cannabis companies, and cannabis oil companies, is therefore clear. With the appropriate Home Office licence, a UK-based medicinal cannabis company can be admitted to the Official List.

The situation for overseas firms is more complex if they ***could*** qualify for the UK licence requirements, but if they do not have such a licence in place. Proceeds from overseas medicinal cannabis business ***may*** constitute 'criminal property' for the purpose of POCA, as it is currently unclear whether the dual criminality transposition test includes where the company possesses a licence issued by an overseas medicines or pharmaceuticals licensing authority. UK firms could

therefore technically be in breach of POCA if they invest in an overseas medicinal cannabis producer or supplier or if they facilitate such investment activities (e.g. as a financial institution, broker or investment house engaged in a client relationship, or allowing clients to invest in related stock).

There is no clear guidance available to clarify where the line goes between investments related to cannabis stock ***being*** criminal property or where it ***may*** be considered criminal property. UK investors in listed cannabis production/distributions companies, based in countries that have fully legalised the production, sale and use of cannabis, may be breaching UK's anti-money laundering laws.

## 3.3 Risks of investing in cannabis related stocks

It is a principle under s340(3)(a) of POCA that property is criminal if it "constitutes a person's benefit from criminal conduct or it represents such a benefit (in whole or part and whether directly or indirectly)". In theory at least, if only a small proportion of a business activity was cultivating cannabis in breach of UK laws, then the whole business could be tainted. Even so, and it is necessary for a firm to considers its own risk appetite, one can outline different types of investment and scenarios that are likely to be higher or lower risk of prosecution, regulatory action, or reputational damage. For ease this has been broken down into two areas; the nature of decision-making/regulatory activity concerned and whether the investment has been made on a primary or secondary market.

### *3.3.1 Active vs. passive decision-making*

One aspect to consider is whether the investment is undertaken in an active way. When there is an active investment, there is a decision taken by a representative of the firm to invest in a particular security that may fall foul of POCA. In such situations it may be considered that such active decisions result in higher risks compared with passive strategies.

The same logic could be applied to third party funds. Where a Fund A is investing itself in a Fund B which contains a security that may fall foul of POCA the link between Fund A and the potential criminal activity concerned may also be considered somewhat removed. There will also be the question of whether full visibility of all the underlying constituents of a fund is available.

In the case of direct instructions from clients to invest in a security that may fall foul of POCA, i.e. an "execution only" instruction, the position appears unclear whether allowing a client to undertake an activity that may fall foul of POCA is any different to the firm itself making such an investment decision. Where the security is to be held in a firm's custody the risks are likely to be higher than where custodianship is not provided.

The position regarding corporate actions is again likely to be nuanced due to the varying actions that can apply. However, it again appears reasonable to consider that if actively participating in a corporate action that results in exposure to a cannabis related security runs a higher risk than simply benefiting from a corporate action that requires no positive action.

### *3.3.2 Primary market or secondary market investment*

Whilst there is again no official guidance in this space, conceptually where investing directly in a security that may fall foul of POCA the risks are likely to be higher investing in the primary market than on the secondary market. Even though it can be argued that in both situations s327 and s328 of POCA applies it appears reasonable to consider that providing monies directly (in effect) to an entity that is falling foul of POCA is a higher risk than simply trading in the securities of the company on the secondary market and seeking to make profits from supply/demand factors.

## 3.4 Defence against Money Laundering

Legal commentators and member firms have proposed or reported establishing a cannabis investment strategy on the basis of one or a combination of the following defences and rationales.

Due to the lack of previous prosecutions for cannabis related investment activities, these proposed defences and rationales are untested and their inclusion below is not intended to provide assurance that they would provide a valid defence; firms should ensure they obtain proper legal advice before relying on any defence referenced below.

### *3.4.1 Adequate consideration defence*

POCA 329(2)(c) contains a defence to the section 329 offence of acquiring, using or having possession of criminal property where the property was acquired for adequate consideration. There appears to be a reasonable argument that the purchase of a cannabis related security for its fair value on a regulated market meets these requirements.

It could be argued that there is greater risk that the subsequent receipt of dividends or coupons from the issuer of the security would not be covered by this defence, either because of the view that this criminal property (the dividend/coupon payment) is distinct from the acquisition transaction and the payments have not been purchased for adequate consideration and/or due to the payment being received directly from a cannabis related company and therefore being at higher risk of being construed as criminal property. An untested response to this concern is that there is no such distinction between the transactions because the acquisition of the security includes acquiring the rights to benefit from it and these rights are a fundamental consideration when assessing its value.

A further potential issue with relying solely on the adequate consideration defence is that it is not available for the section 328 of entering into or becoming concerned in an arrangement which facilitates the acquisition, retention, use or control of criminal property by another person.

### *3.4.2 Production under license*

Another challenging area is the ambiguity surrounding the equivalence test for overseas licensing regimes. Under UK law, cannabis related activities would be deemed to be an offence if they took place in the UK. If the activities are licenced in the relevant country, they could be deemed equivalently licenced. However, there is only acknowledged equivalence for those that have explicitly applied for a UK licence.

Section 7 of the Misuse of Drugs Act 1971 permits the cultivation, production, supply and possession of cannabis if done under license or authority provided by the Secretary of State. The sale of cannabis under another country's licensing regime could therefore be argued to be equivalent and permissible. This is potentially more likely to be the case if the license is for medicinal rather than recreational purposes, but the argument has been made that there is scope for both as there is no judicial precedent for this test.

### *3.4.3 Suspicious Activity Reports*

Legal commentators and member firms have reported making use of the suspicious activity reporting regime as a defence when undertaken cannabis related investment activity, either to request a defence against money laundering or as a disclosure after an investment has come to light. The making of an authorised disclosure is a defence which is available for all three money laundering offences under POCA (s327(2), s328(2) and s329(2)) and it therefore appears to be a relatively common risk mitigation strategy reported by firms participating in cannabis investment activity.

The establishment of a SAR process for cannabis related investment transactions may be burdensome for the firm's nominated officer and internal staff, as each disclosure must relate to

specific activity/transaction(s). Firms may take a view on which types of activities warrant disclosure in this way.

#### *3.4.4 De minimis principle*

Notwithstanding section 340(3) of POCA (as referenced above), some firms may adopt an approach which incorporates materiality thresholds for practical reasons and as an application of the de minimis principle. For example, a firm may take the view that the de minimis principle renders investment into a company which only generates less than *x.x*% of its revenue from cannabis related activities or a fund with a large number of other portfolio constituents as presenting low legal or regulatory risk.

There are no known specific materiality thresholds for the purposes of cannabis related investment activities which have a rationale or basis in UK law.

#### *3.4.5 Placing reliance on FCA vetting*

It is noted that the FCA has adopted a policy of refusing to admit recreational cannabis companies to the Official List and assessing medicinal cannabis companies on a case by case basis. The FCA guidance issued in relation to firms allowed, or not allowed, onto the Official list, states that only firms where the FCA are "satisfied POCA does not apply and they otherwise satisfy the criteria for listing" will be granted admitted to the Official List, thus suggesting that investments in these firms would not constitute an offence under POCA.

#### *3.4.6 Pragmatic/purposive approach*

Some firms may have chosen to take a pragmatic approach based on the view that officially traded cannabis related investment activity is theoretically criminalised due to a quirk of the law rather than intentional public policy. As a result, there may be a perceived low likelihood of prosecution or regulatory action and some firms have chosen to impose limited or no restrictions on the cannabis related investment activity which it participates in.

The adoption of this approach may stem from considerations such as the lack of previous prosecutions, absence of definitive or consistent comment from government bodies on this topic, perceived public mood shifting towards tolerance (particularly in relation to medicinal usage), the high volume of public participation in cannabis related investment activity and the view that any prosecution is unlikely to be in the public interest. However, any firms taking this view should consider whether there are any implications from the FCA's statements on cannabis related investments.

### 3.5 Navigating a Risk Based Approach

With the legal and regulatory picture around investment in cannabis related stock remaining unclear, many financial institutions navigate a carefully considered risk-based approach to cannabis investment. There are many nuances in the potential type of exposure to cannabis investment which will impact the level of risk faced.

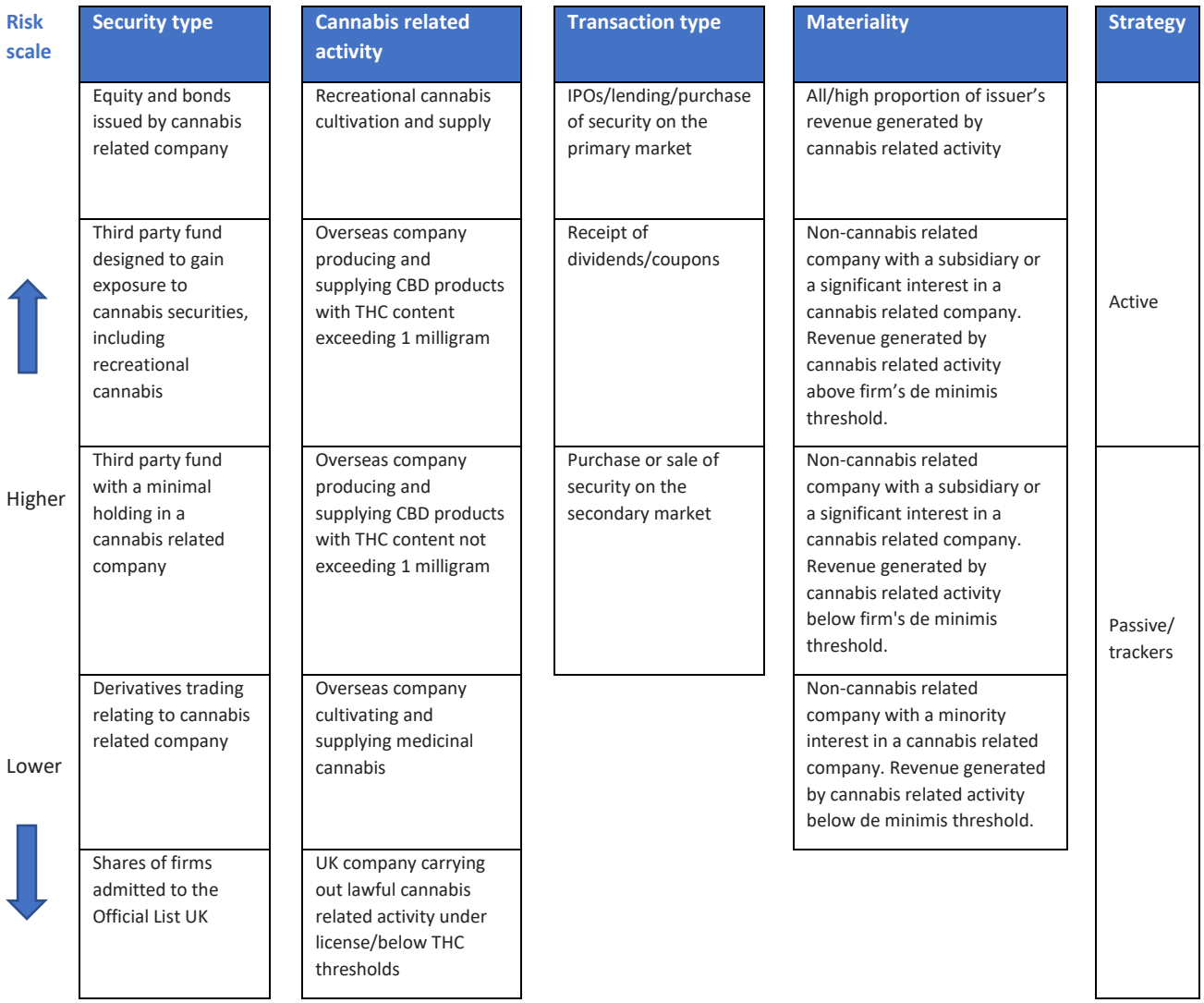
A firm may choose to respond to this topic in accordance with its risk-based approach in the following ways:

- Carrying out an assessment of the types of investment activity the firm engages in where there may be exposure to cannabis, whether as part of its AML risk assessment, a standalone risk assessment process or via another method. This may include an analysis of the firm's existing investment holdings, its fund or investment product objectives, the

markets or jurisdictions which it invests in, its investment teams' strategies or its client types (where clients trade in individual securities on their own account).

- Development of a 'house view' on the topic in light of the available legal and regulatory guidance and any relevant reputational considerations, including: forming a judgment on what is or is not permitted or is at a higher risk of being deemed illegal; any risk management processes or available defences, such as when a SAR should be filed; whether to impose any firm-wide prohibitions; and the use of any materiality thresholds. Appropriate escalation and approval of the house view by senior management, if relevant.
- Incorporation of the house view into company-wide policies, procedures and training, including general education on the issue and any obligations which staff have, such as complying with a ban on specific activities or submitting internal SARs.
- Incorporation of the topic into the firm's external SAR reporting procedures.
- The use of internal or externally sourced data on securities where there is exposure to cannabis-related activities and using this data for pre-trade, post-trade or periodic screening against investment holdings.
- Agreement on the way in which the firm's house view will be communicated to clients, if relevant, including in any terms and conditions or due diligence questionnaire responses.
- Consideration of any due diligence which should be performed on any key third party relationships or relevant contractual provisions inserted; for example, where investment management is delegated.
- Ongoing monitoring of the evolving legal and regulatory picture around this topic, including output from government bodies, trade associations and legal bulletins.

### *3.5.1 Potential risk scale*




| Security type | Cannabis related activity | Transaction type | Materiality | Strategy |
|---|---|---|---|---|
| Equity and bonds issued by cannabis related company | Recreational cannabis cultivation and supply | IPOs/lending/purchase of security on the primary market | All/high proportion of issuer's revenue generated by cannabis related activity | Active |
| Third party fund designed to gain exposure to cannabis securities, including recreational cannabis | Overseas company producing and supplying CBD products with THC content exceeding 1 milligram | Receipt of dividends/coupons | Non-cannabis related company with a subsidiary or a significant interest in a cannabis related company. Revenue generated by cannabis related activity above firm's de minimis threshold. | |
| Third party fund with a minimal holding in a cannabis related company | Overseas company producing and supplying CBD products with THC content not exceeding 1 milligram | Purchase or sale of security on the secondary market | Non-cannabis related company with a subsidiary or a significant interest in a cannabis related company. Revenue generated by cannabis related activity below firm's de minimis threshold. | Passive/ trackers |
| Derivatives trading relating to cannabis related company | Overseas company cultivating and supplying medicinal cannabis | | Non-cannabis related company with a minority interest in a cannabis related company. Revenue generated by cannabis related activity below de minimis threshold. | |
| Shares of firms admitted to the Official List UK | UK company carrying out lawful cannabis related activity under license/below THC thresholds | | | |

## 3.6 Investment restriction support (data, lists and screening)

As part of a firm's risk-based approach consideration can be made to whether a screening solution of cannabis related securities in their client portfolios is a control that would help mitigate relevant risks. To support this process, data in the form of cannabis related issuers and securities are available from several market data and specialist vendors. These lists should ideally provide a granular view on the type of security, classification, associated reference data, listing information and the type of cannabis related activity affecting the issuer of the security.

Data on cannabis related issuers and securities is mainly used for:

- Pre-trade clearance to restrict trading of the restricted securities;
- Post-trade audit to ensure no restricted security has been traded;
- Issuer or counterparty profiling for flagging of risks such as money laundering risk.

