HM Treasury

Anti-Money Laundering and Counter-Terrorist Financing:

Supervision Report 2015-17

March 2018

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Foreword

The UK's anti-money laundering and counter-terrorist financing regime has a clear aim: to ensure that the UK's financial system is a hostile environment for illicit finance, whilst minimising the burden on legitimate businesses and law-abiding people.

We are working in partnership with the private sector to deliver on this aim. We have implemented the biggest reforms to our regime in a decade as we deliver on our 2016 Action Plan for anti-money laundering and counter-terrorist finance, addressing the vulnerabilities identified through the 2015 National Risk Assessment (NRA). The Criminal Finances Act, which received Royal Assent on 27 April 2017, enhances law enforcement's powers to investigate and punish money laundering (ML) and terrorist financing (TF) activity, and to recover criminal and terrorist assets. And the new Money Laundering Regulations (MLRs) took effect on 26 June 2017, bringing our regime into line with the latest international standards.

Effective supervision is key to a truly successful risk-based regime that focusses supervisory and law enforcement resources on the highest risk but does not place unnecessary burdens on business. The UK is already ahead of many countries in requiring all the sectors covered by AML/CTF international standards, such as accountants and lawyers, to be supervised for AML/CFT. As this report shows, our supervisors are playing an increasingly effective role as they take steps to address the vulnerabilities identified in the first National Risk Assessment. In January 2017, the FCA fined Deutsche Bank £163m, its largest ever financial penalty for AML failings, while in April 2017, the SRA imposedan £80,000 fine on a City of London law firm and several its directors for non-compliance with the MLRs. HMRC has just published a thematic review of compliance in the Money Service Business (MSB) sector, looking specifically at good and bad practice in principal-agent relationships. Collaboration with law enforcement is strengthening, as demonstrated by the Accountancy Affinity Group's work with law enforcement to develop a new risk matrix which will help facilitate a consistent risk-based approach across the accountancy sector.

The government and supervisors will take further steps to strengthen the AML/CFT regime. The MLRs clarified and strengthened the expectations on all supervisors. As guidance is updated to reflect the MLRs, it is also being streamlined and simplified to help businesses understand what is required of them. The newly-established Office for Professional Body AML Supervision will help ensure professional body supervisors meet the high standards required by the MLRs and work across the regime to tighten our defences against illicit finance.

These reforms provide a strong basis for ensuring that our regime is robust, proportionate and responsive to emerging threats. They help fulfil our commitment to an effective supervisory regime that takes a truly risk-based approach and does not impose unnecessary burdens on businesses.

I would like to thank the supervisors for their contributions to this report. The Treasury is committed to working in partnership with the supervisors as we lead the global fight against illicit financial flows.

John Glen MP
Economic Secretary to the Treasury

Statement by Paul Simkins, Chair of the AML Supervisors' Forum

Over the two years covered by this report the AML supervisors have invested heavily in reinforcing the UK's AML regime by sharing good practice, addressing risk and building wider and better engagement across the regime.

Since the implementation of the 2007 regulations, the supervisors have worked hard within their sectors, with the Treasury and with the Home Office, to raise awareness and improve consistency of supervision and the recording of a wide range of our activities. This sustained period of development appears to have paid off with supervisors recording good levels of compliance. Excluding the results from HMRC's highly effective themed reviews of Money Service Businesses, levels of non-compliance have averaged 5% or less of the entities reviewed over this reporting period. We have also seen exceptional levels of suspicious activity reports (SARs) from the financial, accountancy and legal sectors. In 2015, the UK legal and accountancy sectors submitted over 40% of all the legal and accountancy SARs submitted in Europe. But there is no cause for complacency when fraud, cyber-crime and money-laundering appear to be global growth industries.

This report also shows that 2017 was a year of considerable challenge and unprecedented change.

Supervisors have further developed our AML programme and the efforts of supervisors and supervised to engage across all parts of the regime have been well rewarded. In particular, the valuable information provided by the NCA's FIU on SARs (guidance, issues, reporting levels across firms, etc.) has enhanced the supervisor's engagement with regulated service providers. However, new sector initiatives to raise the quality of reporting by promoting standard templates and closer work with the UKFIU are expected to significantly enhance the quality and usefulness of SARs going forward.

Furthermore, as highlighted by the Economic Secretary, our regime-wide focus on AML/CTF risk will enable informed application of the new regulatory requirements by both supervisors and supervised.

The greatest opportunity to increase effectiveness through 2018 and beyond is sharing - sharing intelligence, skills and experience right across the AML/CTF arena. It is essential that all parts of the regime work together effectively and efficiently - and key to this is developing cross-regime relationships built on trust and shared goals to deter, detect and disrupt the real villains involved in the most serious areas of criminal activity.

Our shared ambition must be to attack the crooks and the crimes that most harm civil society and cause greatest damage to our economy and I am confident the supervisors are fully committed to supporting government and law enforcement in this ambition.

Executive summary

This is the Treasury's sixth report on anti-money laundering (AML) and counter-terrorist financing (CFT) supervision. This report incorporates activity undertaken in 2015/16 and 2016/17, which supervisors provided to support the UK's submission to the Financial Action Task Force (FATF), to demonstrate the effectiveness of the UK's supervisory regime. Going forward, the Treasury will revert to publishing this report annually.

Under the Money Laundering Regulations, the Treasury is responsible for appointing AML supervisors and works closely with them to ensure they deliver on the government's ambition for a risk-based approach to supervision that minimises unnecessary burdens on businesses. This regular report demonstrates how the Treasury and supervisors work together to deliver this objective, and provides transparency as to supervisory activity.

The UK's AML/CFT regime is based on the international standards set by the Financial Action Task Force (FATF). EU member states sought to reflect the latest FATF standards in the Fourth EU Money Laundering Directive (4MLD), which was transposed into UK law on 26 June 2017 through the MLRs.

The 2015 NRA of Money Laundering and Terrorist Financing identified and assessed the money laundering and financing of terrorism risks faced by the UK. It found that the effectiveness of the supervisory regime in the UK is inconsistent and, whilst some supervisors are highly effective in some areas, there is room for improvement across the board including in understanding and applying a risk-based approach to supervision and in providing a credible deterrent. It also found that data is not yet shared between supervisors freely or frequently enough, which exposes some supervised sectors to risk where there are overlaps in supervision.

