Handbook of Anti Money Laundering
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6 THE UK REGULATORY FRAMEWORK

6.1 BACKGROUND

In the UK, financial services regulation has travelled through a series of routes to arrive at the current position, which itself is in a period of change. Initially, regulation in the UK for banking was the clear responsibility of the Bank of England, with its powers being enshrined in a series of banking laws and guidance published in various regulations.

This changed with the development of broader financial services regulation as a result of the implementation of the Financial Services Act 1986. This did not really change the responsibilities of the Bank of England, which remained a full central bank with responsibility for the regulation of banks, but introduced the Securities and Investments Board. The Board carried out very little direct regulation, but did ensure that a series of industry-based regulators achieved the standards of regulation required. Effectively, this enshrined the principle of self-regulation which became a driver for UK financial services regulation for a decade. The Securities and Investments Board was eventually replaced by the Financial Services Authority (FSA), which also took over the responsibilities for the majority of the self-regulatory bodies that previously existed (for example, the Personal Investment Authority (PIA) and the Investment Managers Regulatory Organisation (IMRO)).

6.2 THE FINANCIAL SERVICES ACT 2012

The most recent development came on 1st April, 2013, when the Financial Services Act 2012 divided the FSA into two new entities: the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA). The FCA regulates the financial services industry with a focus on consumers and stability within the industry, while the PRA, which is a part of the Bank of England, is responsible for the prudential regulation of banks, building societies, credit unions, insurers and major investment firms.

The Financial Services Act 2012 made significant amendments to the Financial Services and Markets Act 2002 (FSMA), which had previously set out the structure of financial service regulation in the UK.

The Financial Services Act imposes both definitive and aspirational objectives on both the FCA and the PRA.

6.3 THE FINANCIAL CONDUCT AUTHORITY OBJECTIVES

The single definitive objective of the FCA is "ensuring that the relevant markets function well". The relevant markets are defined as the financial markets, the markets for regulated financial services and the markets for services that are provided by persons other than authorised persons in carrying on regulated activities but are provided without contravening the general prohibition (see Section 6.6, "Fit and Proper Person Rules" below), and the FCA must take the following aspirational objectives into account when fulfilling this strategic objective.

6.3.1 The Integrity Objective

The integrity objective means protecting and enhancing the integrity of the UK financial system, including its soundness, stability and resilience, its not being used for a purpose connected with financial crime, its not being affected by behaviour that amounts to market abuse, the orderly operation of the financial markets and the transparency of the price-formation process in those markets.

This is similar to the "market confidence" objective which was imposed on the FSA by FSMA, although this objective was only written in very vague terms. The "integrity" objective is a direct response to the substantial negative publicity received by the banking sector during the 2008 crash and subsequent recession, and so the new regulatory requirements have a political as well as fiscal side to them.

The reduction of financial crime was a specified objective under the previous FSMA regime, but has now been reduced to the status of only a consideration as part of a wider objective. This could be seen to weaken the level of attention that is given to this area by regulators, although there is no evidence that this is actually the case. By focussing the regulation on systemic system maintenance and the customer, as the two regulators are now primarily tasked with achieving, the criminal law issues with respect to money laundering and terrorist financing become, to some extent, of secondary importance.

6.3.2 The Protection of Consumers Objective

The protection of consumers objective means securing the appropriate degree of protection for consumers, and was originally imposed on the Financial Services Authority under FSMA. In considering what degree of protection may be appropriate, the Authority must have regard to the differing degrees of risk involved in different kinds of investment or other transaction; the differing degrees of experience and expertise that different consumers may have in relation to different kinds of regulated activity; any information which the consumer financial education body has provided to the Authority in the exercise of the consumer financial education function; the needs that consumers may have for advice and accurate information; and the general principle that consumers should take responsibility for their decisions.

In addition to these considerations, the 2012 Act adds three extra factors which were not imposed on the FSA: the general principle that those providing regulated financial services should be expected to provide consumers with a level of care that is appropriate having regard to the degree of risk involved in relation to the investment or other transaction and the capabilities of the consumers in question; the differing expectations that consumers may have in relation to different kinds of investment or other transaction; and any information which the operator of the ombudsman scheme has provided to the FCA. These considerations have a protective nature to them, and are likely to have been implemented in response to the financial crisis and the negative publicity which followed.

6.3.3 The Competition Objective

The competition objective refers to the regulator promoting effective competition in the interests of consumers in the markets for regulated financial services. The matters to which the FCA may have regard include the needs of different consumers who use or may use those services, including their need for information that enables them to make informed choices; the ease with which consumers who may wish to use those services, including consumers in areas affected by social or economic deprivation, can access them; the ease with which consumers who obtain those services can change the person from whom they obtain them; the ease with which new entrants can enter the market; and how far competition is encouraging innovation.