The handling of cannabis related securities varies across the settlement and asset servicing chain; some service providers will publish their own guidance and lists which investment firms would need to incorporate into their investment restrictions process; this is typically done within the pre-trade clearance workflow. Revisions to these restriction lists are quite common with newly identified securities frequently added to the lists. Upon restrictions becoming effective, investment firms holding the restricted securities in custody may be able to continue holding the securities, generally without a specific deadline for divestment or transfer. They will, however, not be able to have new trades in the restricted securities settled or have new trades transferred into custody.

Firms may look to maintain a continual monitoring process with several datasets potentially forming the universal view on the securities to restricted. Once established this view should be centralised so that front office functions, compliance, legal, risk and operations can have a synchronised data view. However, as firms are required to conduct their own risk-based assessment, it is possible that some securities could be excepted from restriction and therefore traded on this policy-based exemption; in these cases, firms should maintain a register with clear details on the exemption and related securities.

## Appendix 1 – Taxonomy

Cannabis belongs to a genus of flowering plants known as Cannabacea; the exact number of species in the genus is disputed but three species are widely recognised: *Cannabis sativa*, *Cannabis indica*, and *Cannabis ruderalis*; *C. ruderalis* may be included within *C. sativa*; all three may be treated as subspecies of a single species, *C. sativa*; or *C. sativa* may be accepted as a single undivided species.

Various types of Cannabis have been described, and variously classified as species, subspecies, or varieties; dependant on the chemical properties of the strains, these can be summarised as:

- **Cannabis** (also known as **Marijuana**), which includes plants cultivated for drug production, described as high-intoxicant or drug types; these strains contain high levels of Delta-9-Tetrahydrocannabinol (THC), the psychoactive component which produces the 'high' that is experienced by users of Cannabis. Cannabis is mainly grown and used for medical or recreational purposes.
- **Hemp**, which includes plants cultivated for fibre and seed production, described as low-intoxicant, non-drug, or fibre types; generally associated with a low THC component (less than 0.3%) and material quantities of Cannabidiol (CBD), which is a non-psychoactive cannabis compound. Hemp is mainly grown and used for industrial purposes.
- Other forms include those that are classified as escaped, hybridised, or wild forms of either of the above types.
- The uses of Cannabis can be classified into three distinct categories: **Medical Cannabis** use is based on the plant or chemical compounds contained within Cannabis to treat a range of diseases and conditions; essentially the product is the same as for recreational use but taken for medical purposes – with the main difference being that medical cannabis has a higher CBD content than recreational cannabis.
- **Recreational Cannabis** use is based on seeking the psychoactive effects of cannabis for pleasure. Users can become dependent on or addicted to cannabis, just as someone can with alcohol and tobacco. A person is deemed to be dependent on marijuana when they have withdrawal symptoms; and is considered addicted to the drug when the drug use interferes with aspects of their and they cannot stop the use.

- **Industrial Hemp** is used to make a variety of commercial and industrial products, including rope, textiles, clothing, shoes, food, paper, bioplastics, insulation, and biofuel.

## Appendix 2– Useful links

https://www.fca.org.uk/news/statements/listings-cannabis-related-businesses

https://www.gov.uk/guidance/controlled-drugs-industrial-hemp

https://www.fca.org.uk/publication/ukla/fca-tn-104.1.pdf

2021/06/28 UK Life Sciences and Healthcare Newsletter | Medicinal Cannabis in the UK: Fund Structuring, Investment and Listing Considerations (dechert.com)

More than puff and smoke: UK poised for cannabis boom but mind the POCA position - Lexology

Cannabis and the UK investor – two years on | Criminal Law Blog | Kingsley Napley

High return, high risk? AML risks arising from investment in the cannabis industry - Lexology

Green Signal! Proceeds with caution - 2 Bedford Row

A Green Light for Business? The Rescheduling of Cannabis-Derived Medicinal Products and the UK's Anti-Money Laundering Regime – BCL Solicitors LLP

Turning over a new leaf: Cannabis, UK investors and the Proceeds of Crime Act 2002 - Macfarlanes

Cross-Border Cannabis Investment: Managing Money Laundering Risk | White & Case LLP (whitecase.com)

# 4. Anti- Money Laundering Transaction Monitoring

## 4.1 What is transaction monitoring?

The purpose of this section of the guide, is to provide guidance and good practice examples for TISA members in relation to financial crime related transaction monitoring, other than in respect of market abuse. Its aim is to help support such institutions in developing a framework to meet the requirements for ongoing monitoring enshrined in the FATF recommendations and Money Laundering Regulations.

Due to the scale, nature and complexity of TISA members and their different business lines it is of course inappropriate and practically impossible to describe what particular monitoring may be required in any given situation. Firms should take their own risk-based approach (RBA) using if wished this guidance as a tool to create an overall effective framework.

For the purposes of this paper, transaction monitoring (TM) is defined in line with UK legislation, namely, it is the scrutiny of transactions undertaken throughout the course of the relationship (including, where necessary, the source of funds) to ensure that the transactions are consistent with the firm's knowledge of the customer, the customer's business and risk profile.

At a high level, TM involves identifying changes in behaviour (including anticipated behaviour) in respect of a client. This supports both compliance with money laundering legislation and identifying fraudulent activity. A firm may also wish to use TM to capture other events that are relevant to anti financial crime considerations – these may be internal or external events. Taking this wider approach is likely to result in a stronger monitoring framework.

TM may be wholly manual in nature (people) or "automated" with then some manual involvement typically being required.

## 4.2 Risk based approach

It is the responsibility of each individual firm to take appropriate steps to assess the money laundering and terrorist financing risks faced by their business and establish proportionate policies, procedures and controls. The business risk assessment required under the Money Laundering Regulations should form the basis of a firm's RBA to transaction monitoring.

The nature of monitoring will vary considerably across firms depending on the nature, size and complexity of their business, as well as the risks to which they are exposed. Industry guidance requires the consideration of risk factors such as customers; geographic area of operation; products or services offered; transactions; and delivery channels. When assessing the risks that are relevant to their approach to monitoring customer activity, TISA members should consider factors such as:

- The nature of relationships with clients, for example the use of introducers and the level of relationship management;
- The extent to which clients can get access to their funds and the method(s) by which that can occur; and
- The ease with which clients can transact or make changes to their portfolio.

These factors are covered further in Section [4].

Following completion of an assessment of their specific risks, firms should adjust the intensity and frequency of monitoring as required:

- In situations of elevated risk, it is probable that more frequent or intensive TM should occur;
- Conversely, in situations of low risk, more limited TM may be deemed satisfactory.

In line with regulation, higher risk client relationships require enhanced ongoing monitoring. The approach to TM for different risks should be documented.

The approach to TM should remain current and be flexible to adapt to changes in risk. Firms should consider a regular refresh based on a defined minimum periodicity or trigger changes in both the:

- External risk environment - for example obtaining intelligence on the evolution of a new criminal typology impacting investment products or an update of the UK National Risk Assessment of Money Laundering[1]; and
- Internal risk environment – for example introduction of a new online only product or expansion of operations to a new jurisdiction.

[1] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/945411/NRA_2020_v1.2_FOR_PUBLICATION.pdf

### 4.3 Manual vs. automated monitoring

When determining a monitoring approach, firms should consider whether they will conduct TM manually, undertake automated TM or a combination of both. Where a high volume of transactional activity is expected, it is likely that an automated system will be required due to the operational challenges in appropriately reviewing large-scale client activity on a timely basis.

Regardless of which approach to monitoring is used, appropriate training should be delivered to all staff who manage clients and their transactions or perform support functions to allow them to recognise what is unusual activity and maintain awareness of what to remain vigilant for.

While this guidance does not cover the maintenance of keeping customer information up to date, it is also important to remember that any approach to monitoring is only as effective as the quality of the underlying customer information. If this information is incomplete or out of date, it may be more difficult to identify unusual or ultimately suspicious behaviour.

When considering an automated system, firms should take note of the questions included in the JMLSG guidance to aid their selection process[2]. In addition, as many solutions were primarily developed for banks or credit institutions which represent a differing risk profile, TISA members will need to assess whether the system typologies are relevant for their products and client transactional activity. Where an automated system is used, firms should ensure they regularly review rule effectiveness and have sufficient resources to manage alerts.

[2] https://jmlsg.org.uk/guidance/current-guidance/

### 4.4 Nature of relationship

Considering and understanding the different types of relationship can help identify potential “red flags”. Having an understanding of the expected behaviours of a client and the r transactions arising and then for variances against these will help identify potentially suspicious transactions. Monitoring for transactions that are not in keeping with the life expectancy of the product is relevant to most

arrangements, be it disinvestment in a short period of time or the unexpected repayment of credit product early.

#### *4.4.1 Relationship Managed*

It is recommended that those clients who are relationship managed should be monitored by the relationship manager. This is because the relationship manager should have the greatest understanding of the client and their expected behaviours. Clients who have incoming and outgoing transfers, for example, whether of cash, investments or other assets, should be reviewed by the relationship manager or their delegate prior or as soon as is reasonably practicable after the transaction, dependent on the firm's risk-based approach.

Dependent on the firm's maturity, the relationship manager could provide assurance to the firm on a regular basis, that they are conducting appropriate and effective oversight of clients and nothing suspicious has been identified, if no reports have been escalated to the financial crime team for investigation. Likewise, a positive return should also be confirmed.

#### *4.4.2 Direct clients*

For those relationships which are not relationship managed, or introduced by an entity which is not regulated, present their own challenges. Firms should consider the risk related to the extent to which the business relationship is conducted on a non face-to-face basis. The Joint Money Laundering Steering Group (JMLSG) suggests key elements of any transaction monitoring system are having up-to-date customer information, on the basis of which it will be possible to spot the unusual and asking pertinent questions to elicit the reasons for unusual transactions or activities in order to judge whether they may represent something suspicious.

#### *4.4.3 Online Only Customers*

Online customers are unlikely to have met an employee of the firm which creates additional issues (e.g., customer impersonation/identity theft). In such cases since there is less likely to be a detailed understanding of the client's background and aspirations etc monitoring is likely to revolve around changes in behaviours and activities out of pattern for clients who use the particular product.

Transaction monitoring may therefore include the monitoring for large sums over a set threshold; whilst being a little presumptuous, firms would naturally expect clients who wish to invest large sums to be introduced by advisors or wealth managers potentially. Similarly, when a PEP has been identified, consideration should be conducted to ascertain if there are ulterior motives to take a direct to client route. These may include further investigation into the source of funds for example.

Due to the remote nature of online customer relationships, close monitoring of transactions could be conducted, requesting reasons for an increase in amounts invested. Firms could establish the rationale behind any unexpected ad hoc payments made or requested by the customer. Further information is also provided in Section [8] below.

#### *4.4.4 Telephone/email*

The ability to transact by email and telephone presents its own risks in respect of how a firm can be confident they are dealing with the client and the request is legitimate. Similar monitoring could be conducted to that of the online route, including monitoring behaviours and for example, considering sudden withdrawal requests into new bank accounts. To combat and identify possible activity of concern, a firm's monitoring programme may include the review of recent account/policy closures following an update of a policy marked 'Gone Away'. Accounts identified has high risk for fraud should be monitored. This could be in 'real time' in that any activity conducted on specific policies is escalated for approval where the client's status is for example set to 'Gone Away'/'Mail Returned.

#### *4.4.5 Advisory firms*

Whilst some firms may have clients who are introduced by an advisor firm, other firms may have clients who are advisers (under the "agent as client rule"). Clients introduced by advisors should be monitored in a similar manner as to direct clients, with the difference being that the adviser could be engaged to understand the reasons for transactions on behalf of the client, on the proviso there is no tipping off risk present in the scenario. Where the adviser is the client, similar engagement could be conducted. However, it is essential that there is an understanding how the advisor will use the product and the expected scale of business. The first line business, who has the relationship with the advisor, could implement a monitoring regime based on identifying unexpected transactional behaviours. Engaging with the advisor is important and key understanding of underlying investors transactional behaviours is vital.

How to monitor customer activity is described in more detail in Section [5].

### 4.5 Monitoring customer activity

A firm's monitoring framework should be based upon a firm's own assessment of client risk at the initial onboarding stage. However, firms should subsequently be considering the ongoing review of specific risk factors which represent those areas of risk which are applicable to the firm. These areas for consideration can be categorised as:

- the initial client onboarding process and assessment of the client risk type;
- transactional;
- client behavioural changes;
- identified negative media; or
- contact from external parties (e.g., regulators or government bodies)

The below sub-sections contain a summary of each of the areas of consideration. Examples of potential monitoring activities are shown in the table in section 8.

#### *4.5.1 Transactional activity*

Ongoing monitoring of transactions is key to identifying unusual activity and should be performed throughout the lifecycle of the client relationship. By performing ongoing monitoring, a firm is better placed to continually know and understand who the customer is and to re-assess any risk factors that exist by maintaining the client relationship. Monitoring can include several factors, but typically will incorporate the following elements:

- source of funds;
- specific monetary thresholds;
- AML geographical risk assessment requirements;
- destination or receipt of funds;
- frequency of transactions compared to value;
- complex or unusual pattern of transactions; and
- parties to a transaction

Transactional monitoring can be conducted at an individual client level comparing possible changes over a specific period of time, or by examining a group of similar clients (peer group).

### *4.5.2 Behavioural activity*

A firm's monitoring programme should not only focus on the transactions conducted by a client, but also regularly examine other client behaviour.

Behavioural monitoring should be used to identify possible changes which could signify unusual or potentially suspicious behaviour which includes but is not limited to the following:

- amendments to static data within a short period of time;
- high risk factor static data changes;
- reactivation of dormant accounts;
- failure to complete telephone security successfully;
- second party fraud attempts - possible evidence of vulnerability;
- victim of fraud with another institution;
- requests for information from third parties and or law enforcement;
- customer's use of the chosen product and how this behaviour compares to other clients; and
- accessing of online accounts outside of a known geographical location of the client.

Behavioural monitoring should be used in conjunction with the transactional monitoring component to build a more informed picture of the client and any associated risks.

### *4.5.3 Negative media and other sources*

Alongside the transactional and behavioural elements, firms should also consider the use of additional sources such as:

- negative media;
- fraud screening (e.g., CIFAS); and
- monitoring of registers for deceased individuals.

The use of negative media and or other sources can provide a firm with an additional proactive element to an overall monitoring programme. Screening of this nature can also support a broader array of topics including fraud prevention and anti-bribery and corruption programmes managed by the firm. In all cases, a firm will need to consider the parameters that will be set to perform such searches to avoid unnecessary false alerts. As a minimum a firm may wish to consider:

- the types of clients and the particular risks that they may represent, that will be subject to screening, comparing to AML typologies applicable to the firm where these are available;
- how such screening will be performed (e.g., automated versus manual) and if a specialist vendor is required;
- which function will review the output of any screening performed; and
- determine the action to be taken when an alert is identified (e.g. suspicious activity reporting, possible exiting of a client relationship, system markers and enhanced monitoring etc.).

#### *4.5.4 Contact from external parties*

Formal requests for client information can take a number of forms including:

- court orders;
- production orders; and
- bankruptcy.

Court Orders can be raised for a variety of reasons and they do not always relate to a financial crime concern. Many orders are for civil matters and can be handled accordingly.

However, any order that insinuates criminal activity, police involvement or makes specific reference to Proceeds of Crime Act, should act as an immediate prompt for specific monitoring to be conducted on the client account in question.

### 4.6 Periodic review of TM framework.

As part of each firm's business wide risk event, the transaction monitoring framework should be subject to appropriately frequent review in order that it continues to meet your business risk profile, and should consider various factors, for example have any of the following have occurred since the last review?