The subsequent Action Plan launched a review of the supervisory regime. Following this review, the government used the MLRs to clarify and strengthen the obligations on all supervisors. In addition, the government established the new Office for Professional Body AML Supervision (OPBAS) hosted by the Financial Conduct Authority (FCA), which will work with professional body AML supervisors to help ensure they provide consistently high standards of supervision. OPBAS will also liaise with statutory supervisors to ensure consistent standards across the regime, and with law enforcement agencies to facilitate the sharing of information.

This report sets out different aspects of the supervisory regime and provides analysis along with quantitative and qualitative data. It includes case studies illustrating how individual supervisors effectively and efficiently manage risk. It focuses on 2015/16 and 2016/17.

This report shows improvements in several areas. The UK's AML/CFT supervisors remain committed to further strengthening their approach, tightening the UK's defences against money laundering whilst minimising unnecessary burdens on legitimate businesses.

The Treasury will continue to work in close partnership with supervisors and other interested parties, including OPBAS, to enhance the proportionality and effectiveness of the AML/CFT regime.

Chapter 1
Introduction

1.1 The international standards on combatting money laundering and the financing of terrorism are set by FATF, and the latest standards were agreed in 2012. These FATF standards form the basis of EU legislation – the Money Laundering Directives – and the Fourth Money Laundering Directive (4MLD) was finalised in June 2015 to give effect to the 2012 standards. In turn, the Money Laundering Directives are transposed into UK law, predominantly through the Money Laundering Regulations (the MLRs). The MLRs took effect on 26 June 2017.

1.2 The MLRs require that financial institutions, including money service businesses, and designated non-financial businesses and professions (DNFBPs) that are 'gatekeepers' to the financial system (including accountants, lawyers, estate agents, casinos, high value dealers and trust or company services providers) have policies, controls and procedures in place to manage the risk of ML/TF. The Proceeds of Crime Act 2002 (POCA) criminalises the facilitation of money laundering and requires that law enforcement is alerted where there is a suspicion of money laundering or terrorist financing, through the submission of a Suspicious Activity Report.

1.3 Financial institutions' and DNFBPs' compliance with these obligations is monitored by 25 AML/CFT supervisors, including the FCA, HMRC and the Gambling Commission, as well as 22 legal and accountancy Professional Body Supervisors (PBSs). The Treasury is responsible for making regulations to appoint AML/CFT supervisors. Over the past two years, three supervisors have stepped down as AML supervisors (the Chartered Institute of Public Financial Accountants, the Insolvency Service and the Northern Irish Department of Enterprise, Trade and Investment), whilst one supervisor (the Chartered Institute of Legal Executives) has joined the regime (see Annex 1 for the full list of current supervisors).

1.4 As in previous years, the Treasury asked all supervisors to provide information on their supervisory activity to inform this report using a standard template. This information was also used to inform the UK's submission to FATF ahead of the UK's Mutual Evaluation Review.

1.5 This report considers AML supervisory activity in 2015/16 and 2016/17 (the two years prior to the 2017 MLRs taking effect) and next steps, including the intended impact of the 2017 MLRs and OPBAS. Each chapter considers a specific area:

- Chapter 2 outline the methodology the Treasury used to develop this report.

- Chapter 3 considers collaboration amongst supervisors and with law enforcement; supervisors' understanding of risk; and supervisors' implementation of a risk-based approach.
- Chapter 4 considers supervisors' work to raise awareness of AML requirements among regulated businesses, through proactive and reactive communications as well as the use of supervisory interventions and sanctions.

Chapter 2
Methodology

2.1 This report considers AML supervisory activity in 2015/16 and 2016/17 – the two years prior to the 2017 MLRs taking effect. Some supervisors provided estimates for 2016 to 2017 as they sought to provide information in time to be included in the Treasury's submission for the UK's Mutual Evaluation Review by FATF.

2.2 Whilst the Treasury has sought quantitative as well as qualitative evidence to help inform and present this report, it is not always appropriate to compare supervisors or draw conclusions on the effectiveness of the regime from quantitative data alone. It is also important to note that some figures are driven by different supervisors' different timetables and engagement with different types of populations which lead to fluctuations year on year. In some cases, supervisors' updates to data collection has meant year-on-year comparisons do not compare like with like.

2.3 International standards for ML/TF supervision are set by FATF in its recommendations and effectiveness methodology (see Annex 3 for the FATF supervisory standards). These standards are implemented in the EU through 4MLD and the UK through the MLRs. The Treasury has reviewed supervisors' returns against these standards, as a minimum benchmark, to identify good practice and areas for potential improvement. In line with previous years, this report covers activity by statutory supervisors – i.e. the FCA, HMRC and the Gambling Commission – and by the legal and accountancy sector professional body supervisors.

2.4 This report focuses on key areas that demonstrate a supervisory regime is effective, and helped inform the UK's submission to FATF demonstrating the effectiveness of the UK's supervisory regime. These areas include:

- Supervisors' understanding of ML/TF risk within their sector;
- How this understanding impacts on their supervisory approach, ensuring resources are deployed according to risk;
- Engagement with law enforcement to share information and facilitate investigations;
- The impact of initiatives intended to promote awareness on compliance; and
- Whether remedial actions, including effective, proportionate and dissuasive sanctions, are applied to penalise breaches and promote compliance;

2.5 In 2016/17, the Treasury amended the template to request more information on several areas, including supervision of Trust or Company Service Providers (TCSPs); the number of supervised persons refused the right to practice for AML/CFT reasons; and data on breaches of the MLRs by the regulated businesses they supervise. This information has been incorporated into this report.

Next steps

2.6 Going forward, all supervisors should look to capture data and case studies that demonstrates the effectiveness of their supervisory activity on an ongoing basis, to illustrate how their understanding of risk influences their supervision, and how their supervisory activity affects compliance.

2.7 The MLRs require all supervisors to provide information to inform this report. The core content of the questionnaire is set out in Schedule 4 of the MLRs. It includes the number of regulated businesses and persons supervised; the number of breaches of the MLRs; and sanctions deployed using powers provided in the MLRs. The Treasury will discuss the updated requirements with supervisors in early 2018, and will seek to continue to improve the consistency of information provided whilst minimising burdens.