The goal of this is to have a broader offering of services available to the customer, which are easy to understand and cost-effective. Of course, the impact of regulation is often to limit the choice available, as fewer firms are able to earn a return adequate to support their cost and capital structures, so the objective, while laudable, may be difficult to achieve in practice. The competition objective did not feature in the previous FSMA regime.

6.4 THE PRUDENTIAL REGULATION AUTHORITY (PRA) OBJECTIVES

The Financial Services Act imposes strategic objectives and an aspirational objective on the PRA in the same way as it does on the FCA. The PRA's main objective is to promote the safety and soundness of PRA-authorised persons, which it must do by seeking to ensure that the business of PRA-authorised persons is carried on in a way which avoids any adverse effect on the stability of the UK financial system, and seeking to minimise the adverse effect that the failure of a PRA-authorised person could be expected to have on the stability of the UK financial system.

6.4.1 Insurance Objective

The only aspirational objective imposed on the PRA is related to the insurance sector. In discharging its general functions so far as relating to a PRA-regulated activity relating to the effecting or carrying out of contracts of insurance or PRA-authorised persons carrying on that activity, the PRA must contribute to the securing of an appropriate degree of protection for those who are, or may become, policyholders. This section applies only if the effecting or carrying out of contracts of insurance as principal is, to any extent, a PRA-regulated activity.

6.5 ENHANCING PUBLIC UNDERSTANDING OF FINANCIAL MATTERS

The FSMA created the Consumer Financial Education Body to enhance the understanding and knowledge of members of the public of financial matters (including the UK financial system), and the ability of members of the public to manage their own financial affairs. The consumer financial education function included, in particular, promoting awareness of:

- The benefits of financial planning;
- The financial advantages and disadvantages in relation to the supply of particular kinds of goods or services;
- The benefits and risks associated with different kinds of financial dealing (which includes informing the FCA and other bodies of those benefits and risks);
- The publication of educational materials or the carrying out of other educational activities;
- The provision of information and advice to members of the public;
- Assisting members of the public with the management of debt; and
- Working with other organisations which provide debt services, with a view to improving the availability to the public of those services, the quality of the services provided and consistency in the services available, in the way in which they are provided and in the advice given.

Although the provisions for its creation are repealed by the Financial Services Act 2012, there are new provisions to continue its existence. Furthermore, the final two parts of its remit – both relating to debt – have been added, in response to the heightened public awareness and political implications of debt since 2008.

6.6 FIT AND PROPER PERSON RULES

The FSMA introduced the regulatory framework through the General Prohibition in 2000, and is unaltered by the recent legislative changes. The General Prohibition states that "no person may carry out a regulated activity in the UK unless they are an authorised or an exempt person". Therefore, firms and individuals who work for firms must be approved by the FCA. In order to be approved by the FCA individuals responsible must be "fit and proper", which means that they are considered appropriate people to be involved with such a significant role.

Individuals will be considered to be "fit and proper" by the FCA in relation to the following:

- Honesty, integrity and reputation;
- Competence and capacity;
- Financial soundness.

Within the rule book of the Financial Conduct Authority the regulations promulgated by the Joint Money Laundering Steering Group (see Chapter 7) are adopted as best practice. No separate detailed guidance regarding money-laundering deterrence and terrorist financing appears within the FCA handbook, although the FCA has released a separate guide to minimising the risk of money laundering, which is not binding.

6.7 FCA REGULATION AND MONEY-LAUNDERING DETERRENCE

With regard to discharging its general functions, both the FCA and the PRA are obliged, under the Financial Services Act, to have regard to:

1. The need to use the resources of each regulator in the most efficient and economic way.
2. The principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction.
3. The desirability of sustainable growth in the economy of the United Kingdom in the medium or long term.
4. The general principle that consumers should take responsibility for their decisions.
5. The responsibilities of the senior management of persons subject to requirements imposed by or under this Act, including those affecting consumers, in relation to compliance with those requirements.
6. The desirability, where appropriate, of each regulator exercising its functions in a way that recognises differences in the nature of, and objectives of, businesses carried on by different persons subject to requirements imposed by or under this Act.
7. The desirability in appropriate cases of each regulator publishing information relating to persons on whom requirements are imposed by or under this Act, or requiring such persons to publish information, as a means of contributing to the advancement by each regulator of its objectives.
8. The principle that the regulators should exercise their functions as transparently as possible.