- Material changes to Regulations or Industry Guidance;
- Peer firms subject to Significant adverse findings or fines for money laundering failures;
- Negative findings identified in any independent monitoring;
- Changes to internal systems or controls;
- Launches of any new products or services, or changes to your client demographic.

And, in terms of the firm's monitoring controls and processes:

- Where thresholds or alert rules apply, are they still appropriate for the current products, client types and firm risk appetite?
- When was the last time the framework was subjected to end-to-end testing to ensure it was working as expected?
- Where processes rely on human intervention, how well documented is that process and are staff adequately trained to perform them?

This is not an exhaustive list but demonstrates that there are a wide range of considerations to make the review successful.

Upon completing such a review, the outcome and any decisions must be fully documented and retained for future reference.

### 4.7 Sources and further reading

- JMLSG Part 1 – 5.7 Monitoring Customer Activity;
- UK National AML Risk Assessment;
- FCA Financial Crime Guide; and
- FATF Recommendations.

## 4.8 Transaction Monitoring – Practical examples

The below tables contain examples of transaction monitoring activities / actions that TISA members may wish to consider for each of the monitoring areas outlined in Section 5. Members must remain aware that these are only examples and do not on their own represent an 'off-the-shelf' approach or recommended framework. Monitoring should be based on a firm's business risk assessment and aligned to members own risk-based approach using either automated or manual monitoring. Equally, thresholds should be determined based on expected client behaviours – remember that the aim of the monitoring is to pinpoint something outside the normal of typical client behaviour. Finally, monitoring activities may be tailored to the risk rating of clients, for example, a value threshold for cash withdrawal may be lower for higher risk customers.

### *4.8.1 Transactional Activity*

| Monitoring theme | Example monitoring activities | Automated / Manual |
|---|---|---|
| **Specific monetary thresholds** | • Ad-hoc cash withdrawals above a percentage of value other than on death.<br>• Ad-hoc cash withdrawals above a value threshold dependent upon a firm's risk appetite in the early stages of a relationship | • Automated<br>• Manual |
| **AML geographical risk assessment requirements** | • Ad-hoc cash withdrawals above percentage or value thresholds to high or very high-risk countries.<br>• Occasional transactions involving jurisdictions on high risk third country list, if during CDD the client was not identified as established in the country.<br>• Additional investments are made a long distance from where the account was originally opened and/or the address registered on the account. | • Automated |
| **Destination or receipt of funds** | • Payment attempts to accounts other than nominated account or where bank account is not verified.<br>• Overseas payments - in or out - from non-UK sort codes or other non-standard payment types.<br>• Conflict of interest checks on lending investment. | • Automated<br>• Manual |
| **Frequency of transactions compared to value** | • Series of connected transactions that appear to be structured to avoid hitting | • Automated<br>• Manual |

| | | |
|---|---|---|
| | value thresholds.<br>• Cumulative thresholds on investment. | |
| **Complex or unusual pattern of transactions** | • Money paid in and then immediately taken out if not appropriate for the product.<br>• Cash receipts and payments out of equal amounts (within 5% variance) in a 3 month period.<br>• Transfers in received and then transferred out of equal holding in a 3 month period.<br>• Routing a payment in a convoluted direction rather than direct to nominated bank account.<br>• Unexpectedly taking money out of a product early, particularly a fixed term product. | • Automated<br>• Manual |
| **Parties to a transaction** | • Third party payments in or out of high value or volume.<br>• Large number of payments from different investor accounts into single bank accounts.<br>• Unexplained payments from a third party.<br>• Payments to employee bank accounts.<br>• Payments from unconnected client accounts to the same bank sort code / account number. | • Automated<br>• Manual |
| **Unexpected transactions** | • Ad-hoc withdrawals made within 6 months of an investment.<br>• Rapid exit of investment product.<br>• Full surrenders/ account/ service closures within 2 years of commencement other than on death. | • Automated<br>• Manual |
| **Unexpected account activity** | • Further investment or withdrawals at values inconsistent with customer's prior | • Automated<br>• Manual through |

| | | |
|---|---|---|
| | account activity.<br>• Payments lodged into an existing product above that indicated at account opening or out of line with evidenced source of funds. | training to report unexpected transactions |

***4.8.2 Behavioural Activity***

| Monitoring theme | Example monitoring activities | Automated / Manual |
|---|---|---|
| **Amendments to static data within a short period of time** | • Postal or e-address mail change with subsequent new regular or ad-hoc withdrawals within 3 months.<br>• Changes to one or more of the following within 30 days: i) address; ii) online access; iii) new device connected to existing online access; iv) new phone number; v) new email address; or vi) new bank mandate. | • Automated<br>• Manual |
| **High risk factor static data changes** | • Change to bank mandate, particularly where follows a static data change that may result in redirection of confirmation or approval.<br>• Address changes involving a move to a high risk or previously unconnected country.<br>• Address change to a potentially higher risk scenario such as a prison address or a PO Box. | • Automated<br>• Manual |
| **Reactivation of dormant accounts** | • Dormant accounts suddenly transacting in high volumes over a short period of time.<br>• Changes to one or more of the following within 30 days prior to reactivation: i) address; ii) online access; iii) new device connected to existing online access; iv) new phone number; v) new email address; or vi) new bank mandate. | • Automated<br>• Manual |
| **Failure to complete security** | • Multiple failures to authenticate online | • Manual |

| | | |
|---|---|---|
| **checks successfully** | leading to the addition of a marker or a block on access until reaccreditation.<br>• Failed phone authentication resulting in the issue of a security concern letter to a trusted address - where possible place marker against account to track any further failed telephone security checks. | • Automated (online) |
| **Second party fraud attempts** | • Known individual attempting to pass themselves off as the account holder – may be an indicator of vulnerability. | • Manual |
| **Victim of fraud with another institution** | • Bank account compromised - informed by customer or banking provider.<br>• Changes to static data. | • Automated<br>• Manual |
| **Requests for information from third parties and or law enforcement** | • Court orders or freezing orders.<br>• Subject access / witness statement request from HMRC Investigation Officer Organised Crime Operations | • Manual |
| **Accessing of online accounts outside of a known geographical location of the client** | • Monitoring of accounts for which the IP address accessing online services differs geographically from the registered address for correspondence.<br>• Device ID or geo-location on mobile access differs from known device or location of the customer. | • Automated |
| **Identification of negative media** | • Review activity of the client to determine if behaviour sits outside the firm's risk appetite<br>• Identification of source of funds to determine if proceeds of crime could be held | • Automated<br>• Manual |

- FATF Typology reports https://eurasiangroup.org/en/fatf-typology-reports

# 5 Anti Bribery & Corruption (ABC) Guide

## 5.1 Introduction

Bribery and corruption are among the most common risks facing global organisations in all sectors, and penalties for failure are increasing. The UK Bribery Act has been in force since 2010 and global anti-bribery legislation continues to be strengthened, requiring improved internal controls to ensure compliance.

The majority of financial services organisations have well established procedures for preventing money laundering, terrorist financing and fraud. This guide will facilitate organisations' implementation of sound anti-bribery and corruption systems and controls. Financial crime in all forms remains a continuous area of vulnerability for organisations and much of the work required for an effective control system is common to all areas.

Companies will design their anti-bribery programme according to their circumstances (internal and external environment) and risk appetite. This guide offers a template for TISA members to ensure their policies and procedures follow best practice and provides a basis for comparison. Companies may wish to incorporate the template/assessment into their broader risk assurance activities.

## 5.2 ABC Framework

### *5.2.1 Governance and Management Information*

The objective is to establish and maintain an ABC programme that sets the standards for appropriate behaviour and ethical business practices.

### *5.2.2 Culture / tone from the top*

Commitment by the board and senior management to a policy of prohibition of ABC is the bedrock for countering ABC. The board and senior management should make a public commitment (website) to prohibiting bribery and corruption in the company's operations.

The board should commit to supporting the implementation of an ABC programme, by:

1. Providing oversight; and
2. Assigning a senior manager to implement the programme.

In doing so, the board should inform themselves of the risks and appropriate policies and procedures required; a record of this should be documented within the board minutes.

### *5.2.3 Senior Management sponsorship*

Senior Management (and the SMF responsible) should give substance to its zero-tolerance policy by supporting the implementation of an ABC programme by:

- A commitment to support the implementation of the programme is made formally with written approval by the board;

- Management designing, reviewing and improving policies and procedures based on regular risk assessments; and
- The board providing oversight to the ABC programme and assigning senior manager clear responsibility for its implementation via their statement of responsibilities.

In a small company the distinction between governance and management roles may need to be modified, with owners or executive directors taking a more hands-on role in the company's anti-bribery activities.

***5.2.4 Roles & responsibilities***

**Chief Executive Officer:**

Responsibility for ensuring the corporate integrity culture and implementation of the anti-bribery programme should be with the CEO.

The CEO should be accountable to the board and should ensure that responsibilities are assigned across the company for implementing the programme.

The CEO should provide tone from the top and it should be the aim of the CEO and senior management to embed the programme in the company such that every manager and employee accepts a personal commitment to the programme and its effective implementation.

**Compliance Officer:**

The CO is responsible for the day-to-day operation of compliance. In large companies, functional responsibility for the programme is commonly assigned to a CO but can often be placed in legal and occasionally in internal audit or risk management. The CO must consider how best to build a team structure to launch, implement and monitor ABC.

In a large company, the CO will be responsible for a network of compliance officers, located throughout the business. In small companies the compliance function may be only part of the job of a human resource professional, a legal officer or finance manager.

The CO should have responsibility for leading the design and implementation of all aspects of the ABC programme.

The CO must be a person of integrity and command the respect of employees.

The CO's responsibilities may include the design and provision of ABC communications and training.

The compliance function should provide reports to management and the board on:

- the implementation of the programme;
- results of risk assessments;
- emerging practices, issues and concerns; and
- recommendations for improvements or additional resources.

The reporting line for the CO is a significant decision for the board. Best practice is for the CO to report directly into the board or a board committee such as an integrity, audit, risk or compliance committee.

The Officer should make regular written reports and presentations to the board meetings, and this could be as often as every quarter.

**Legal function:**

The legal function has a key role in implementing the ABC programme, advising the board on the legal context for bribery and corruption and related/emerging laws and regulations. The function should be responsible for ensuring that the company has procedures in place for monitoring relevant laws in the jurisdictions in which it operates, and for ensuring that the company is compliant with them. It should also ensure that the programme meets the requirements of data and privacy laws in its due diligence.

**Other functions:**

Other roles may include:

***Ethics Officer***: The role may sometimes be combined with that of the CO. The ethics officer's role will be to develop and communicate the company's commitments to ethics and values and build an ethical culture across the company. Activities will include communications and publications, contributing to training on ethics, anti-corruption and conflicts of interest. The ethics officer may also act as an adviser and counsellor to employees on ethical concerns.

***Human resources:*** The human resources function has a critical role in the design of the anti-bribery programme including organisational and personnel planning.

***Internal audit*****:** Internal audit can provide advice on the design and monitoring of the anti-bribery programme, audit the design and effectiveness once implemented and function as a speak up channel.

***5.2.5 Independent review of programme***

Oversight can be carried out directly by the board, but more often it is through a board committee such as risk or audit. The committee should provide an independent review, and this will be achieved by the composition of its members being all or mostly non-executive directors. Many companies have formed compliance committees to provide increased focus on the anti-bribery programme.

The committee should be a means of providing the board with confidence that oversight is being carried out expertly and carefully but should not substitute for the board's responsibility to provide oversight. The board must be provided with appropriate and timely management information to draw its own conclusions.

## 5.3 Assessing bribery and corruption risk (risk-based approach)

The ABC programme should be informed by periodic risk assessments to ensure that the programme is proportionate to the organisations:

- Location;
- Size;
- Industry; and
- Products and services.

In order to determine the scope of the assessment at the appropriate level, an initial pre-assessment exercise may identify the high-level topics which will then be used to assess each business area. For example:

- UK vs EMEA vs Global assessments. Global assessments are likely to have more geographical risk variables;
- The types of service a firm may offer e.g. traditional asset manager vs. a more diverse business;
- Legacy business areas that need to be take into account which, may have a different risk profile.

A single set of questions and scope should be used for each for each business area assessed to ensure consistency of outcomes.

### *5.3.1 Assessment methodology*

A prescribed list of questions under topic headings such as Nature of Operations, Geographical factors etc., emailed to stakeholders for completion may be an effective use of time but may not be particularly robust unless stakeholders are highly engaged and understand what the objective of the exercise. A series of interview style sessions, although potentially time consuming and resource intensive, can provide for more robust outcomes.

Key considerations in performing the risk assessments of each business area are:

- Legal and regulatory landscape and it's implementation/enforcement within different jurisdictions i.e. FCPA;
- Jurisdictional risk which includes:
    - the organisation's footprint in that country, including size, product and customer type/industry.
    - the country's risk, based on perceived levels of corruption highlighted by country reports and corruption league tables published by reputable organisations ie Transparency International;
- Third party relationships and due diligence (incl. intermediaries);
- Regulated vs unregulated 3rd parties;
- Subsidiaries;
- Acquisitions, joint ventures and mergers;
- Physical assets business e.g., Real Estate;
- Gifts and Hospitality, political contributions, sponsorships, charitable donations and the applicability of the associated policies to the business area;
- Risk of customer/client facilitation and / or a customer or client laundering the proceeds of bribery & corruption; and
- How the assessment designed to articulate whether the risk is inherent or residual.

The risk assessment may identify any gaps or area(s) for improvement, some examples of which are:

- Inconsistent implementation of 'global' policies;
- Lack of awareness among staff;
- Previously acquired businesses that are not fully integrated; and
- Additional controls that are required to lower residual risks to bring within the firms' risk appetite.

The risk assessment process should have appropriate governance with an appropriate Committee or other governance group reviewing and and challenging the process and outcomes.

Any actions identified to improve the control environment and lower the residual risk should be tracked to completion with regular reporting of process to the governance body appointed with oversight of the process.

## 5.4 Policies and Procedures

### *5.4.1 Documented, risk based, policies and procedures*

Effective, embedded policies and procedures are an essential element in Anti Bribery and Corruption compliance. The Act provides a defence where the organisation can prove it had in place adequate policies and procedures to prevent bribery occurring on its behalf.

An organisation's procedures to prevent bribery, by persons associated with it, should be proportionate to the bribery risks it faces and to the nature, scale and complexity of the organisation's activities. Such policies and procedures may be stand-alone or integrated with other related policies and procedures.

The Ministry of Justice has produced guidance on adequate procedures and has developed six 'principles' to enable firms to develop their policies and procedures considering:

1. -Proportionality
2. -Top Level Commitment
3. -Risk Assessment
4. -Due Diligence
5. -Communication
6. -Monitoring and Review

Demonstrating policies to staff, supported by effective and robust policies and procedures, enables staff to understand the issues involved, what it means to them and what they can do to prevent bribery and corruption within their area of responsibility.

Good practice includes senior management leading by example by complying with the firm's anti bribery and corruption policies and procedures.

Policies should include:

- The firms approach to reducing and controlling the risks of bribery;
- Rules about accepting gifts, hospitality, or donations;
- Guidance on how to conduct business, e.g., negotiating contracts;
- Rules on avoiding or stopping conflicts of interest; and
- Recruitment and staff: staff working in areas of the business or positions identified as a higher risk should be subject to enhanced vetting process in comparison to staff in positions identified as a lower risk of a bribery and corruption perspective. The should also be a process/policy detailing the firm's approach to managing conflicts where staff are recommended by a client. If employment agencies are used, processes should be in place to ensure that they adhere to the appropriate vetting standards.