2.8 Beyond this, the Treasury may request additional information where it would be helpful to inform this report. Going forward, OPBAS will collect the supervisors' annual returns from PBSs on behalf of the Treasury. It will contribute the input on PBSs to the Treasury to incorporate into future supervision reports, which will continue to consider activity across the supervisory regime.

Chapter 3

Understanding and implementing a risk-based approach

Context

3.1 Supervisors should implement a risk-based approach to their supervision, using their understanding of the ML/TF risk posed within their supervised population to target resources on the activities that criminals are most likely to exploit. This will ensure that supervision is focused where it will have the greatest impact on detecting, deterring and disrupting criminals whilst minimising unnecessary burdens on legitimate businesses.

3.2 An effective risk-based approach requires a deep understanding of the supervised population, differentiating between types of firm, the services they provide, and their clients, amongst other factors. There are various resources available to assist supervisors with building understanding of risk, such as the guidelines published by the European Supervisory Authorities and reports published by the Financial Action Task Force (FATF). The MLRs also require supervisors to draw on the UK's National Risk Assessment of ML/TF (published in 2017) as they carry out their own risk assessments, and to disseminate its findings to their supervised populations.

3.3 Collaboration amongst supervisors, and with law enforcement, is also useful to share skills, knowledge and experience. In addition to improving supervisors' monitoring of their members, these relationships also enable supervisors to aid law enforcement investigations, ensuring criminals are successfully identified and prosecuted. Adequate data protection safeguards, both in terms of processes and the integrity of supervisory personnel, underpin this collaboration and are key to ensuring information is used appropriately.

3.4 A robust and up-to-date risk methodology is key to effective implementation of a risk-based approach. All supervisors have access to a range of monitoring tools to ensure the firms they supervise are implementing appropriate AML/CFT controls, including powers to request information; require attendance at interview; and to access businesses' premises. In practice, supervisory activity often helps a supervisor update its understanding of the risk faced by its population, and in turn refine its supervisory approach to focus resources where they have greatest effect.

Analysis

Supervisors' understanding of risk

3.5 Respondents demonstrated a high awareness of how their members' supervised activities can be exploited by criminals. Many are looking to build on this through thematic reviews, collaboration with other supervisors and law enforcement, and close relationships with MLROs of leading regulated businesses. There is a good understanding of the factors that can exacerbate or mitigate those risks, including the specific services at greatest risk of exploitation, the characteristics of the clients being served, the jurisdictions involved in a transaction, and the business's history of compliance with their obligations in the regulations.

3.6 Different supervisors continue to apply this understanding in different ways as they implement a risk-based approach to supervising their regulated businesses. To an extent this reflects the different size, activities and nature of the sectors and regulated businesses they supervise. Some supervisors have taken different approaches where they supervise similar services, especially in the accountancy and legal sectors where there are 23 active supervisors, of which 22 are PBSs. For example, the sophistication of risk classification varies by supervisor. Some PBSs classified their members as either entirely low or entirely high risk depending on their size or the nature of the activities they supervise. However, some supervisors apply more sophisticated methodologies to their entire populations, whilst others are currently piloting a more sophisticated methodology on a small proportion of their members. The accountancy affinity group has created a single risk methodology to assess risk posed by individual businesses in conjunction with law enforcement - this is currently being implemented. The legal sector affinity group is currently discussing developing a similar methodology.

Box 3.A: Case study – Independent review of the FCA's AML supervision by the IMF in 2016

In its 2016 Financial Sector Assessment Programme of the UK, the IMF highlighted that around a fifth of global banking activity is booked in the UK, and the size, complexity, range of products and services, volume of transactions and interconnectedness with the international financial sector exacerbates the risks of money laundering in the UK's banking sector.

The IMF also noted that AML/CFT is a priority for the FCA, and that the FCA's AML/CFT supervisory framework operates on a risk-basis. The FCA's focus on, and deep understanding of, the largest, most systemically important banks reflects the higher risk these banks pose, as they account for 95% of the UK's retail banking market and 77% of the UK's wholesale market. The FCA's understanding of these banks has been enhanced through its Systematic AML Programme, which provides deep-dive reviews of the 14 major retail and investment banks on a four yearly cycle. This also improves awareness of AML/CFT issues within the banks – as the IMF noted in its Financial Sector Assessment Program (FSAP), senior managers in many banks, including the large banks, are prioritising AML.

The IMF also suggested that the FCA give more attention to lower-risk smaller banks. Respondents to the Treasury's Call for information on the AML supervisory regime and the Better Regulation Executive's Cutting Red Tape Review of the UK's AML/CFT regime agreed. As a result, the FCA has implemented reforms to enhance its approach to supervision for smaller banks, including by increasing resources allocated to improving communications with those firms; carrying out more onsite visits for smaller banks; and introducing a programme of risk assurance visits directed at smaller firms to test whether their lower-risk ratings remain accurate.

Supervisors' inspections

3.7 Supervisors vary the scope of their onsite and offsite inspections depending on their internal processes and the risk faced by the individual business. For example, some supervisors prioritise visiting larger businesses that require more complex controls and rely on desk-based reviews and complementary telephone interviews for less risky businesses. Several supervisors noted that businesses often find visits helpful as they provide support and reassurance to the business that it has appropriate AML/CFT controls and safeguards in place.

3.8 Many supervisors request information from their supervised populations to conduct light-touch desk-based reviews and develop an up-to-date understanding of risk within their sectors. This helps them target resources, focusing on areas that face the greatest risk. Most supervisors carry out visits on a cyclical basis, but also prioritise firms for an inspection where intelligence suggests closer examination is necessary. Amongst other sources, supervisors highlight that their desk-based reviews, customer complaints and their members' past compliance record may trigger closer examination.

3.9 Most supervisors, especially PBSs, integrate AML into their wider monitoring of their members' compliance with other rules, including their code of ethics and continuous professional development. This increases the breadth of monitoring whilst minimising unnecessary burdens and enables those supervisors to leverage their specialist knowledge of their members' services. Many PBSs noted that they have sought to strengthen their focus on AML/CFT compliance within their existing supervisory framework over the past two years and intend to continue to do so.

Focus – Desk Based Reviews

3.10 In 2016/17, 17 supervisors used annual questionnaires to collect up-to-date information from their supervised populations on a range of issues, including AML compliance. These supervisors note that they continue to adapt the

AML/CFT components of their questionnaire to collect more useful information.