The FCA's outline requirements relating to money laundering are contained in the FCA rulebook, under the Senior Management Arrangements, Systems and Controls (SYSC) rules. Having comparatively limited "rules" supplemented by a non-binding guidebook has enabled firms to have more discretion when choosing to adopt anti-money-laundering practices. Guidelines relating to money laundering contained in SYSC include the following:

- A firm must take reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements and standards under the regulatory system and for countering the risk that the firm might be used to further financial crime.
- A firm must ensure that these systems and controls enable it to identify, assess, monitor and manage money-laundering risk, and are comprehensive and proportionate to the nature, scale and complexity of its activities.
- A firm must carry out regular assessments of the adequacy of these systems and controls to ensure that it continues to comply with the requirements.
- The FCA, when considering whether a breach of its rules on systems and controls against money laundering has occurred, will have regard to whether a firm has

followed relevant provisions in the guidance for the UK financial sector issued by the Joint Money Laundering Steering Group.

- In identifying its money-laundering risk and in establishing the nature of these systems and controls, a firm should consider a range of factors, including its customer, product and activity profiles, its distribution channels, the complexity and volume of its transactions, its processes and systems and its operating environment.

The rulebook also provides that a firm should ensure that the systems and controls include:

- Appropriate training for its employees in relation to money laundering.
- Appropriate provision of information to its governing body and senior management, including a report at least annually by that firm's Money Laundering Reporting Officer (MLRO) on the operation and effectiveness of those systems and controls.
- Appropriate documentation of its risk-management policies and risk profile in relation to money laundering, including documentation of its application of those policies.
- Appropriate measures to ensure that money-laundering risk is taken into account in its day-to-day operation, including in relation to the development of new products, the taking on of new customers and changes in its business profile.
- Appropriate measures to ensure that procedures for identification of new customers do not unreasonably deny access to its services to potential customers who cannot reasonably be expected to produce detailed evidence of identity.

A firm must allocate to a director or senior manager (who may also be the Money Laundering Reporting Officer) overall responsibility within the firm for the establishment and maintenance of effective anti-money-laundering systems and controls.

Additionally, a firm must appoint an individual as MLRO, with responsibility for oversight of its compliance with the FCA's rules on systems and controls against money laundering, and ensure that its MLRO has a level of authority and independence within the firm and access to resources and information sufficient to enable him to carry out that responsibility. The job of the MLRO within a firm is to act as the focal point for all activity within the firm relating to combating money laundering. The FCA expects that a firm's MLRO will be based in the United Kingdom.

The regulatory structure under which UK money-laundering deterrence and terrorist-financing legislation operates is considered in the following sections.

6.8 THE PROCEEDS OF CRIME ACT 2002

The Proceeds of Crime Act 2002 (POCA) consolidates and extends the existing UK legislation regarding money laundering. The legislation covers all crimes and any dealing in criminal property, with no exceptions and unusually no de minimis. The effect of this is that any theft or other criminal offence regardless of value is, in principle, subject to these rules. The POCA has three main objectives:

1. It establishes the Assets Recovery Agency to conduct an investigation to discover whether a person holds criminal assets and to recover the assets in question.

2. It creates five investigative powers for the law-enforcement agencies:
   - A production order;
   - A search and seizure order;
   - A disclosure order;
   - A customer information order;
   - An account-monitoring order.
3. It establishes the following criminal offences:
   - Acquiring, using, possessing, concealing, disguising, converting, transferring or removing criminal property from the jurisdiction, or entering into or becoming involved in an arrangement to facilitate the acquisition, retention, use or control of criminal property by another person.
   - For persons working in the regulated sector, of failing to make a report where they have knowledge or suspicion of money laundering or reasonable grounds for having knowledge or suspicion that another person is laundering the proceeds of any criminal conduct, as soon as is reasonably practical after the information came to their attention in the course of their regulated business activities.
   - For anyone taking any action likely to prejudice an investigation by informing (tipping off) the person who is the subject of a suspicious report, that a report has been made to a nominated officer or to the Serious Organised Crime Agency (SOCA),[1] or that the police or customs authorities are carrying out, or intend to carry out, a money-laundering investigation.
   - Destroying or disposing of documents which are relevant to an investigation.
   - Failing to comply with a requirement imposed under a customer information order, or knowingly or recklessly making a statement in purported compliance with a customer information order that is false or misleading in a material particular.

POCA also sets out the maximum penalties as follows:

- For the offence of money laundering, 14 years' imprisonment and/or an unlimited fine. However, an offence is not committed if the offence was reported to SOCA as soon as was reasonably practical.
- For failing to make a report of suspected money laundering or for "tipping off", five years' imprisonment and/or an unlimited fine.
- For destroying or disposing of relevant documents, five years' imprisonment and/or an unlimited fine.