Staff responsible for implementing and monitoring anti-bribery and corruption policies and procedures should have adequate levels of anti-corruption expertise.

***5.4.2 Remuneration structures***

Policies should take into account good compliance behaviours, and not exclusively reward for revenue generation. Policies should be constructed and reviewed regularly to ensure they do not encourage unacceptable risk taking.

***5.4.3 Code of ethics***

Setting out the expected behaviours of those representing the organisation is an important aspect of ABC compliance. Ensuring the organisation embeds the appropriate culture is important and this should be driven by senior management demonstrating the expected behaviours to set the example to staff.

It is recommended third parties representing the organisation should be made aware, and if possible, agree to follow these Code of ethics.

***5.4.4 Third parties / intermediaries***

It is good practice for the firm to clearly set out behaviour expected of those acting on its behalf.

As noted previously, the firm can be prosecuted should a third party acting on its behalf attempt a bribe. The policy and procedures should include that the third party agrees to follow the firm's code of ethics. Prior to the business relationship commencing, the third party's due diligence should include assurance on their own ABC policy and how they enforce their requirements, including a review of the third party's own anti-bribery and corruption controls. Any negative responses to these points should act as a red flag to future dealings with the third party.

***5.4.5 Whistleblowing, investigation, dismissal***

Procedures for whistleblowing and reporting suspicions, including the use of hotlines, should be clear and communicated to all staff. If hotlines are not provided, firms should consider measures to allow staff to raise concerns in confidence or, where possible, anonymously, with adequate levels of protection which staff should be made aware of.

As good practice, if firms do not provide staff with access to whistleblowing hotlines, it is recommended that they have processes in place to allow staff to raise concerns in confidence or, where possible, anonymously, with adequate levels of protection.

***5.4.6 Gifts & Hospitality***

The Gifts and Hospitality (G&H) policies and procedures should clearly define the approval process and the applicable thresholds. Processes in place should identify unusual or unauthorised G&H, and deviations from approval limits for G&H. Staff should be trained on G & H policies, relevant to their role, and should be regularly reminded to disclose G & H in line with the policy.

As good practice it is recommended that, where appropriate, the firm refers to existing sources of information, such as expense registers, policy queries and whistleblowing and complaints hotlines, to monitor the effectiveness of its anti- bribery and corruption policies and procedures.

***5.4.7 Facilitation payments***

Facilitation payments, which are payments to induce officials to perform routine functions they are otherwise obligated to perform, are bribes and a firm's policies and procedures should reflect this. Procedures should include the oversight and approval before a payment is made to a third party, following appropriate due diligence on the entity and/ or individual.

***5.4.8 Political and charitable contributions and public officials' definition***

The policies and procedures should describe how political and charitable donations are approved at an appropriate level, with input from the appropriate control function, such as compliance, and subject to appropriate due diligence. Processes should also consider whether there are conflicts present with the action of the giving and whether the action, although meeting the policy could have subsequent reputational risk at a later stage. Public officials' definition should be included to help ensure circumstance are identified and appropriate procedures followed.

***5.4.9 Books and record keeping***

Policies and procedures should ensure evidence of events is captured, alongside monitoring and regular testing of procedures to demonstrate adequacy.

***5.4.10 Training and Awareness***

Training and awareness of policies and procedures created to support ABC efforts is key to the successful delivery of an effective framework.

As noted in the earlier section, multiple policies are likely to be in place to support ABC. The nature and depth of training required on each area should reflect the area being trained (e.g., complexity, rate of change, level of risk) and the target audience (scope of responsibilities, knowledge and experience).

In addition, the scale and complexity of an organisation and its subsidiaries (where captured by the compliance framework) is also likely to have a bearing on the type(s) of training to be provided. Regardless of the scale and complexity it is important that training is delivered to all the right people in an effective manner, at appropriate frequencies and with adequate recordkeeping of the training undertaken.

There are multiple methods to provide training and awareness, broadly, these fall into one of the following:

- Day to day interaction with subject matter experts e.g., compliance;
- Policy and other reading – supported by regular attestations;
- Computer based training and testing; and/or
- Face to face structured training including webinars for remote or home-based staff.

Tailored training and communications reflecting the nature of the business and risks arising will be of most value to the organisation and its employees. For example, policy reading together with attentions does have benefits although, where risks are elevated or individuals are likely to encounter an area as part of their role, this will often not be sufficient to provide adequate awareness. In such situations, tailored training should be provided. The reasoning for each type of training should be recorded.

When identifying the staff that should receive training and awareness, this should include directors and officers as well as all employees. In certain cases, particularly where the risks are elevated, agents and business partners may need to be included (or adequate assurance provided that they are subject to their own ABC requirements which, are adequate for the risks posed to the business). It is important that those subject to policies and procedures have access to these and know where to refer for additional guidance.

Examples of focussed training include:

- Practical advice or case studies to address real-life scenarios;
- How to obtain ethics advice on a case-by-case basis as needs arise;
- Examples of prior incidents at the firm and the lessons learned;
- Bespoke training to areas where misconduct has occurred; and
- Training on 'red flags' that are most likely to be applicable to the firm.

It is also important that the "gatekeepers" to ABC control processes receive adequate guidance and training so that it can be shown they have sufficient understanding of the processes that must be followed, the nature of risks to be alert to and when and how to escalate concerns.

As in most areas of compliance, the "tone from the top" greatly assists in any training programme. Messaging in respect of the expectations from staff should be clear, with failure to engage reported, actioned appropriately, and where necessary fed into performance and other reviews e.g., annual fitness and Fitness and Propriety certifications.

### 5.5 Monitoring for compliance

Monitoring and auditing of a firm's ABC framework is recommended to review compliance with applicable policies and procedures. The nature, frequency and depth of monitoring and auditing should be based on the level of bribery and corruption risk, the results from past reviews and the nature, scale and complexity of the organisation.

Such monitoring should include reviewing individual policy areas that form part of the overall ABC framework e.g., gifts and hospitality, whistleblowing, third party procedures but also the framework itself i.e., the ABC policy, the ABC risk assessment and governance. Remediation of any findings should be undertaken in a timely manner.

Whilst not strictly "monitoring", an effective ABC framework includes appropriate investigation of potential misconduct and is included in this section for ease. Hallmarks of an appropriate investigation include:

- Being undertaken in a timely and thorough way by independent qualified personnel;
- Appropriate documentation – both the assessment and the firm's responses to findings;
- Analysis of the issue e.g., the root cause of the misconduct (control failings, lack of policies/procedures, poor training etc) and whether the issues are systemic issues in nature; and
- Appropriate escalation to senior management and the undertaking of disciplinary and remedial actions where necessary.

### 5.6 Anti-Bribery and Corruption for Financial Services Organisations

Summary of considerations for ABC Compliance by Financial Services Organisations:

- Most anti bribery and corruption threat will come from third parties such as suppliers, service providers, introducers and agents. Third parties of this type are often the focus of investigation by law enforcement (SFO) and prosecution is brought under the UK Bribery Act 2010. Firms should conduct a risk assessment of all third parties and ensure that they have adequate procedures in place to handle the risk of misconduct by these third parties as well as their own employees.
- Anti-bribery and corruption risk and compliance must also be viewed from an international perspective. For businesses in any sector, bribery and corruption are a focus for enforcement agencies across the globe. An understanding of geo-political risk is helpful; many firms use the Corruption Perception Index produced by Transparency International and updated annually.
- Additionally, the focus on controls, systems and procedures to prevent bribery and corruption is key. As mentioned, this is underpinned by a robust and tailored risk assessment, to understand the threats posed and put in place adequate procedures designed to meet business and jurisdictional risk. Monitoring and adjusting procedures on a regular basis is critical to providing up-to-date and effective protection against bribery and corruption.

### 5.7 Links to useful resources:

**Financial Conduct Authority**

Thematic Review

Anti-Money Laundering and Anti-Bribery and Corruption Systems and Controls

https://www.fca.org.uk/publication/thematic-reviews/tr13-09.pdf

Bribery & Corruption note for FS organisations

https://www.fca.org.uk/firms/financial-crime/bribery-corruption

Financial Crime Guide

https://www.handbook.fca.org.uk/handbook/FCG/1/?view=chapter

**Serious Fraud Office**

Bribery Act Guidance

https://www.sfo.gov.uk/publications/guidance-policy-and-protocols/bribery-act-guidance/

**Ministry of Justice**

UK Bribery Act

https://www.legislation.gov.uk/ukpga/2010/23/contents

UK Bribery Act Guidance

https://www.justice.gov.uk/downloads/legislation/bribery-act-2010-guidance.pdf

**Transparency International**

Corruption Perception Index and useful publications

https://www.transparency.org/en/cpi/2019/index/nzl#

https://www.transparency.org.uk/publications

**UK Government**

Anti-Corruption Plan 2017-2022 ( latest update)

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/902020/6.6451_Anti-Corruption_Strategy_Year_2_Update.pdf

## 5.8 TISA Anti Bribery and Corruption High Level Risk Assessment Template

### 5.8.1. Purpose of the template

This bribery and corruption self-assessment template takes the user through key questions all organisations ought to consider in order to:

- better understand and articulate the threat;
- establish the risks faced; and
- assess the organisations capacity to manage and mitigate those risks.

We have set out a series of points to consider for each question to help users identify areas to assist with their risk assessment approach to counter bribery and corruption activity. We also recommend summarising the current activity within the organisation for each question and documenting next steps.

Those responsible for bribery and corruption within the organisation will be responsible for co-ordinating the completion of the form, but we recommend that it is approved by top level management.

### 5.8.2 Key Definitions

In this document several definitions are used. It is important to relate the following to your organisation:

| | |
|---|---|
| **Bribery** | Bribery is defined as – offering, promising, agreeing to receive or giving of a financial or other advantage to induce or reward improper functions or activities and/or the request or receipt of such an advantage. |
| **Corruption** | Corruption is defined as - the abuse of power by an official (or any employee entrusted to carry out the functions of government, including contractors) for personal gain. |
| **Risk Assessment** | A bribery and corruption risk assessment builds a comprehensive picture of the risks that an organisation faces, evaluates controls and assesses the likelihood and impact of these risks on the organisation. |
| **Top Level Management** | Board of directors (or any other equivalent body or person) |

**5.8.3 TISA Anti Bribery and Corruption High Level Risk Assessment Template**

**Having completed the assessment sheet, please provide an overview of where your organisation currently is in terms of the following areas:**

**Governance and MI** ☐ Red ☐ Amber ☐ Green

| Overview | |
|---|---|

**Assessing bribery and corruption risk (risk-based approach)** ☐ Red ☐ Amber ☐ Green

| Overview | |
|---|---|

**Policies and procedures** ☐ Red ☐ Amber ☐ Green

| Overview | |
|---|---|

**Training and awareness** ☐ Red ☐ Amber ☐ Green

Overview

**Monitoring for Compliance** ☐ Red ☐ Amber ☐ Green

Overview

**Reporting and investigation** ☐ Red ☐ Amber ☐ Green

Overview

**Supplier Management/Third Party Relationships** ☐ Red ☐ Amber ☐ Green

| Overview | |
|---|---|

**Governance and MI**

**Does your organisation establish and maintain an ABC programme that sets the standards for appropriate behaviour and ethical business practices?**

**Points to consider**:

| Element | Yes | Developing | No | Don't know |
|---|---|---|---|---|
| Culture / tone from the top | | | | |
| Senior Management sponsorship of the programme | | | | |
| Roles & responsibilities | | | | |
| Resource / skill sets | | | | |
| Internal reporting framework (event driven and regular MI) | | | | |
| Independent review of programme | | | | |

**In the space below, please provide a brief overview of current activity and future plans:**

| |
|---|
| |

**Assessing bribery and corruption risk (risk-based approach)**

**Does your organisation have an ABC programme which is informed by periodic risk assessments to ensure the programme is proportionate to your organisations:**

- Location
- Size

- Industry
- Products and Services

**Points to consider:**

| Element | Yes | Developing | No | Don't know |
|---|---|---|---|---|
| Legal and regulatory landscape and it's implementation and enforcement within different jurisdictions i.e. FCPA | | | | |
| Third party relationships and due diligence (incl. intermediaries) | | | | |
| Subsidiaries | | | | |
| Jurisdictional Risk eg footprints in high risk countries based on perceived levels of corruption highlighted by country reports and corruption league tables published by reputable organisations ie Transparency International | | | | |
| Acquisitions / joint ventures / mergers | | | | |
| Gifts & Hospitality, political contributions / sponsorships / charitable donations | | | | |
| Customer / client risk: risk of facilitation and / or laundering the proceeds of bribery & corruption (link with AML framework) | | | | |
| Products/services offered | | | | |

**In the space below, please provide a brief overview of current activity and future plans:**

| |
|---|
| |

**Policies and Procedures**

**Does your organisation have documented and risk-based policies and procedures in place to combat the risks associated with Bribery and Corruption?**

**Points to consider**:

| Element | Yes | Developing | No | Don't know |
|---|---|---|---|---|
| Staff recruitment and vetting, including procedures for work experience e.g. referrals by customers | | | | |
| Remuneration structures | | | | |
| Code of ethics | | | | |
| Third parties / intermediaries | | | | |
| Whistleblowing, investigation, dismissal | | | | |
| Charitable giving | | | | |
| Gifts & Hospitality including a G&H register | | | | |
| Facilitation payments | | | | |
| Political contributions | | | | |
| Marketing sponsorship | | | | |
| Books and record keeping | | | | |
| Public officials' definition | | | | |

**In the space below, please provide a brief overview of current activity and future plans:**

| |
|---|
| |

**Training and Awareness**

**Does your organisation have a training programme in place to help staff with the prevention and detection of the risks associated with Bribery and Corruption, and is it effectively communicated and applicable to all persons at all levels?**

**Points to consider:**

| Element | Yes | Developing | No | Don't know |
|---|---|---|---|---|
| Risk based training for all staff (incl. Board training) | | | | |
| Subsidiaries / third parties | | | | |
| Maintenance of training completion records | | | | |
| Bespoke training for higher risk areas/roles eg Supplier Management, Commercial/Sales | | | | |

**In the space below, please provide a brief overview of current activity and future plans:**

| |
|---|
| |

**Do you communicate/raise awareness of bribery and corruption within your organisation and the channels available to report suspicions?**

| Yes | Developing | No | Don't know |
|---|---|---|---|
| | | | |

**In the space below, please provide a brief overview of current activity and future plans:**

| |
|---|
| |

**Monitoring for Compliance**

**Does your organisation have a monitoring programme in place (including control testing) to review compliance with applicable policies and procedures relating to Bribery and Corruption?**

**Points to consider:**

| Element | Yes | Developing | No | Don't know |
|---|---|---|---|---|
| Annual monitoring programme | | | | |
| Remediation programme | | | | |
| Document retention | | | | |
| Annual policy, process and procedure reviews | | | | |

**In the space below, please provide a brief overview of current activity and future plans:**

| |
|---|
| |

**Reporting and Investigation**

**Do you have systems and processes for i) recording and capturing all incidents, ii) investigating allegations and iii) dedicated resource for either investigating internally or for arrangements with external investigators associated with bribery and corruption?**

**Points to consider:**

| Element | Yes | Developing | No | Don't know |
|---|---|---|---|---|
| System for recording incidents of bribery and corruption | | | | |

| Element | Yes | Developing | No | Don't know |
|---|---|---|---|---|
| System for recording breaches of the counter bribery and corruption control system | | | | |
| Process for reporting incidents and breaches to top level management | | | | |
| Process to report allegations of bribery and corruption internally | | | | |
| Process to report allegations of bribery and corruption to external agency | | | | |
| Case acceptance criteria for bribery and corruption | | | | |
| Trained internal capability to respond to incidents of bribery and corruption | | | | |
| Case management system to log allegations | | | | |
| An arrangement with external investigators | | | | |
| Plan to continually develop skills and capability of investigators | | | | |
| Sanctions and Redress policy for investigators to refer to | | | | |

**In the space below, please provide a brief overview of current activity and future plans:**

| |
|---|
| |

**<u>Supplier Management/Third Party relationships</u>**

**Does your organisation review the counter bribery and corruption procedures of outsourced service providers and promote awareness of bribery and corruption with outsourced partners / supply chain??**

**Points to consider:**

| Element | Yes | Developing | No | Don't know |
|---|---|---|---|---|
| Procedures of outsourced service providers/suppliers reviewed | | | | |

| Element | Yes | Developing | No | Don't know |
|---|---|---|---|---|
| Counter bribery and corruption requirements are built into contracts | | | | |
| How to report incidents of bribery and corruption is promoted with outsourced partners | | | | |
| Audit clauses built into third party contracts | | | | |

**In the space below, please provide a brief overview of current activity and future plans:**

| |
|---|
| |

# 6. Application of the 'Three Lines' model

## 6.1. Purpose of this review

The TISA Financial Crime Working Group has explored how the three lines model is currently operating, what is best practice, and moving forwards the ideal target operating model for AML /CTF. In this context, the roles, and responsibilities in each of the three lines of defence are further explained and this paper serves to outline how the MLRO's team should be developed once first line activities are fully passed to first line ownership.