3.11 Most supervisors used desk-based reviews as a supervisory tool. Where applicable, they provided details on the outcomes of desk-based reviews – see table below – and complemented these with case studies.

Table 3.A: Desk-based reviews and outcomes by sector 2016/17 (2015/16)

	Accountancy sector	Legal sector	FCA	Gambling Commission*	HMRC**
Total number of DBRs undertaken	6,846 (6 406)	697 (1963)	154 (134)	72 (24)	269 (631)
Number of DBRs where business assessed as "compliant"	5,191 (5,870)	134 (129)	73 (77)	43 (12)	–
Number of DBRs where business assessed as "generally compliant"	1,310 (1,175)	371 (367)	74 (45)	27 (11)	–
Number of DBRs where business assessed as "non-compliant"	158 (151)	42 (21)	7 (6)	2 (1)	–
Number of DBRs where final assessments are unavailable	187 (33)	150 (1,446)	0 (0)	0 (0)	269 (631)

*The Gambling Commission adopted new compliance indicators in 2015/16. These are good (i.e. compliant), adequate and just adequate (i.e. generally compliant) and inadequate (non-compliant).

**The outcomes of HMRC's DBRs are excluded from the breakdown of firms assessed as 'compliant', 'generally compliant', and 'non-compliant'. HMRC DBRs are one part of a package of compliance interventions available to HMRC, such as visits, and do not always constitute a full compliance assessment. HMRC has indicated the outcome of the complete assessment in the "Compliance visits" table below.

Box 3.B: Case study – Law Society of Scotland

In 2015/16, the Law Society of Scotland created a new 'AML Auditor' role and focused more senior resources on identifying and mitigating the risk that Scottish solicitors may wittingly or unwittingly facilitate money laundering.

The AML Auditor's initial focus was on working with larger firms to understand the more complex AML challenges faced by such firms and how these are mitigated. Last year, the Law Society carried out a desk-based review of its 33 largest member firms. This exercise found reasonable compliance levels whilst also identifying aspects of processes where there was scope for improvement.

In their responses to these findings, firms either explained how their systems provided sufficient safeguards, satisfying the Law Society, or initiated action plans to address the Law Society's concerns. The Law Society will schedule follow up actions to ensure that the action plans are delivered as expected. Looking forward, the Law Society of Scotland is amending its approach to the supervision of small and medium sized firms and intends to increase the use of desk-based reviews to complement their existing onsite inspection programme.

Focus – Onsite visits

3.12 In 2016/17, 22 supervisors carried out visits as part of their supervisory actions, up from 21 in the previous year. All supervisors record the firm's compliance with AML/CFT requirements following these visits, though the results of some visits were still being finalised when supervisors submitted information to the Treasury for this report.

Table 3.B: Onsite visits and outcomes by sector 2016/17 (2015/16)

	Accountancy sector	Legal sector	FCA	Gambling Commission*	HMRC**
Total number of visits undertaken	1,631 (1,812)	710 (759)	100 (116)	9 (18)	1,564 (1,217)
Number of visits where business assessed as "compliant"	921 (1,048)	247 (267)	27 (10)	1 (11)	360 (109)
Number of visits where business assessed as "generally compliant"	542 (633)	103 (82)	27 (33)	1 (6)	110 (222)
Number of visits where business assessed as "non-compliant"	141 (119)	151 (151)	4 (16)	7 (1)	485 (163)

Number of visits where final assessments are unavailable	27 (12)	209 (259)	42 (58)	0 (0)	609 (723)

*The Gambling Commission adopted new compliance indicators in 2015/16. These are good (i.e. compliant), adequate and just adequate (i.e. generally compliant) and inadequate (non-compliant). In 2016/17, there was 1 visit, which was classified as "good". Figures provided by the Gambling Commission in these years focused on visits to firms that are subject to the Money Laundering Regulations, rather than the Proceeds of Crime Act, and are therefore lower than in previous years.

**In some cases, HMRC visits several agents as well as the registered principal business, or carries out more than one visit/desk-based review of the same business as part of a single assessment. This action gives rise to a single, overall assessment of the risks considered, which is reflected in the table above. HMRC's visits are carried out on a targeted basis and therefore do not consider all aspects of a business's compliance with the MLRs. The compliance rating in the table above is HMRC's assessment against the risks examined, not the business's overall compliance.

Box 3.C: Case study – HMRC's thematic review of Money Services Businesses

HMRC has produced its first Thematic Review, focusing on one of the most complex sectors it supervises – Money Service Businesses (MSBs). This review is due to be published in early 2018.

HMRC worked closely with MSB principals to conduct almost 1,500 compliance interventions in 2014-15 on agents operating across the largest money transmission networks.

MSB principals rely on a network of around 45,000 agents to transmit money across the globe. There are risks associated with these large, complex agent networks, and the recent National Risk Assessment found the risk of MSBs being used to launder money and finance terrorism to be high.

HMRC's review assesses the relationships between principal MSBs and their agents, the on-boarding process and effective ongoing management of risk undertaken by the registered MSB principals.

While the review identifies some evidence of close working relationships and clear processes, including effective policies and procedures for recruiting agents and transaction monitoring, it uncovered some serious failings. These included ineffective monitoring of change in agent ownership, inadequate training of agency staff and ineffective systems for undertaking customer due diligence.

HMRC has shared recommendations and an action plan with principal MSBs. HMRC continues to work closely with principals and their agents to tackle the failings and meet the recommendations of their review.

Box 3.D: Case study – Chartered Institute of Taxation (CIOT)

An initial visit to a member was scheduled in August 2015. The member had been chosen because of a lack of AML knowledge demonstrated through queries to the helpline. During the visit to the member, it became clear that the member was not meeting all the requirements of the regulations. He had not undertaken any formal AML training and was not familiar with the Consultative Committee of Accountancy Bodies (CCAB)'s guidance although he was familiar with some issues through the supervisor's AML newsletters and his regular attendance at the supervisor's conferences.

As part of the action plan, the member was sent a hard copy of the CCAB guidance. He was asked to ensure he and his staff familiarised themselves with this by a set date. He was also sent a link to the training providers' information on the supervisor's website to assist him in arranging suitable training. Follow up phone calls and emails took place to guide the member on the requirements set out in the action plan and provide further education on the requirements of the MLRs.