The Proceeds of Crime Act is just one of the many laws which impacts on money laundering and terrorist financing. It needs to be considered in terms of its impact on other

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[1] Note that on the 7th October, 2013, the Serious Organised Crime Agency (SOCA) became the National Crime Agency (NCA).

relevant regulation, including the Policing and Crime Act 2009, Coroners and Justice Act 2009, UK Borders Act 2007 and, most recently, the Crime and Courts Act 2013, as well as the four codes of practice which supplemented this legislation.

6.9 TERRORISM ACT 2000, AND THE ANTI-TERRORISM CRIME AND SECURITY ACT 2001

The Terrorism Act 2000 establishes a series of offences related to the involvement of persons or organisations in arrangements for facilitating, raising or using funds for terrorist purposes.

The Terrorism Act sets out the following criminal offences:

- For any person not to report the existence of terrorist property where there are reasonable grounds for knowing or suspecting the existence of terrorist property.
- For anyone taking any action likely to prejudice an investigation by informing (i.e. tipping off) the person who is the subject of a suspicion report, or anybody else that a disclosure has been made to a nominated officer or to the SOCA, or that the police or customs authorities are carrying out, or intending to carry out, a terrorist-financing investigation.
- For anyone entering into or becoming concerned in an arrangement which facilitates the retention or control by, or on behalf of, another person of terrorist property by concealment, by removal from the jurisdiction, by transfer to nominees or in any other way.

Other counter-terrorism legislation was passed in 2005 (Prevention of Terrorism Act 2005), 2006 (Terrorism Act 2006), 2008 (Counter-Terrorism Act 2008) and 2010 (the Terrorist Asset-Freezing etc. Act 2010), all of which state the prevention of terrorism as one of their purposes in their introductory text. This repeated strengthening of the counter-terrorism framework highlights the UK's dedication to preventing this area of financial crime. Under the Terrorist Asset-Freezing etc. Act 2010, the Treasury is required to publish a quarterly report to Parliament on its operation of the UK's asset-freezing regime.

The parallels to the POCA can be seen clearly, with the general wording being both consistent and similar.

The Terrorism Act then sets out the following penalties:

- The maximum penalty for failure to report under the circumstances set out above is five years' imprisonment and/or an unlimited fine.
- The maximum penalty for the offence of actual money laundering is 14 years' imprisonment and/or a unlimited fine.

Again, these are consistent with the approach adopted by the POCA.

The Anti-terrorism Crime and Security Act 2001 gives the authorities power to seize terrorist cash, to freeze terrorist assets and to direct firms in the regulated sector to provide the authorities with specified information on customers and their (terrorism-related) activities. As such, it implements those of the nine special recommendations of the Financial Action Task Force (FATF) not already incorporated into UK legislation.

6.10 MONEY LAUNDERING REGULATIONS 2007

The Money Laundering Regulations 2007 specify arrangements which must be in place within firms within the scope of the regulations, in order to prevent operations relating to money laundering or terrorist financing.

6.10.1 The Scope of the Regulations

In terms of their scope, the Money Laundering Regulations apply, *inter alia*, to:

- The regulated activities of all financial sector firms which include:
  - banks, building societies and other credit institutions;
  - individuals and firms engaged in regulated investment activities under the Financial Services and Markets Act 2000 (FSMA);
  - issuers of electronic money;
  - insurance companies undertaking long-term life business, including the life business of Lloyds of London;
  - Bureaux de change, cheque-encashment centres and money-transmission services;
  - Trust and company service providers;
  - Casinos;
  - Dealers in high-value goods (including auctioneers) who accept payment in cash of EUR 15,000 or more, whether this is a single or linked transaction;
  - Lawyers and accountants when undertaking relevant business.

6.10.2 The Key Requirements

Persons who are subject to the Money Laundering Regulations are required to establish adequate and appropriate policies and procedures in order to prevent operations relating to money laundering or terrorist financing, covering:

- Customer due diligence
- Reporting
- Record-keeping
- Internal control
- Risk assessment and management
- Compliance management
- Communications.

The FCA institutes proceedings for offences committed under the regulations against both regulated and non-regulated firms. A breach of the money-laundering regulations is not dependent on whether money laundering has actually taken place. Firms can be sanctioned for not having adequate anti-money laundering/counter-terrorist-funding systems. Failure to comply with any of the Money Laundering Regulations constitutes a punishable offence by a maximum of two years' imprisonment, a fine or both.

As you can see, these broadly address the issues set out in the EU's Third Directive, as discussed in Chapter 4.