## 6.2. Introduction to the three lines of defence (3LOD) model

In the financial sector, an established internal control and risk management approach that helps firms strengthen, clarify, and coordinate their essential governance, internal control and risk management roles and responsibilities is the 3LOD model- now known as the Three Lines Model (3LM).

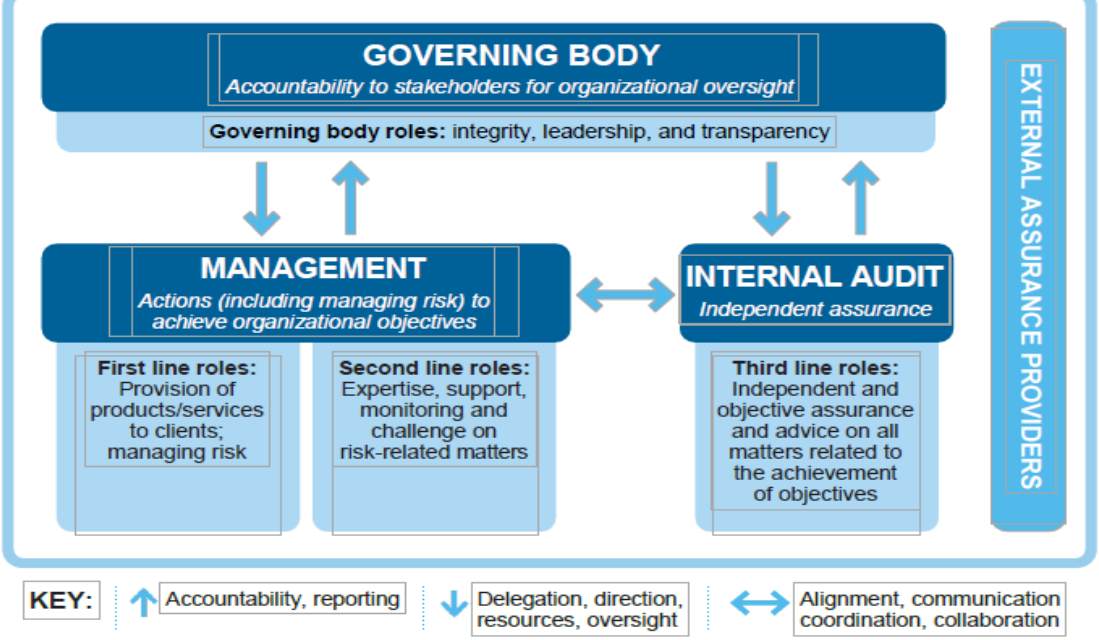
The first reference to the 3LOD in the FSA's publicly available documents dates from 2003 where it would appear that firms had adopted the 3LOD model without the FSA requiring them to, though it is not clear what the driver for this adoption was. In July 2020 an updated version of the 3LM model was published by the Institute of Internal Audit. This version sets out three key areas of responsibility and six principles.

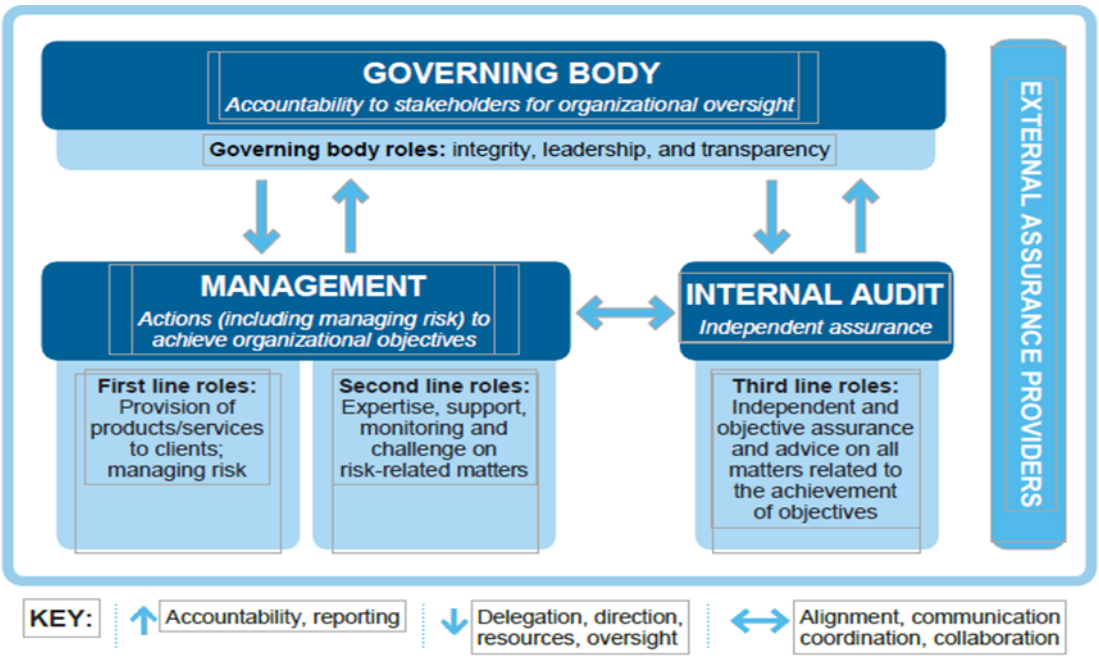
Even with its evolution, the framework of the 3LM has predominantly stayed the same. The 3LM model distinguishes three groups (or lines) with the Board sitting above the model performing a 'model oversight' role through the activities of:

- Set 'Tone at the Top'
- Perform strategic risk assessments
- Establish risk appetite, strategy, targets
- Safeguard mission and values as cornerstone of the firm's culture
- Approve internal control system, risk and compliance framework, methodologies, overall policies and roles and responsibilities
- Approve adequate system for internal controls over financial reporting
- Leverage risk and compliance information into decision making process and evaluate business operations activities on a risk-adjusted basis

The model has the lines divided by:

- 1st line is business operations who have risk ownership




Implementing the 3LM model increases the ability of a firm to achieve its strategic objectives by:

a. Identify and mitigating negative risks (those that threaten strategy); and

b. Identifying opportunities and placing the business in a position to take the same'

### 6.3. Application of the three lines model to AML /CTF and the role of the MLRO

The 3LOD model, is how most firms in the financial sector now approach risk management as it helps firms identify structures and processes that best assist the achievement of objectives.

The UK regulations make a clear distinction between activities that are the specific responsibility of the MLRO, and activities that should be completed by the 2nd Line of Defence (2LOD) more broadly.

**2LOD responsibilities**:

1) Responding to escalations and requests for guidance on scenarios or complex issues not adequately covered by standard operating procedures, with special emphasis on any activity that employs subjective decision making and reasoning, escalating to the MLRO where necessary;

2) Continuous engagement with key 1LOD stakeholders to educate them on all financial crime prevention matters (including projects) to improve regulatory awareness and knowledge throughout the business;

3) Monitoring and testing - Performing sample-based reviews of 1LOD operational and control processes (at a frequency and sample size appropriate to their respective criticality within the overall framework) and performing reviews of documented 1LOD procedures and controls (whether on a periodic basis or following any material change or event) to ensure they remain in line with expectations and escalating to the MLRO where necessary;

4) Conducting a risk assessment - to identify where the firm's business is vulnerable to ML and TF (within MLR), as it relates to the firm's activities, products and clients, and in recognition of any known limitations, reliance on manual processes or other key dependencies;

5) Reporting and escalating management information and concerns to MLRO and/or senior management - as identified through above or other related activities.

6) Setting appropriate policies to ensure adherence to regulatory requirements as well ensuring there are relevant frameworks and governance meetings in place.

7) Conduct oversight to ensure first line adherence to risk frameworks and policy and challenge where appropriate.

8) Keeping abreast of industry trends alongside national and international findings concerning countries of concern and regulatory developments, proactively identifying and assessing current, emerging and future financial crime threats which may impact the firm/or will do in the future.

**MLRO Specific responsibilities**:

1) Responsible for the oversight of all aspects of the firm's AML/CTF activities and be the focal point for all AML related activity.

2) Overseeing the Monitoring and testing activities performed in 2LOD, ensuring any findings are brought to the attention of senior management;

3) Producing a compliance report - The "MLRO report" - for senior management at least annually;

4) Receiving management information and concerns

5) Investigating internal suspicious activity reports, and making external reports to the UK Financial Intelligence Unit (NCA) where required (**see note 1**);

6) Responding promptly to any reasonable request for information made by the Regulator and/or law enforcement;

7) Participating in the firm's establishment of a risk based approach to prevent ML/CTF;

8) Ensuring the Annual Financial Crime Report (SUP 16 Annex 42 AR) - commonly referred to as REPCRIM - is submitted to the FCA.

**Note 1** - Unless a different person has been appointed as Nominated Officer under POCA.

## 6.4. FCA expectations of firms

The FCA expects firms to have adequate organisational structures in place to mitigate the furtherance of financial crime and has specific regulatory requirements detailed in their Handbook (SYSC 6.3). Specifically, in November 2017 the FCA stated that: "Structurally, firms are seeking to clarify the shifting boundaries of the first and second lines of defence to help define the responsibilities of the compliance function, with regard, for instance, to financial crime. Such organisational change is likely to continue in the coming years." The TISA FCWG recognise that there is still a diverse range of MLRO mandates which typically include the core elements of acting with full independence to provide effect governance and oversight, and be both a partner and a challenger, to ensure regulatory requirements, both the letter, and the spirit of the law, and regulations, are effectively applied. It is critical that the MLRO's mandate and desired outcomes are absolutely clear, understood by internal and external stakeholders, and maintained to support business strategy, growth, and innovation.

In May 2021 the FCA issued a Dear CEO letter to retail banks with details of the AML /CTF common control failings it has found and needed to be addressed. This included the following on the 3LOD:

- Poor understanding of the 3L in practice
- Inappropriate allocation of responsibilities resulting in blurring of 1L and 2L
- Lack of technical knowledge in the 1L
- 1L not fully understanding the financial crime risk faced by the firm, impacting the ability to identify and tackle potentially suspicious activity
- 2L undertaking 1L roles which restricts the 2L ability to independently monitor and test the control framework, which can lead to gaps in the understanding of risk exposure.

## 6.5. Conclusion

For realising the benefits and robust embedding of the 3LM, the roles, responsibilities, activities, policies, and procedures within the responsibility of each line of defence should be clear and transparent to everyone in the firm. The 3LM is most effective when there is collaboration and communication across both the 1L and 2L roles of management and internal audit to ensure there is no unnecessary duplication, overlap, or gaps. Once the mandate is clarified it should be possible to translate this into key priorities, key activities, and the skills, competencies and resources required for the lines, including the MLRO, to be capable of discharging its mandate effectively in support of SMCR. The right balance needs to be found between the independence of the MLRO function and its close collaboration with the business. The 3L need to work together to ensure that a firm has a coherent risk structure, and it appears that for AML /CTF the target operating model is mainly consistent. In the FCA experience, firms where those in business roles fully understand the relevant risks and know that part of their role and responsibilities is to help mitigate those risks, are significantly better at mitigating risks than their peers so the direction needs increased momentum.

The appendix below (Appendix 3) details the current position found in the industry (across surveyed TISA member firms) for AML /CTF and the target operating model. Red indicates that a low number of firms gave a positive response to the particular Line, with Amber being a smaller number of positive response and Green being the highest number of firms performing a task in a particular Line. For example, in Task 4 it appears the majority of firms surveyed have Sars emanating from the 1L, with some firms having SARS emanating from the MLRO, and the majority of firms plan to move the responsibility of the task to the 1L, 2L and MLRO.

It appears that the results of this review have identified differing levels of maturity in relation to the reorganisation of the operating model, with some movement of activities that were previously in the 2L to the 1L. Some firms have moved towards a more empowered 1L with a clear understanding of its role in delivering risk management. But this has not been entirely one-way traffic – there have also been examples of insufficient clarity of the different types of testing objectives performed across the 3L. Such organisational change is likely to continue in the coming years. There are some tasks where

the direction is for both 1L and 2L to complete, but from their own responsibility perspective. The current trend on the positioning of the MLRO, is to move to reporting to the CRO (or CEO), away from Compliance as defined in the FCA Handbook, and for good reasons such as to recognise the importance of countering financial crime, not least to provide the over-arching view of risks and risk management that is required of a CRO.