A further visit was arranged in March 2016. On the follow-up visit, the member had taken on board the points raised with him. All staff had undergone training, including reading and familiarising themselves with the CCAB guidance, and the member had improved his assessment of risk and consideration of the customer due diligence (CDD) of his clients.

Areas of identified non-compliance

3.13 In 2015/16, the Treasury asked supervisors to share cases where a regulated business had breached the MLRs and to identify which regulation had been breached and the resulting penalty. This data suggests that, across the regime, the most common failings are that regulated businesses have not carried out a client risk assessment or they have failed to apply appropriate CDD. Supervisors found that regulated businesses are relatively less likely to fail to carry out ongoing monitoring on clients or implement AML/CFT policies and procedures, and still less likely to fail to maintain records or provide adequate training.

Collaboration with law enforcement

3.14 Many supervisors highlighted their attendance at regular meetings where they discuss best practice, share information and coordinate activities, especially:

- the anti-money laundering supervisors' forum (AMLSF), which all supervisors are invited to attend. The Treasury, the Home Office and the National Crime Agency also attend. The AMLSF is currently chaired by Paul Simkins, the Director of Quality Assurance at the Institute of Chartered Accountants in England and Wales; and

- the accountancy affinity group, which is attended by accountancy professional bodies and currently chaired by Charlotte Ali, Professional Standards Officer at the Chartered Institute of Taxation; and
- the legal affinity group, which is attended by legal professional bodies and currently chaired by Ian Messer, Director of Financial Compliance at the Law Society of Scotland.

3.15 Some supervisors also attend discussion groups, including those run by the Royal United Services Institute and other UK and international specialist fora. The AMLSF chair, and the accountancy and legal affinity group chairs, also attend the Money Laundering Advisory Committee – a joint HMT/Home Office-led meeting which brings government, law enforcement and the private sector together to discuss the overarching AML regime. The key outcomes from these discussions are cascaded to all supervisors by the chairs of the AMLSF and affinity groups.

3.16 Several supervisors also noted that their membership of FIN-NET facilitates sharing of operational information with law enforcement and government, whilst more attended Shared Intelligence Service meetings which are solely attended by supervisors. Accountancy PBSs highlighted their work, through the affinity group, to develop and implement processes to improve the flow of information with law enforcement.

3.17 Several supervisors noted that they have cooperated with overseas counterparts and law enforcement. Those supervisors that have not reported engagement with foreign supervisors or overseas law enforcement noted that they stand ready to do so, if requested, but that their supervised population is UK-based and has a predominantly domestic client base.

Box 3.E: Case study – FIN-NET

In late 2016, a supervisor shared information with other FIN-NET members on a potential criminal case they had started to investigate. The FIN-NET secretariat carried out routine checks using information the supervisor had provided, and found that a law enforcement agency had investigated the same subject two years earlier. The Secretariat connected the investigating officer with the law enforcement team that had conducted the previous investigation, helping the case progress.

Box 3.F: Case study – FIN-NET 2

In late 2016, law enforcement shared information with FIN-NET members about an ongoing investigation. Within days, an overseas-based supervisor responded with information about the subject of the investigation, enabling law enforcement to expand the investigation and collaborate with the overseas supervisor. Had the law enforcement agency and the overseas regulator not been members of FIN-NET, they would not have made the connection in this case.

Review and next steps

3.18 Supervisors generally have a good understanding of how the services they supervise could be exploited by criminals. Collaboration has helped ensure this understanding is consistent across sectors – many supervisors highlighted common indicators of risk where they supervised similar populations. The accountancy affinity group's work with law enforcement to develop a single risk matrix has helped to develop shared understanding in the accountancy sector.

3.19 The MLRs require all supervisors to adopt a risk-based approach to AML/CFT supervision, drawing on their risk assessments, and to base the frequency and intensity of their onsite and off-site supervision on the risk profile of the regulated business. Many PBSs noted that they could further strengthen their focus on AML/CFT compliance within their overarching frameworks, and that they intend to do so.

3.20 Going forward, OPBAS will provide a source of expertise on AML supervision and will engage with all supervisors to discuss and share best practice, and with law enforcement to facilitate better information sharing. It will work with PBSs, in particular, to further strengthen the risk-based approach. OPBAS may provide training or additional guidance, building on its sourcebook on effective supervisory principles, to help PBSs deliver effective outcomes.

Chapter 4
Promoting and ensuring compliance

Context

4.1 Supervisors should help ensure their regulated businesses implement appropriate controls to mitigate money laundering risks by promoting a clear understanding of the AML/CFT requirements, and providing help and support where necessary. Where there are failures to implement adequate controls, these should be promptly identified and remedied. Where appropriate, supervisors should issue sanctions, such as fines, public censure or the suspension or withdrawal of the right to provide services. The Treasury recognises that penalties are not appropriate in all circumstances – supervisors may draw on a number of tools to promote compliance, including providing advice and action plans.

4.2 Overall, effective supervision should leverage enforcement action to motivate regulated businesses to comply with their AML/CFT obligations and mitigate risk – the quantity of punishments is not in itself an indicator of effective supervision. In addition, enforcement action should be effective and proportionate, as well as dissuasive. This is in line with the risk-based approach supervisors and regulated businesses should adopt to mitigate ML/TF risk, ensuring they allocate resources efficiently and do not create unnecessary burdens on supervised businesses.

Analysis

Raising awareness

4.3 Industry experts and professional bodies provide guidance to help regulated businesses understand their obligations in the MLRs, and adopt a risk-based approach to fulfilling them. Guidance provides detailed advice on how businesses can efficiently and effectively detect, deter and disrupt criminals and terrorists, targeting resources at risk whilst minimising unnecessary burdens on business. The MLRs enable firms that have followed guidance published by a supervisory authority or other appropriate body, and approved by the Treasury, to have this taken into account by a court as well as by the relevant supervisor or law enforcement when they are deciding whether a requirement has been contravened.