## Appendix 3

| | | Who completes task | | | | | Who do you aim to complete task? | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **Task** | **1LOD** | **1B** | **2LOD** | **MLRO team** | | **1LOD** | **1B** | **2LOD** | **MLRO team** |
| 1 | Processing alerts generated from electronic verification and screening to determine if a true match | | | | | | | | | |
| 2 | Processing updates received from OFSI relating to financial sanctions to determine if a match on the client database | | | | | | | | | |
| 3 | Contact with OFSI for obtaining a financial sanctions licence | | | | | | | | | |
| 4 | Reporting an internal SAR for further investigation to determine if reportable to the NCA as a reasonable suspicion | | | | | | | | | |
| 5 | Processing internal SARs received, reporting as appropriate to NCA, and associated record keeping | | | | | | | | | |
| 6 | Generating business case for application rejection /business relationship termination due to Proceeds of Crime risk | | | | | | | | | |
| 7 | Approval/decline of application rejection /business relationship termination due to Proceeds of Crime risk | | | | | | | | | |
| 8 | DAML submission to NCA, and associated record keeping | | | | | | | | | |
| 9 | Generating business case for approval of business relationship with PEP /local PEP | | | | | | | | | |
| 10 | Approval /decline of business relationship with PEP /local PEP | | | | | | | | | |
| 11 | Processing 3rd party contact requesting information e.g. from DWP, restraint orders, confiscation orders, court orders | | | | | | | | | |
| 12 | Providing statements to authorities in relation to Proceeds of Crime investigations | | | | | | | | | |
| 13 | Generating materials for guidance to clients on preventing financial crime e.g. scam awareness | | | | | | | | | |
| 14 | Generating AML /CTF training materials to colleagues | | | | | | | | | |
| 15 | Key control testing including quality assurance | | | | | | | | | |
| 16 | Generating general AML /CTF MI for management committees | | | | | | | | | |
| 17 | Generating general AML /CTF MI for Board reporting | | | | | | | | | |
| 18 | Formal MLRO report to Board, and periodic updates | | | | | | | | | |
| 19 | Generating AML /CTF MI for third party contracts e.g. providing details on processing volumes to partners | | | | | | | | | |
| 20 | Producing assurance documents for third parties (comfort letters, attestations, Wolfsberg questionnaires, etc) | | | | | | | | | |
| 21 | Approval /signature for assurance documents for third parties (comfort letters, attestations, Wolfsberg questionnaires) | | | | | | | | | |
| 22 | AML /CTF risk assessment - core and when generated from other triggers such as change in the target | | | | | | | | | |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | market for products /services | | | | | | | | | |
| 23 | Approval of AML /CTF risk assessment - core and when generated from other changes | | | | | | | | | |
| 24 | Ownership of AML /CTF Policy | | | | | | | | | |
| 25 | Ownership of AML /CTF procedures /processes | | | | | | | | | |
| 26 | Monitoring the effectiveness of AML /CTF systems and controls, the fulfilment of AML /CTF duties by the firm | | | | | | | | | |
| 27 | Monitoring to identify potential reasonable suspicions | | | | | | | | | |
| 28 | Generating core data for FCA REP CRIM | | | | | | | | | |
| 29 | Collating and submitting the FCA REP CRIM | | | | | | | | | |
| 30 | Maintenance of record and cascade when changes relating to AML /CTF high risk jurisdictions | | | | | | | | | |
| 31 | Project consultation to ensure AML /CTF risks are identified and managed to within appetite | | | | | | | | | |
| 32 | Thematic AML /CTF risk reviews | | | | | | | | | |
| 33 | Horizon scanning and industry threats and trends – identification and cascade, including thoughts on preventions /solution | | | | | | | | | |
| 34 | Maintain a robust AML /CTF prevention framework and ensure appropriate controls are in place to mitigate firm's exposure | | | | | | | | | |
| 35 | Oversight /challenge to the 1LOD on the firm's approach to combating the AML /CTF threat with aim to improve processes /reduce risk | | | | | | | | | |
| 36 | Define and communicate an AML /CTF strategy, aligned with the firms risk appetite and strategic direction | | | | | | | | | |
| 37 | Management /Board Committee Representation | | | | | | | | | |

# 7. Trust Registration Service (TRS)

## 7.1. Introduction

The Trust Registration Service (TRS) was introduced by the Her Majesty's Revenue and Customers (HMRC) as part of the UK's implementation of the Fifth Money Laundering Directive (5MLD). This came into effect on 1st September 2022. Full details are contained in the Trust Registration Service Manual on the HMRC website:

https://www.gov.uk/hmrc-internal-manuals/trust-registration-service-manual/trsm70000

The TRS is intended to ensure transparency about the ownership of assets held in trusts in the UK (or with tax obligations in the UK) and is an extension of the previously adopted requirements governing the registration and transparency of UK incorporated companies.

As a result, Trustees are required to register their Trust when specific criteria are met, and firms subject to UK Money Laundering Regulations (referred to as 'Relevant Persons' by HMRC) are required to request the trust's 'Proof of Registration' to check for discrepancies between the extract and information they already hold about the trust on incorporation documents and application forms.

The new requirements for relevant persons is referred to as 'discrepancy reporting', which has been introduced gradually:

- Performing discrepancy reporting prior to onboarding new trust relationships from 1st September 2022.
- Performing discrepancy reporting on existing trust relationships from 1st April 2023

https://www.legislation.gov.uk/uksi/2017/692/regulation/30A - Regulation 30A (1)(e)

## 7.2. Core requirements

From 1st September 2022, Trustees became responsible for determining whether they need to register the Trust with TRS and where that is necessary, providing key data points about the trust during such registration. Trustees are also made aware that they may be required to provide proof of their TRS registration to obliged entities upon request. Trusts in existence prior to this date are expected to have registered by that date. Trusts created from that date onwards have up to 90 days to register.

Also from 1st September, Relevant Persons became required to obtain appropriate proof of TRS registration as part of the onboarding process for new Trust relationships, so that any material discrepancies (between trust deeds / application forms and the TRS) can be identified and either resolved with the Trustees or reported to the HMRC. Note that the required proof is referred to as "Proof of Registration", and is different to the "declared copy of trust", which some Trustees may provide instead but is not acceptable.

There are scenarios where a Trust does not need to register with TRS, and noting that Trustees may not always be professional persons, it is recommended that firms require Trustees to sign a declaration containing the specific exemption reason(s) in these situations and a declaration re: the trust having zero

tax liabilities, referring them to seek professional advice if they are unsure. This detail will support the firms' obligations to perform reasonableness checks on such exemptions, which would otherwise be impossible without seeking more information.

Following registration with TRS, Trustees have up to 90 days to notify TRS of any material changes to details or circumstances of the Trust.

**Determining whether a trust is required to register**

The HMRC Trust Registration Service Manual contains a comprehensive description of the different types of trust and whether they are required to register or not, based on the specific circumstances of the Trust AND its UK Tax liability under section TRSM20000 - Types of trust that need to be registered.

Firms are not required to be Trust experts, so any associated literature must make clear that it is the Trustees' responsibility to decide whether their trust is exempt from reporting. The Firm should decide to what extent they want to obtain information from the Trustees to ensure that they have followed the HMRC guidance on registration. As an example, the lead trustee could be asked the following questions to Determine whether the Trust should be registered:

| **Question – to be completed by any customers acting in the capacity of trustees** | **Yes** | **No** |
|---|---|---|
| Do you need to get, or already have, a Unique Taxpayer Reference for the trust? | | |
| Has the trust has become liable for any UK Relevant Taxes (regardless of if it is a Schedule 3A Trust)? | | |
| Is it a UK Express Trust with no UK Relevant Tax Liability, that is **not** a Schedule 3A Trust? | | |
| Is it a non-UK Express Trust that has;<br>• acquired land or property in the UK, or<br>• has at least one trustee resident in the UK and has entered into a 'business relationship' within the UK? | | |
| Is it a non-UK resident trust that has;<br>• become liable for tax on UK assets, or<br>• become liable for tax on income coming from the UK, or<br>• a relief that needs to be claimed through Self-Assessment to cover a | | |

| | | |
|---|---|---|
| UK asset or income tax liability? | | |

| **Question – only complete if you have answered "Yes" to any of the questions in the table above** | **Yes (Date)** | **No** |
|---|---|---|
| Is the trust registered with HMRC's Trust Registration Service?<br>*If so, please provide;*<br>• *the date of registration, and*<br>• *a "Proof of Registration" document downloaded from TRS* | | |
| If the trust is not currently registered, do you intend to register the trust with HMRC's Trust Registration Service?<br>*If so, please provide the applicable HMRC deadline for registration.* | | |
| If you have answered "No" to both the questions above, please provide the reason for non-registration of the trust: | | |

### 7.3. Onboarding (incl. declarations)

Firms considerations and requirements

- Firms should ensure that application forms have a section whereby the Trusts registrable status is determined/declared. The Trust URN/UTR number should be requested with a sub section that allows the applicant to declare that the Trust is not registrable.
- Firms should determine to what lengths they want to verify the registrable status of a trust.
- Some firms have provided a space on the application form to provide a reason why a trust is not deemed registrable, and this can then be assessed. In contrast some firms may choose to not obtain a reason why as place the reliance on the trustee in assessing the requirement of the trust to be registered and their declaration of this on the application form.

- Firms must request the TRS proof of registration document (in line with TRSM70040 - Discrepancy reporting guidance) for registrable trusts.

*N.B From the 1st April 2023, it is necessary to request a proof of registration certificate in relation to trusts not only on the establishment of a business relationship but also whenever a firm is required to update CDD due to AML trigger events. See ongoing verification section.*

Application process

Following the receipt of the Proof of Registration document, firms need to conduct the discrepancy reporting checks between the extract and the client's application details. If there are no discrepancies identified the application can proceed.

If a discrepancy is identified, the firm needs to undertake further checks:

- First the firm should determine if the discrepancy is material or not (see section on material discrepancies).
- If there are discrepancies identified the first actions should be to correspond with the trustees/applicants to query the findings. It may be that the information provided in the application was erroneous and can be easily corrected by the trustees.
- If the details on the TRS register need updating the Trustees will need to update this. They will have 90 days to make the required updates.
- Until the corrected proof of registration certificate is received the application should not proceed, or firms should follow their usual CDD exception process where the requirement to obtain the TRS extract should be included as a mandatory requirement
- Firms should adopt a reasonable time frame and process to follow up with the applicant to get the TRS register updated where required.
- Where the trustee or agent subsequently submits a revised proof of registration document and the material discrepancy has been resolved, the firm would no longer be required to report the discrepancy to HMRC.
- If the discrepancy is material and there has been no update to the TRS register in light of the discrepancy being raised with the trustees/applicants the discrepancy report should be submitted as soon as practicably possible (see section on Material Discrepancy Identified).
- The discrepancy report that was made should be logged internally for record keeping purposes.

### 7.4. Ongoing verification

The new requirement to conduct on-going discrepancy reporting for trusts (to HMRC) and corporates (Companies House) came into effect from 1 April 2023.

Where a change in information is noted an updated Proof of Registration extract is requested to ensure that HMRC also have the up-to-date information.

A firm's on-going reporting of discrepancies should use a risk-based approach based on the types and number of trusts in the client base, and the services provided to them. A starting point can be to separate your high-risk trusts from your medium/standard/low risk trusts.

### 7.5. High-risk trust clients

The firm could conduct an initial review of all trust clients, in conjunction with the new reporting requirement, to ensure the Proof of Registration is on file and any discrepancies reported appropriately. The timeline for such a review of existing client should be agreed based on the firm's risk appetite, the scale of the task. Following such an initial implementation exercise, the Proof of Registration could be updated following a 'trigger event'. Trigger events typically include:

- Change of name
- Change of trust status from not required to register to required
- New trustee/beneficiary
- Trustee/beneficiary/settlor moving country

The trigger events may be identified when a client requests to update information, during a suitability review, or a periodic client review, or as an event driven review.

For high-risk trust clients, it would be prudent to take a proactive approach and use the periodic review to ask the trust client to confirm if there have been any changes to client information that would lead to a trigger event. This means that TRS data is considered on the same regular cycle as the high-risk reviews (most likely annual).

### 7.6. Non high-risk risk trust clients

For non-high risk trust clients, a firm may rely on identifying updates, that would require a new Proof of Registration form, through their trigger event process.

### 7.7. Identifying material discrepancies

The Proof of Registration extract can contain various forms of discrepancies, so firms need to have an agreed definition for the reportable 'material' discrepancies. Below is an example of what such a decision matrix could look like:

| Potentially Reportable Material Discrepancies | Non-Material Discrepancies |
|---|---|
| A registerable trust has not been registered on TRS and the registration deadline has passed | A registerable trust has not been registered on TRS but the registration deadline has not |

| | |
|---|---|
| | passed |
| Missing beneficial owners, or information about beneficial owners, on the TRS Record / Proof of Registration? | Minor spelling errors, missing middle names or discrepancies deriving from us of common abbreviations |
| Discrepancies in information which mean the identity, or nature of control of the beneficial owners cannot reasonably be discerned (eg: DoB, country of residence or nationality of any beneficial owner, or address of Lead Trustee which could prevent official communication / investigation) | Minor discrepancies in information that do not compromise discerning the identity, or nature of control of the beneficial owners (eg previously verified non-Lead Trustee Beneficial Owner addresses not up to date, or minor address discrepancies that would not prevent official communication) |
| Discrepancy in the name of the trust whereby, in consideration with other provided details, a reasonable person could conclude that the trust name is incorrect or could refer to a different trust | Discrepancy in the name of the trust whereby, in consideration with other provided details, a reasonable person could conclude that the trust name is a shortened or variance of the original name, but not "incorrect" nor that name of a different trust |

Firms should also agree what to check when receiving the extract, for example:

| **TRS Proof of Registration (PoR) Document Content Checklist** | **Yes – No Discrepancies (or n/a)** | **No – But only Minor Discrepancies** | **No –At least one Material Discrepancy** |
|---|---|---|---|
| **Does the PoR contain the HMRC logo?** | | n/a | |
| **Does the trust name and address match our records?** | | | |
| **Does the PoR contain this statement:** "This document confirms that the trust named below has been registered on the Trust Registration Service in the United Kingdom. Details of the beneficial owners of the trust as held on the | | n/a | |

| | | | |
|---|---|---|---|
| register are shown below." | | | |
| **Is the trust start date on the PoR before the date we commenced servicing this trust as a customer?** | | | |
| **Does the information on the PoR regarding all the individual beneficial owners of the trust, match our records?**<br>*This information relates to full name, month & year of birth, country of residence, nationality, and ensuring there are no missing beneficial owners.* | | | |
| **Does the information on the PoR regarding all the associated companies, trusts or charities match our records (as trustees, settlors, beneficiaries, protectors or otherwise entities that exercise control over the trust)?**<br>*If relevant, this information is company, trust or charity name, country of residence for each, and any missing associated entities.* | | | |
| **Do the classes of beneficiaries on the PoR match our records of the classes of beneficiaries?** | | | |

### 7.8. Material discrepancy identified

Should TRS evidence be received, and a material discrepancy identified, attempts should initially be made to resolve this with the trustee(s). Whilst the corrected evidence is outstanding the Due Diligence requirements should be marked as outstanding and a firm can apply restrictions to the account or prevent proceeds from being released. Should corrected evidence not be received within 30 days, further restrictions to the account could be applied and a discrepancy report should be made to HMRC.

<u>After reporting material discrepancy to HMRC</u>

At this stage the account will be restricted, and consideration should be given to whether the discrepancy may be a deliberate attempt to conceal information, in which case the firm's internal SAR procedure should be followed to ensure compliance with obligation to report suspicion. Chasers should continue to be sent

to the trustees to request TRS evidence and the appropriate account restrictions should remain until resolved.

### 7.9. How to deal with no response or disagreements

Proof of Registration not provided

When taking on new business, the general rule of thumb should be to obtain the HMRC Proof of Registration before completing the on-boarding of a new client. However, when dealing with a newly established trust, it should be taken into account that the trust has 90 days to register with HMRC.

Each firm should ensure that their on-boarding procedures include the expectations around timelines for obtaining the Proof of Registration. The approach in relation to new business will vary depending on business model and risk appetite; with some firms not allowing completion of on-boarding until the TRS extract has been received whilst other firms may allow for flexibility to provide the extract post on-boarding in certain circumstances for non-high-risk clients.

If no TRS evidence is received at on-boarding, the account should be marked to show due diligence requirements are outstanding and expectations around operation of that account whilst awaiting the HMRC extract. For example, restrictions can be applied to the account (including the prevention of proceeds from being released until the client file is complete).

If the newly on-boarded trust has exceeded the 90 days grace period provided by the HMRC to register, but still hasn't provided the Proof of Registration, a firm may consider adding further restrictions the account until the document has been provided.