4.4 Many supervisors considered that the businesses they supervise allocate sufficient resources to manage and mitigate the ML/TF risk they face and that awareness of ML/TF risks is improving across the regime. That said, they noted that smaller firms, including sole practitioners, and those with long-standing relationships with a small group of clients were less likely to be aware of their obligations in the MLRs, and therefore less likely to comply. To help counter this, supervisors provide advice proactively, as well as reactively, to help their populations comply with the MLRs. Most supervisors provide information online, including through webinars, and many stand ready to answer specific queries through an email or a telephone advice service.

4.5 Other forms of engagement include email updates, membership magazines, provision of training events or AML/CFT specific sessions at professional conferences or roadshows. Some supervisors provide software to help their members fulfil their obligations, and help inform their risk-based approach to supervision. In some cases, AML training is a core and necessary part of the continuous professional development required for members.

Box 4.A: Case study – The 'Flag It Up' Campaign

In February 2017, as part of the Home Office's 'Flag it up' campaign (aimed at improving SARs reporting in the legal and accountancy sectors), the Financial Intelligence Unit (FIU) co-hosted a webinar in collaboration with the Home Office and Institute of Chartered Accountants of England and Wales. It reached over 200 viewers from over 50 firms in the accountancy sector. This is the first time this style of communication has been used by the FIU and it was used to signpost good practice, criminal typologies and guidance relating to SAR submissions. In June 2017, Home Office data showed an increase of 153% in NCA website views on the FIU SAR guidance pages. There was also an increase in SARs reporting during the campaign period.

Box 4.B: Case study – Guidance for regulated businesses

As far as possible, guidance should be clear, consistent and comprehensive to help regulated businesses comply with their obligations easily. The Better Regulation Executive (BRE), as part of its Cutting Red Tape Review of the AML/CFT Regime, highlighted that there were over 1,720 pages of guidance to help regulated businesses comply with their obligations – in the legal sector, each of the 9 legal AML supervisors provided its own guidance. Submissions to the BRE's Review, and respondents to a separate Treasury-led Call for Information on the AML/CFT Supervisory regime, highlighted that this guidance could be unclear, repetitive or inconsistent. This can create confusion and unnecessary burdens on regulated businesses whilst contributing to disproportionate compliance and a less effective regime.

As a result, the Treasury announced its intention to work with supervisors and industry to provide one piece of Treasury-approved guidance per sector, as guidance is updated to reflect the 2017 MLRs.

Refusing licences to provide services

4.6 Refusing a licence to practise can prevent criminals from infiltrating the regulated sector, providing a key safeguard. Many key staff in regulated businesses are subject to a 'fit and proper' test, through which supervisors consider a number of factors, including the potential risk that the individual may facilitate ML/TF, to determine whether it is in the public interest that an individual be permitted to practice.

4.7 Many PBSs have well-established processes to assess prospective new members. For example, they may require individuals to have particular qualifications and work experience, to have completed training and continuous professional development, and to undergo fit and proper or criminality checks. Consequently, prospective members that may pose a risk to the AML/CFT regime may be rejected before they gain membership. In 2015/16, 20 applications for membership were rejected by legal PBSs and 30 applications were rejected by accountancy PBSs.

4.8 The Gambling Commission and the FCA often issue 'minded to refuse' letters prior to formally declining an application for a license to practice – this reduces the expense of undergoing a time consuming and complex rejection process. 124 applications to the FCA were withdrawn in 2015/16, the majority of which followed a 'minded to refuse' letter from the FCA to the applicant, and 2 applications were refused. 28 applications to the Gambling Commission were withdrawn in 2015/16, whilst 4 were refused.

4.9 HMRC does not have members, and so the application it receives from a prospective regulated business is often the first AML/CFT contact HMRC has with the applicant, and the first opportunity to refuse the right to practice. HMRC is increasingly requesting more information from businesses seeking to be supervised by them. In 2015/16, 102 businesses did not complete their registrations after HMRC requested further information and in 2016/17, 75 businesses did not complete their applications. Those that did complete the process provided sufficient detail, meaning that HMRC was content to register them.

4.10 HMRC also conducts fit and proper tests on certain individuals in MSBs and TCSPs. In 2015/16, 27 individuals failed the fit and proper test, and in 2016/17, 59 individuals failed. Under the 2017 MLRs, in addition to the fit and proper tests in MSBs and TCSPs, HMRC will also conduct criminality tests for key individuals in accountancy service providers, high value dealers and estate agency businesses, ensuring that individuals who have a relevant criminal conviction are not able to hold the relevant positions.

Enforcement action

4.11 This section considers enforcement action across the regime, and by the individual statutory supervisors and the legal and accountancy sector affinity groups. Each supervisor investigates a failure to comply with the MLRs and considers how to ensure that the penalty is effective, proportionate and dissuasive.

4.12 Overall, the data shows an increase in the use of most enforcement actions between 2014/15 and 2015/16 and then a slight decrease in 2016/17.

Table 4.A: Enforcement action across the regime

Enforcement action*	Number of actions taken 2014/15	Number of actions taken 2015/16	Number of actions taken 2016/17
Suspension	2	10	8
Fine	724	1,170	935
Reprimand	57	45	31
Undertaking/condition	72	16	74
Warning	498	341	325
Action plan	999	1,371	593

**See Annex 2 for a definition of each penalty used in this table.*

Box 4.C: Case study: different penalties for similar breaches

It is for each individual supervisor to determine an appropriate sanction following a breach of the MLRs, implementing a penalty that is effective, proportionate and dissuasive, having taken into account any exacerbating or mitigating factors. The focus should be on outcomes.

Supervisors can, and do, issue different sanctions for similar breaches of the MLRs. Case studies submitted by a legal PBS, an accountancy PBS, and HMRC help to illustrate this point:

- Whilst on a routine inspection, a legal PBS found that a legal firm had not completed CDD on 3 client files. This was reported to the legal PBS's main regulatory committee, which decided to provide guidance and a warning, followed by a re-inspection. The re-inspection found, again, that CDD had not been completed on some client files and the firm was again referred to the main regulatory committee. The committee then decided to issue further guidance and a formal warning, followed by a further re-inspection. The subsequent re-inspection found that the firm was satisfactorily complying with its obligations, and this was reported to and noted by the legal PBS's main regulatory committee.

- Whilst on a routine inspection, an accountancy PBS found that a regulated firm had only recorded some ID and not completed formal CDD, had not carried out client risk assessments, and had not retained records of client information. The accountancy PBS offered advice and guidance, but this was not acted on and a second visit found that the issues had not been remedied. Consequently, the PBS's independent regulatory committee required the regulated firm to pay for a third inspection, and warned that further steps may be taken if insufficient progress is demonstrated.

HMRC identified that a firm had failed to undertake CDD and issued a warning, then undertook a follow-up visit. The visit identified that the breaches identified in the previous intervention had not been remedied, so HMRC issued a penalty of £800 on the business.

Table 4.B: Focus: enforcement action by members of the accountancy affinity group1

Enforcement action	Number of actions taken 2014/15	Number of actions taken 2015/16	Number of actions taken 2016/17
Expulsion/withdrawal of membership	13	19	23
Suspension	1	2	3
Fine	33	14	35
Reprimand	51	41	28
Undertaking/condition	44	13	70
Warning	298	238	205
Action plan	483	670	582

Box 4.D: Case study – ICAEW

ICAEW decided to visit a member firm after receiving intelligence that this firm might not be complying with its obligations. On the visit, ICAEW found that the firm had not carried out CDD on existing clients, did not regularly review its compliance procedures, and did not provide relevant training to staff.

ICAEW concluded that the firm's response to these issues was inadequate, and referred the firm to the independent Practice Assurance Committee (PAC). The PAC required the firm to follow an action plan to address its failings; to pay for an independent external review of its processes; and to pay for a follow-up visit by ICAEW, if ICAEW considered it necessary.

[1] Although HMRC are a member of the accountancy affinity group, their figures are not included here and are shown separately below.

The PAC considered the outcomes of the review and found that the firm was still failing to comply with its obligations. The PAC issued a further action plan, which the firm fully implemented. The firm is now considered to comply with its obligations.

Due to the member firm's repeated failure to fulfil its obligations, the PAC ordered that the member firm be publicly reprimanded and pay a fine of £10,000 and costs of £2,268. This firm has been prioritised for future visits, and will be visited again in 2018.

Table 4.C: Focus: enforcement action by members of the legal affinity group

Enforcement action	Number of actions taken 2014/15	Number of actions taken 2015/16	Number of actions taken 2016/17
Expulsion/withdrawal of membership	32	7	6
Suspension	1	8	5
Fine	12	3	5
Undertaking/condition	27	3	3
Reprimand	6	0	3

4.13 Legal PBSs aligned their approach to provide data on enforcement specifically due to AML/CFT in 2015/16 – consequently data for previous years is not directly comparable.

Box 4.E: Case study – Solicitors Regulation Authority (SRA)

Three partners at a City of London law firm were penalised with a £10,000 fine each, as part of an £80,000 fine by the Solicitors Disciplinary Tribunal for breaching money-laundering rules. An international law firm, specialising in insurance, maritime and aviation law, was found to have allowed a client bank account to be used as an escrow facility which breached professional regulation.

All three partners were understood to have admitted breaching the professional rules, and were fined £10,000 each, with the rest of the £80,000 fine levied against the firm. The tribunal found that they had failed to adhere to the Money Laundering Regulations 2007. They also failed to heed the guidance in the SRA's fraudulent financial arrangements warning and their warning notice on money laundering. The firm was found to have failed to have adequate procedures in place to deal with dormant client balances.

Table 4.D: Focus: enforcement action by the FCA

Enforcement action	Number of actions taken 2014/15	Number of actions taken 2015/16	Number of actions taken 2016/17
Action plan	23	56	72
Early interventions	8	8	7
Section 166 reports	6	6	5
Fines	1	1	3

4.14 The FCA has a range of tools to address AML/CFT deficiencies in firms. In addition to financial penalties, the FCA uses early intervention techniques, firm-specific action plans as well as the power to require firms to cease certain types of business. The FCA can also require a firm to have a report undertaken by an independent skilled person – a Section 166 Report - to review aspects of a firm's activities that cause concern or where further analysis is required.

Box 4.F: Case study – FCA

In January 2017, the FCA fined Deutsche Bank £163m for serious failings in its AML controls. Between January 2012 and December 2015, the firm had failed to maintain an adequate AML control framework.

Deutsche Bank exposed the UK financial system to the risks of financial crime due to deficiencies in their AML control framework, particularly in relation to the establishment of new customer relationships and ongoing monitoring of transactions.

This is the largest financial penalty for AML control failings ever imposed by the FCA or the Financial Services Authority, the predecessor regulator. The size of the fine reflects the seriousness of Deutsche Bank’s failings. Deutsche Bank is continuing to undertake remedial action and has committed significant resources to improving its AML control framework.

Table 4.E: Focus: enforcement action by the Gambling Commission

Enforcement action	Number of actions taken 2014/15	Number of actions taken 2015/16	Number of actions taken 2016/17
Withdrawal of licence	2	0	0
Voluntary settlement	2	4	4
Undertaking/condition	1	0	1
Warning/condition	1	0	1
Advice to conduct	1	0	0

4.15 Since 2015/16, the Gambling Commission has provided data specifically on its AML sanctions. Earlier data also covers sanctions for other breaches.

Box 4.G: Case study – Thematic work undertaken by the Gambling Commission

In 2016, the Gambling Commission reviewed 11 non-remote casinos' compliance with the MLRs and identified a number of areas for improvement, including their processes for undertaking due diligence and ongoing monitoring of clients, their record keeping and their reporting of suspicious activity.

As a result, the Gambling Commission wrote to all non-remote casino operators setting out its findings and proposing that it work with the sector to ensure all casinos have robust safeguards in place to prevent money laundering. In response, the National Casino Forum created an AML working group to provide guidelines on best practice in AML/CFT controls. The Gambling Commission is monitoring the outcome of this work, and stands ready to intervene with enforcement action if necessary.

Table 4.F: Focus: enforcement action by HMRC

Enforcement action	Number of actions taken 2014/15	Number of actions taken 2015/16	Number of actions taken 2016/17
Fine	677	1,152	892
Warning	199	102	119
Action plan	492	243	231

4.16 HMRC has taken more enforcement action in recent years, including the number and value of penalties issued. Penalties for registration offences (for example, late renewals or trading while unregistered) increased by over 70% from 2014-15 to 2015-16 and the value of penalties issued in 2016-17 was the highest annual amount during HMRC's tenure as a supervisor, totalling over £1.1m.