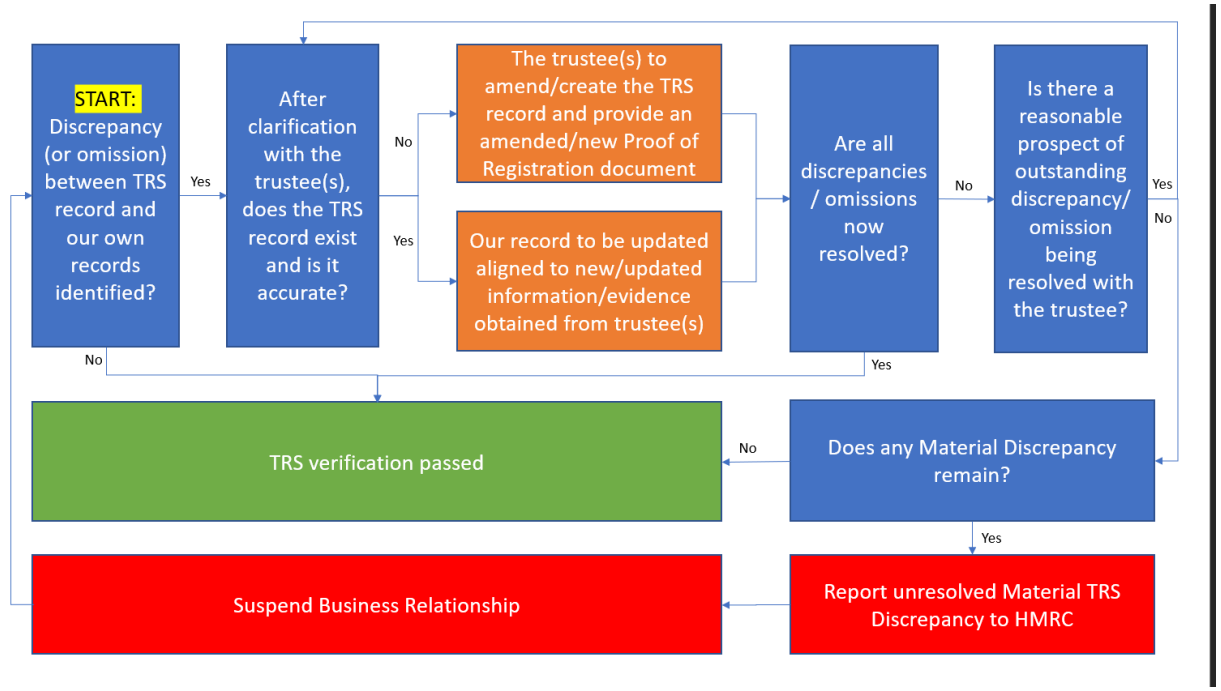
For the existing client book, each firm needs to assess when and how to best obtain the registration extract (see on-going verification). When a trust has been asked by the FI to provide their proof of registration, HMRC guidance under TRSM70060 recommends that firms can allow short period of time, not exceeding 30 days, from the date at which the proof of registration was requested before considering whether to cease engagement with the client and report the discrepancy. Firms can choose to use existing consequences for incomplete CDD if the extract is not provided, such as limiting transactions or freezing the account whilst awaiting the required documentation.

Disagreements - What to do when challenged

Should trustee(s) say that their trust is exempt from registration they will be asked to explain why this is the case. An initial assessment will be conducted by comparing the trust to the list of exemptions in the TRS Manual.

If there is a disagreement, a discussion will be had with the trustee(s) to see if this can be resolved. If the disagreement remains a discrepancy, the firm should consider reporting this to HMRC, based upon the guidance under TRSM70070 of the HMRC TRS manual. **If the Firm believes that the discrepancy may be a** deliberate attempt to conceal information, the firm's internal SAR procedure should be followed to ensure compliance with the Firm's obligation to report suspicion.

**The Firm could create a decision tree to determine whether suspension – or other restriction - of an account is required, for example:**



# 8. Introduction to Sanctions

## 8.1. What are sanctions?

Financial sanctions are restrictions put in place to achieve a specific foreign policy or national security objective. Financial sanctions are generally imposed to:

- coerce a regime, or individuals within a regime, into changing their behaviour;
- constrain a target by denying them access to key resources needed to continue their offending behaviour;
- signal disapproval; and/or
- protect the value of assets that have been misappropriated from a country until these assets can be repatriated.

Financial sanctions work by imposing restrictions on the use of financial assets and services in order to achieve specific policy objectives such as those described above. In the context of financial sanctions, these restrictions can include:

- Targeted asset freezes: these apply to named individuals and entities and restrict access to funds and economic resources.
- Restrictions on a wide variety of financial markets and services: these can apply to named individuals and entities, specified groups, or entire sectors and include, for example, investment bans or restrictions.
- Directions to cease all business: these will specify the type of business and can apply to a specific person, group, sector or country.

## 8.2. A breach of financial sanctions may be a criminal offence, punishable upon conviction by up to 7 years in prison. There are both civil and criminal enforcement options to remedy breaches of financial sanctions and Law enforcement agencies may consider prosecution for breaches of financial sanctions. What regimes are applicable to me?

Determining which financial sanctions regimes are applicable to your firm can be a complex process that depends on a number of factors, including the nature of your business, the countries with which you do business, geographical spread of your clients, and the specific sanctions programs that are in place at the national or international level.

Here are some steps that you can take to determine which financial sanctions regimes may apply to you:

1. **Identify the relevant sanctions lists**: Start by identifying the lists of sanctioned individuals, entities, and countries that are relevant to your business. This may include national sanctions lists, such as those published by the U.S. Treasury Department or the UK, as well as international lists, such as those published by the United Nations.
2. **Determine if your business activities are covered by the sanctions**: Once you have identified the relevant sanctions lists, you will need to determine if your business activities are covered by the sanctions. This may involve reviewing the specific provisions of the sanctions programs and assessing whether your business activities could be considered prohibited under the sanctions.
3. **If unsure, seek legal advice**: If you are unsure about which sanctions regimes apply to your business, or if you have concerns about your compliance with sanctions regulations, you should seek legal advice.

Overall, it is important to stay up-to-date with developments in sanctions regimes and to take proactive steps to ensure compliance with applicable sanctions regulations. The inherent risks being faced by firms are rising in relation to sanctions e.g. Russia.

Failure to comply with sanctions regulations can result in serious legal and financial consequences, including fines, penalties, and reputational damage.

The most common regimes that firms are required to engage in are the sanctions regimes of the United Kingdom, European Union, United Nations and United States of America.

| Jurisdiction | Responsible Body | Sanctions Lists | Guidance and Information |
|---|---|---|---|
| **United Kingdom** | Office of Financial Sanctions Implementation (OFSI) | OFSI Financial Sanctions searchable list | OFSI Guidance |
| **European Union** | European Council | EU Sanctions map and list | EU Guidance |
| **United Nations** | United Nations (UN) Security Council | United Nations Security Council Consolidated List | UN Sanctions Information |
| **United States of America** | Office of Foreign Assets Control (OFAC) | OFAC Sanctions searchable list | OFAC Sanctions Programs and Information |

While the above sanctions list can aid identification of exposure to sanctions risk, firms cannot solely rely on screening against these lists. Some regimes may be more comprehensive at blocking activities or countries in comparison to list based regimes. Furthermore, many jurisdictions, including the US, UK and EU, explicitly sanction an entity or individual but apply the concept of ownership and control. This indirectly sanctions parties that are under the control or ownership of the sanctioned subject; a well known example of this is the OFAC 50% rule. Office of Foreign Assets Control (treasury.gov). Firms should be mindful of each relevant jurisdictions' approach to ownership and control and consider this on a case by case basis.

### 8.3. What role does OFSI play?

OFSI, which is part of HM Treasury, helps to ensure that financial sanctions are properly understood, implemented and enforced in the United Kingdom. It interprets and applies relevant sanctions regulations, provides guidance, enforces regulations, monitors compliance, and engages with stakeholders to promote compliance. OFSI's role is critical in promoting global efforts against money laundering, terrorist financing, and other illicit activities targeted by financial sanctions. In 2022, in response to the Russian invasion of

Ukraine, OFSI imposed several sanctions on Russia.

OFSI's website has contact details and several useful links including general guidance, how to report financial sanctions breaches and how to subscribe to OFSI's free email alerts. Additional information on compliance and expectations can also be found in OFSI's guidance on enforcement, including additional information about ownership and control determinations.

**Where do I report potential breaches?**

Any sanctions breaches, or information pertaining to designated persons, are reportable to the relevant body in the jurisdiction within which the sanctions have been breached.

Any breaches of sanctions within the UK should be reported to the Office for Financial Sanctions Implementation (OFSI). Reports of a suspected designated person, frozen assets, credits to frozen accounts and suspected breaches should be emailed to ofsi@hmtreasury.gov.uk using the Compliance Reporting Form.

OFSI recommends that you seek the advice of legal counsel if you are unsure of your compliance or reporting obligations.

Regulated firms should also consider whether they have additional external reporting responsibilities. In particular, a Russia sanctions statement published by the FCA in February 2022 advised that the FCA should be notified when certain OFSI reporting responsibilities were triggered. In certain cases, it may also be appropriate to file a SAR with the NCA, for example where there are also concerns related to money laundering, terrorist financing or sanctions evasion schemes.

**Licences**

Where a firm believes it is necessary to undertake a transaction involving a person or organisation who is subject to financial sanctions (whether directly or indirectly), the firm must firstly obtain a licence to allow the activity to take place without breaching financial sanctions. The firm should not assume that a licence will be granted or engage in any activities prohibited by financial sanctions unless they have a valid licence.

OFSI can only issue a licence where there are legal grounds to do so. OFSI's guidance on licences provides further information, including on how to apply for a licence and what types of licences are available. Firms can apply for an urgent licence, but firms should be aware that the OFSI application form advises applying at least 4 weeks in advance of a licence being required, or longer if practicable. Firms will need to manage their customers' expectations accordingly.

**Sanctions Control Framework**

Your sanctions controls framework should start with defining your sanctions risk appetite. This must be agreed by the Board. The agreed appetite will provide the foundation against which you assess whether the right controls are in place to ensure your business operates within that appetite. If a firm's risk appetite to breach financial sanctions, or to facilitate sanctions evasion, is very low, the firm's controls to mitigate that risk (e.g. client due diligence, client screening, asset screening) would need to operate effectively to meet that expectation. If there are concerns about the controls, meaning that the firm is not operating within appetite, this will need to be reported back to the Board with a proposed mitigation plan.

Financial crime prevention requires a risk-based financial crime control environment so it is key to design and implement a comprehensive risk assessment, which will serve as the basis for the control environment.

The control environment will need to consist of a number of key components. This guidance will serve to document what those components are and focus on practical guidance for the most complex issues.

| Sanctions Control Framework | | | |
|---|---|---|---|
| | Framework and Culture | Systems and Controls | Assurance and Reporting |
| Governance | Structure and Corporate Governance Arrangements<br><br>Risk Management Framework | Staff Training and Awareness | Management Information<br><br>Assurance |
| Processes | Policies and Procedures<br><br>Horizon Scanning<br><br>Risk Assessments | Customer Screening<br><br>Payment Screening<br><br>Investment Due Diligence<br><br>Third Party / Supplier Due Diligence | Breach Reporting<br><br>Testing and Monitoring (including configuration and performance of screening system) |

### 8.4. Risk Assessment

The Risk Assessment is the cornerstone for designing the sanctions control framework. It should assess the risks in relation to:

- Customer Base
- Delivery Channel

- ➢ Geography
- ➢ Products and Services
- ➢ Transactions

Such an assessment will consider the nature of the firm, the products it offers and the way in which customers engage with it, the interaction it has with external third parties which in turn will influence the control environment. Typically, a control environment would have consideration of a number of common elements.

To the extent possible, a firm should consider aligning their Sanctions Risk Assessment (including the assessment of inherent and residual risks) with their existing risk frameworks and assessments.

The risk assessment typically provides a holistic view of the business, it considers the nature, scale and complexity of the business, and usually documents the following:

- Identification of the risks:
- processes which are touch points for sanctioned individuals and/or entities and the risk they expose the business to, this will help to identify where the risks are.
    - Assign who owns each risk on behalf of the business, for example, the MLRO.
- Inherent risk assessment:
    - The potential impact each risk can have on the business for example, a regulatory fine if there is potential for a breach to occur.
    - Score the potential impact and the likelihood of each of the risks coming to fruition, then multiply these together (or use your existing methodology) to calculate the inherent risk score.
- Control framework
    - Consider what controls are currently in place to identify and mitigate sanctions risk and document whether they are preventive or detective controls.
    - Also consider the effectiveness of these controls - are they effective, mostly effective, partially effective or not effective?
    - Identify where the material gaps and vulnerabilities are within the current processes.
- Residual risk assessment
    - After identifying the risks and applying the controls, reassess what the possible impact is on the business, for example, unlikely to result in regulatory impact.
    - Score the residual impact and likelihood of each risk coming to fruition whilst considering the controls which are in place, then multiply these (or use your existing methodology) to give the residual risk score.
    - Carefully document the residual risk rating rationale.
    - Consider the residual risks that remain in comparison to your firm's risk appetite and consider if any further action/new controls are required to further mitigate the risks identified.

Depending on the structure of the business, the risk assessments can be broken down into different business areas or by product.

Once the Risk Assessment is fully documented, it should then be determined how frequently it should be reviewed. This could be annually or on an ad hoc basis where there has either been a change in risk appetite, a new product or service introduced, off the back of regulatory change or any other business changes such as system upgrades. The Risk Assessment should also have appropriate oversight based on the businesses Governance structure.

### 8.5. Governance

Firms should have in place a robust Governance Structure which outlines the business's organisational structure as well as clearly defining the lines of responsibility, including the first, second and third lines of defence. The responsibility for the oversight of financial crime risks, including Sanctions should be appropriately documented and assigned to relevant individual(s) with SMCR accountabilities (see Policies and Procedures section). Management information on the current status of the business sanctions risk exposure and mitigation should be presented to relevant responsible committees and/or individuals.

### 8.6. Policies and Procedures

Firms should document their risk appetite and risk assessment in respect of sanctions. Firms should also document their approach to sanctions compliance, including, where considered necessary, detailed operating procedures.

When documenting your sanctions compliance framework, consider including the following areas:

- Introduction
- Purpose of policy/document (or a policy statement)
    - This should detail:
        - The purpose of the policy/document;
        - The legislation the policy/document intends to meet; and
        - Reference the firm's stance in relation to sanctions (linking this to risk appetite).
- Scope and reach of the policy/document
- Definitions
- Document detail
    - This should detail:
        - High level overview of the sanctions framework in relation to customers, investment instruments and third parties (e.g. screening, enhanced due diligence etc.);
        - Roles and responsibilities;
        - Reporting and MI activities; and
        - Breach consequences.
- Training arrangements
- Review arrangements and associated documentation

Firms should document the linkage between this document and the subsequent operating procedures, which by their very nature will be specific to the firm (although further guidance can be found below).

### 8.7. Customer Lifecycle

Sanctions can be applied against both individuals and legal entities. Consequently, firms should consider

sanctions in the context of:

1. Customers (whether this is an individual customer or a corporate customer); and
2. Any third party with whom the firm interacts.

This section focuses on the customer (with third parties considered in the section below). Obligations in relation to customers can be considered in the context of the customer lifecycle:

- ➢ Onboarding
- ➢ Ongoing Customer Relationship
- ➢ Investing (See "Third Party Relationships").