4.17 HMRC does not have members so cannot expel members, but it can de-register businesses it supervises. There are a range of reasons for de-registration, including enforcement action (for example, HMRC can withdraw the fit and proper status of key personnel, and where no other fit and proper individuals can take over these key roles, the business must stop providing the regulated service, which can mean it closing) and administrative reasons (for example, if a business stops providing services subject to the MLRs).

4.18 Alongside its supervisory role, HMRC can also pursue prosecutions through its law enforcement powers under the Proceeds of Crime Act 2002 (POCA), which covers money laundering offences. Staff working on supervisory issues work closely with the wider investigation teams elsewhere in HMRC to ensure intelligence is shared effectively. In the financial years 2015/16 and 2016/17, 64 successful prosecutions were secured for money laundering and related offences.

Box 4.H: Case Study - HMRC

HMRC visited an MSB in 2012/13 and subsequently issued a series of advice letters to support it in meeting the required standard of compliance. These related to CDD, record keeping and policies and procedures. The business had previously received three warning letters for non-compliance with obligations under the MLRs 2007.

HMRC undertook a further follow-up visit to the business in July 2017, where it found the business had not adequately addressed its shortcomings. As a result, HMRC issued a penalty for £7,327. As the business had received numerous warnings and advice letters, no behaviour-based reduction was applied to the penalty.

A second follow-up visit showed that the business had made the necessary improvements and was found to be fully compliant with its obligations.

Review and next steps

4.19 Supervisors play a key role in ensuring regulated businesses are aware of their AML/CFT obligations. The Treasury is currently working with industry and supervisors to streamline the AML/CFT guidance provided for regulated businesses to support compliance with the MLRs, whilst minimising unnecessary burdens. In addition, the 2017 MLRs require all supervisors to provide the businesses they monitor with up-to-date information on ML/TF risks.

4.20 Supervisors have a range of tools to ensure that the businesses they supervise comply with their obligations. It is for each supervisor to determine an appropriate response following identification of shortcomings. The MLRs require all supervisors to maintain records of their supervisory activities, including their decisions not to act in a specific case. PBSs, in particular, are required by the MLRs to ensure their supervisory functions are operated independently of all other non-disciplinary functions. Going forward, OPBAS will liaise with all supervisors to discuss best practice in promoting and ensuring compliance. OPBAS will work with PBSs, in particular, to help ensure they promote consistently high levels of compliance across the regime, including through raising awareness and providing an effective deterrent.

Annex A

List of supervisors

Accountancy professional body AML supervisors

- Association of Accounting Technicians
- Association of Chartered Certified Accountants
- Association of International Accountants
- Association of Taxation Technicians
- Chartered Institute of Management Accountants
- Chartered Institute of Taxation
- Insolvency Practitioners Association
- Institute of Certified Bookkeepers
- Institute of Chartered Accountants in England and Wales
- Institute of Chartered Accountants in Ireland
- Institute of Chartered Accountants of Scotland
- Institute of Financial Accountants
- International Association of Bookkeepers

Legal professional body AML supervisors

- Chartered Institute of Legal Executives
- Council for Licensed Conveyancers
- Faculty of Advocates
- Faculty Office of the Archbishop of Canterbury
- General Council of the Bar
- General Council of the Bar of Northern Ireland
- Law Society
- Law Society of Northern Ireland
- Law Society of Scotland

Statutory AML supervisors

- HM Revenue and Customs
- The Financial Conduct Authority
- The Gambling Commission

Annex B

Definitions of sanctions or penalties

- Expulsion: To remove membership, authorisation, fit and proper status, and/or registration.
- Suspension: To suspend membership, authorisation, fit and proper status and/or registration.
- Fine: To levy a financial penalty.
- Reprimand: Any type of formal written warning issued by a tribunal, committee or organisation.
- Undertaking or condition: Any formal requirement to implement remediation or restrict ability to carry on business or offer specific services.
- Action plan: Any communication seeking improvements which is considered as part of the general capacity development and monitoring programme, rather than part of a formal disciplinary programme.
- Warning: Any communication with a firm cautioning against specific conduct.

Annex C

Characteristics of an effective AML/CFT supervisory system (FATF)

Immediate Outcome 3: Supervisors appropriately supervise, monitor and regulate financial institutions and DNFBPs for compliance with AML/CFT requirements commensurate with their risks.[1]

Characteristics of an effective system

- Supervision and monitoring address and mitigate the ML/TF risks in the financial and other relevant sectors by:
    - preventing criminals and their associates from holding, or being the beneficial owner of, a significant or controlling interest or a management function in financial institutions or DNFBPs; and
    - promptly identifying, remedying, and sanctioning, where appropriate, violations of AML/CFT requirements or failings in ML/TF risk management.
- Supervisors provide financial institutions and DNFBPs with adequate feedback and guidance on compliance with AML/CFT requirements. Over time, supervision and monitoring improve the level of AML/CFT compliance, and discourage attempts by criminals to abuse the financial and DNFBP sectors, particularly in the sectors most exposed to ML/TF risks.
- This outcome relates primarily to Recommendations 14, 26 to 28, 34 and 35, and also elements of Recommendations 1 and 40.

Core Issues to be considered in determining if Outcome 3 is being achieved

- How well does licensing, registration or other controls implemented by supervisors or other authorities prevent criminals and their associates from holding, or being the beneficial owner of a significant or controlling interest or holding a management function in financial institutions or DNFBPs? How well are breaches of such licensing or registration requirements detected?
- How well do the supervisors identify and maintain an understanding of the ML/TF risks in the financial and other sectors as a whole, between different sectors and types of institution, and of individual institutions?

[1] http://www.fatf-gafi.org/media/fatf/content/images/FATF%20Methodology%2022%20Feb%202013%20.pdf

- With a view to mitigating the risks, how well do supervisors, on a risk-sensitive basis, supervise or monitor the extent to which financial institutions and DNFBPs are complying with their AML/CFT requirements?
- To what extent are remedial actions and/or effective, proportionate and dissuasive sanctions applied in practice?
- To what extent are supervisors able to demonstrate that their actions have an effect on compliance by financial institutions and DNFBPs?
- How well do the supervisors promote a clear understanding by financial institutions and DNFBPs of their AML/CFT obligations and ML/TF risks?

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