Onboarding

**Systems, Sanctions Lists and Parameters**

Firms should have in place systems to screen customers against Sanctions Lists. The Sanctions Lists firms conduct their screening against will be dependent upon the jurisdictions with which they interact or within which they operate and offer services. Consequently, firms should create and select the relevant Sanctions List in full consideration of their own unique risk assessment.

In the context of jurisdictional reach, firms should consider what exchanges their customers are able to interact with and whether there is an expectation to screen customers before directing customers to those exchanges.

Firms should have detailed documentation around:

- The Sanctions Lists selected;
- The frequency with which internal Sanctions Lists are updated;
- The frequency with which screening is completed; and
- The calibration of any matching logic deployed by automated systems when searching for potential matches, including the ability to identify:
    - Exact Matching: compares names exactly as they appear, character by character (will not account for minor variations or discrepancies in spelling or formatting)
    - Phonetic Matching: analysing the sounds of names rather than their exact spellings, (useful for words that can have different spellings or variations)
    - Fuzzy Matching: comparing names based on similarity, taking into account variations in spelling, typos, abbreviations, and other factors to predefined thresholds.
    - Token-based Matching: splitting names into individual words or parts of words to enhance ability to match transposed data. (can often be used to exclude common words - e.g. limited - to focus on unique words to improve accuracy.)
    - Transliteration Matching: Transliteration matching is used when dealing with names written in different scripts or languages between client lists and watchlists
    - Alias Matching: consider known aliases or alternative names for individuals. These algorithms help identify matches even when individuals use different names or aliases.

The above is not an exhaustive list but represents some of the most common ways in which screening tools can compare data to identify potential matches that require further investigation. Firms should determine, based on their own risk-based approach, which name matching logics to employ.

It's important to note that different screening systems may use a combination of these name matching logics or employ additional proprietary algorithms to improve accuracy and reduce false positives or false negatives in identifying potential matches.

This information should be reviewed frequently and at least on an annual basis.

## 8.8. Screening

Screening activities must be conducted prior to entering into the business relationship. Firms should have in place detailed procedures documenting how Sanctions Screening systems operate and how Screening activities will be conducted (accounting for the nature of the customer base e.g. Corporate Entities should also require screening of Directors and Beneficial Owners). Within these procedures firms should consider the benefit of templated dismissal notes, which would serve to ensure that alert dismissals are detailed, consistent and applicable to the firm's business model.

Firms should have in place a training programme to ensure that employees conducting screening checks are suitably qualified to review, and escalate, potential sanctions matches. Furthermore, firms should have in place detailed procedures covering:

- How to review potential sanction matches (including the specific discounting factors that must be applied and the expected timescales);
- How to escalate potential sanctions matches (including the imposition of restrictions to prevent specific activity taking place pending the resolution of the alert ; and
- To whom potential matches should be escalated (including how this is done and the steps taken to alert the required individuals/teams to those escalated matches).

If it is not possible to conclude that the potential match is a Sanctioned Party, it might be appropriate for the firm to put additional questions to the client or conduct Enhanced Due Diligence upon them so as to understand whether there is a legal basis for entering into a business relationship.

## 8.9. Escalation and Internal Reporting

Firms should have in place mechanisms for

- escalating suspected sanctions matches or breaches to the relevant team or person within the organisation
- where the circumstances of a sanctions match or breach prompt a suspicion of financial crime being attempted or having occurred (e.g. a sanctioned client using the firm's services purposely to conceal funds), for escalating Suspicious Activity Reports (SARs) to the firm's MLRO or equivalent.

The distinction is made here as it is not invariably the case that a suspected sanctions match will have indicators of financial crime taking place – it may simply be that a person or entity has become sanctioned, without further factors in the firm's relationship with that person or entity to indicate criminal activity. It is important to consider both viewpoints to determine whether or not there is additional risk of tipping off (in the case of a formal SAR being required).

The escalation should be reviewed, and in the event that the review identifies a true match in respect of, the business relationship must be refused, and a report made to the relevant authority (see "Where do I Report Potential Breaches").

## 8.10. Controls Testing, Quality Assurance and Reviews

Screening represents a key control within the Sanctions Control Framework. Consequently, firms should have measures in place to ensure that controls are working as intended (controls testing), that the controls are being operated by people correctly (quality assurance) and that arrangements are reviewed on a regular basis (but at least annually). Where firms are using off-the-shelf screening tools, they should be comfortable with the settings and fuzzy logic employed by those systems and ensure the systems are properly calibrated to the firm's own risk appetite and assessment. Firms should also consider frequent testing of the fuzzy logic, utilising external expertise if necessary to validate the effectiveness of the screening tool, including the level of false positives being produced.

Ongoing

Alongside an obligation to conduct screening prior to entering into a business relationship, firms also have an obligation to conduct screening on an ongoing basis.

This requirement is a risk-based one, so should be tied to the firm's risk assessment. Potential models for re-screening include periodic batch screening through to live screening. The appropriate cadence will be based on a number of differing factors, such as customer base, jurisdictional reach etc. Consideration should also be given to the wider macro-economic climate which may result in changes to the screening cadence or prompt exceptional one-off exercises e.g. Sanctions issued in relation to Russia's activities within Ukraine, saw an unprecedented level of Sanctions issued, with some targeting specific nationalities.

Ongoing screening is performed in the same way as identified above. The only significant difference is that if a true match is identified, firms must take immediate steps to freeze assets alongside reporting the matter to the relevant authority (see chapter Where do I report potential breaches?). Firms should therefore have processes and procedures in place that allow it to freeze assets and prevent any interaction with them.

## 8.11. Third Party Relationships

Firms will assess within their risk assessment the third parties with whom they interact and the risks that arise from those interactions.

Within the investment industry, at a minimum, these interactions are likely to include:

- Corporate Shareholding (Corporate Governance)
- Financial Instruments
- Third Party Service Providers/Vendors

Unless the regulated firm is performing sanction screening on their investors/customers to mitigate their own risks and potential liabilities associated with breaching financial sanctions, the regulated firm should have a sufficiently detailed level of understanding and oversight over any screening systems, processes and controls performed by their third party service provider on their behalf.

**Corporate Shareholding**

Investment and Savings firms (or providers) will have a variety of ownership structures. For example, some providers might be privately owned, whereas others might be listed on a regulated exchange.

Sanctions are applicable to both individuals and legal entities and consequently sanctions implications can arise at a corporate shareholder level.

*Case: This was evidenced in the instance of Evraz Plc whereby trading in shares was restricted owing to a significant shareholder (in this case Roman Abramovich) being subject to international sanctions.*

As a result, firms, and in particular listed companies, should take steps to conduct sanctions screening of their corporate shareholders and beneficial owners. This screening should be conducted utilising a risk-based approach, taking into account the firm's risk assessment (which will include geographical considerations).

Where a firm identifies a match, steps should be taken to ensure that no transfer of ownership can occur whilst the matter is reported to the relevant authority (see chapter Where do I report potential breaches?). It might be appropriate to seek a licence (see chapter Licences), but in any event it is recommended that you seek legal counsel upon identification of a match.

**Financial Instruments**

Sanctions may be imposed which forbid firms from transacting in, providing financing for, or otherwise dealing in certain financial instruments (e.g. those issued by a sanctioned entity). As such, firms are also required to screen for financial instruments issued by a directly or indirectly sanctioned issuer, or where a sanctioned ultimate borrower benefits from the proceeds, i.e. in the case of debt instruments.

Firms should have in place appropriate processes, systems and controls to support the identification of such securities. This is necessary to ensure that sanctioned securities are appropriately restricted such that they cannot be traded. Firms must also ensure that there is no ownership of any sanctioned security within portfolios managed or held in custody.

It is important to note that there are nuances to consider in relation to sanctions impacting securities trading, depending upon the regulator and individual sanctions program. For example, whereas some EU and UK sanctions programs explicitly prohibit trading in specified financial instruments, both authorities

have issued guidance and FAQs which indicate that it is not necessarily prohibited to sell securities issued by entities subject to an asset freeze on the secondary market (other than in certain circumstances, e.g. where this would make funds or economic resources available to the target). On the other hand, guidance and FAQs on OFAC's SDN designations more clearly require securities issued by target entities to be blocked from trading unless a General License applies.

Trading in financial instruments can also be restricted through implicit sanctions.
Identifying indirectly sanctioned issuers (i.e. implicit sanctions) can be challenging, with connections to the sanctioned party being through multiple layers of ownership requiring detailed analysis which few firms have the resources and tools to do effectively. An increasing number of firms therefore implement specialist screening tools and sanctions lists that help them to identify implicitly sanctioned companies and financial instruments and allows the firm to make a risk-based decision on which business relationships/transactions to allow and which to restrict. Firms should still consider some level of review on the information presented by these external screening tools and lists and determine for themselves whether they are comfortable acquiring or disposing of a financial instrument which the system has presented as potentially sanctioned.

The use of sanctions has increased significantly in recent years, most noticeably with the sanctions imposed against Russia and Belarus, but also with the introduction of sanctions to combat corruption and human rights offenders. The scope of sanctions is widening, and firms therefore need to consider the risks of potential future sanctions, and residual risk when sanctions are lifted (covered in more detail below). With the sanctions coming into force against Russia, many firms pulled out of the region entirely, a form of 'self-sanctioning' that also became part of corporate ESG strategies, with focus on the reputational risk of engaging with the aggressor in the conflict.

Trade & Portfolio screening

Broadly, financial sanctions cover the following instrument types:

- Equity issuance, including shares and depositary receipts
- Fixed income products, i.e., bonds (corporate and municipal), certificates of deposit (CDs).
- Derivatives, i.e., futures, options, structured products, warrants.
- Exchange Traded Funds (ETFs) containing sanctioned component securities, or ETFs within an ETF issued by a sanctioned entity or containing a sanctioned component.
- Open-ended and closed-end mutual funds containing sanctioned component securities, or funds within the fund which themselves contain a sanctioned component.
- Crypto-assets

Firms should have appropriate trade and portfolio screening controls in place that are in-line with their risk appetite. The frequency and timing of trades and portfolio holdings subject to the screening described

below should be appropriately tailored to the firm (e.g. size, complexity, risk exposure, etc) and/or the issuer's and/or financial instrument's characteristics such as its exposure to countries targeted by sanctions. Firms should consider implementing the following controls:

- Pre-trade and post-trade screening; and
- Screening of all portfolio holdings - to allow for identification of potentially missed trades which would constitute a breach, new designations or changes to capital structure of issuer which brings it in scope of implicit sanctions.

  Some examples of what investment restrictions and trading system alerts may target include:

  - Exposure to target countries – will need to be updated as appropriate.
  - Issuers subject to sanctions (the implications of which may require further investigation). Firms will need to consider both issuers which are subject to explicit sanctions and the implementation of a process to identify issuers subject to implicit sanctions via ownership and control, e.g. by screening beneficial owners or sourcing additional ownership and control data.
  - Securities subject to sanctions (e.g. sectoral sanctions, broad prohibition of purchases of Russian securities or more targeted restrictions against securities issued after specific dates).

In line with the firm's risk appetite, firms should also consider whether to utilise external ongoing data feeds or manual lists to identify potential or actual sanctioned financial instruments prior to trading. Firms utilising external tools and/or data providers should ensure the systems are calibrated to their business model and risks and not simply use "off-the-shelf" services without appropriate initial and ongoing due diligence on the provider, product and the performance of the controls.

Investment restrictions can be applied for many different reasons within a firm. It is important that sanctions restrictions are well communicated and understood by trading staff.

Where an alert is raised in relation to a security, issuer or country, manual assessment is likely to be required of whether or not the trade is permissible in light of any applicable sanctions regimes or the firm's internal policies. For example, sectoral sanctions may limit the issue date or maturity period of impacted securities or an issuer being subject to an asset freeze may not prohibit a secondary market trade. Firms should maintain procedures for the escalation and review of sanctions trading alerts, including the requirement to keep an appropriate audit trail of any investigation and decisions made.

Instruments with residual risk

While in specific circumstances it is permitted for some instruments to be traded or held within a portfolio (e.g. those falling outside of the investment ban/sectoral sanctions criteria), a degree of residual risk

remains. It is important to note that such instruments may later become sanctioned, meaning that ongoing monitoring is crucial. Therefore, depending upon its risk appetite a firm may wish to 'self-sanction' by implementing a blanket ban on the trading/holding of any issuance by any sanctioned issuer.

Reporting

The differences should be considered between reporting frozen assets for a client subject to sanctions (which are more clearly reportable) and securities issued by an entity subject to asset freezing or blocking sanctions (where the guidance is less extensive and obligations may vary between regimes administered by different authorities). Firms should make an assessment, in consideration of the specific regime and the currently available guidance, about the circumstances in which trading or holding securities issued by a sanctioned party are reportable and under which reporting obligation (see chapter Where do I report potential breaches?). Firms should carefully document all assessments of impacted investments, including decisions made with regards to reporting..

Other areas of impact

In addition to risks surrounding the assets themselves, firms should also consider the sanctions risks arising from the following and implement appropriate control processes:

- Screening and due diligence of transaction counterparties (brokers or private buyers) of any assets which may be impacted by sanctions regimes
- Potential sanctions exposure from custodians or sub custodians in jurisdictions impacted by sanctions
- Payments received in relation to securities (e.g., dividends, coupons, principal) subject to sanctions and any obligations around how these are to be treated – for example, where OFAC might require that such payments are to be rejected or blocked/frozen

It may be beneficial for firms to monitor and/or anticipate how counter sanctions issued by potentially hostile governments – such as Russia and China – impact the firm's operations, such as limiting its ability to mitigate risk (by preventing the ability to sell off higher risk assets) or otherwise force firms into undesirable custody situations or information disclosure requirements.

Although not explicitly related to implementation of sanctions compliance obligations, it may also be helpful for staff in sanctions advisory roles to provide informational input into the internal pricing and valuation of securities which have become less liquid due to the imposition of sanctions.

**Third Party Service Providers/Vendors**

The majority of sanctions will have the same impact on business-to-business service relationships, and so are similarly important for financial institutions when conducting due diligence on third party service

providers. Whether at outset or once live, sanctions impacting a service provider could result in an immediate need to discontinue use of, and payment for, the service being provided, leading to

- disruption of normal business processes and client-facing services
- reputational damage, through association with a sanctioned business
- breach of regulatory/legal obligations (in particular, where the service provided fulfils a critical outsource need or otherwise helps the firm to discharge regulatory responsibilities)

When considering how to manage these risks it is suggested that firms assess all providers to determine their importance to the operation of the business, and the potential for disruption to business activities if a provider's service was unavailable, for example due to the application of sanctions, and consider having the results of this assessment reviewed and approved by the relevant management body (Board or sub-committee). This is particularly important where a provider is fulfilling a critical/material outsource role in relation to regulatory or legal requirements.

Firms should consider screening third party providers for sanctions and adverse media. In line with the firm's risk appetite, the firm may also choose to screen a third party provider's UBOs, controlling persons, directors, etc. When determining the frequency and timing of such screening and the parties to be screened, firms should consider characteristics of the provider such as the provider's nexus to a country targeted by sanctions and the materiality of the business relationship (e.g. is this a critical supplier, does the firm provide material financial resources to this supplier, etc.).

Other factors to consider include:

- Maintaining due diligence records in the firm's procurement function
- ensure supplier service disruption due to sanctions is covered in the firm's business continuity plan
- ensure that provider contracts have void or break clauses to cover the eventuality of the provider's operations being compromised by sanctions
- require senior managers with responsibility for each provider relationship and corresponding operations to maintain a view of the market for alternative providers, in case one is needed to replace a provider affected by sanctions.