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Internal Controls, Policies and Procedures

10.1 Duty to Establish Policies and Procedures

No financial institution or professional sector firm is immune from the risk of being used to launder the proceeds of crime. The reputational risk from becoming involved with criminal money can be fatal for any financial institution or professional firm, regardless of whether a criminal prosecution is brought against the business. All relevant institutions and firms should therefore be vigilant in guarding against their involvement or misuse for money laundering activities

Financial institutions and professional firms should establish clear responsibilities and accountabilities to ensure that policies, procedures and controls are introduced and maintained which deter criminals from using their facilities for money laundering. Business relationships should not be entered into or funds accepted where there is reasonable cause to believe that the assets or funds concerned have been acquired illegally or represent the proceeds of criminal activity. In addition to complying with the law, such a policy makes good business sense and will help to guard against fraud and bad debts.

In line with the interpretative note to FATF Recommendation 15, relevant businesses should consider appointing a money laundering compliance officer at managerial level to undertake this role (which may in any case be a legal requirement). This role may be combined with that of the money laundering reporting officer (see section 10.3).

FATF Recommendation 15 states that:

Financial institutions should develop programmes against money laundering and terrorist financing. These programmes should include:

a) The development of internal policies, procedures and controls, including appropriate compliance management arrangements, and adequate screening procedures to ensure high standards when hiring employees;

b) A ongoing employee training programme;

c) A audit function to test the system.

Recommendation 16 extends this requirement to lawyers and accountants when they are carrying out financial transactions for clients relating to:

- Buying and selling of real estate;
- Managing of client money, securities or other assets;

- Management of bank, savings or securities accounts;
- Organisation of contributions for the creation, operation or management of companies;
- Creation, operation or management of legal persons or arrangements, and buying and selling of business entities.

10.2 The Need to Tailor Policies and Procedures

Financial institutions should consider the money laundering risks posed by the products and services they offer, and devise their procedures with due regard to those risks. The highest risk generally relates to those products or services where third party funds can be freely received or where funds can be paid to, or received, from third parties without evidence of identity of the third party being taken. For example, some of the highest risk products are those offering money transfer facilities through cheque books, telegraphic transfers, deposits from third parties, cash withdrawals or other means. Bank current accounts naturally fall within this category because third party funds are continually received for credit to the account and it would be wholly impractical to identify all providers of such funds.

Some of the lowest risk products are those where funds can only be received from a named investor by way of payment from an account held in the investor's name and where the funds can only be returned to the named investor. No third party funding or payments are possible and therefore the beneficial owner of the funds deposited or invested is always the same. Insurance products and some deposit/savings accounts generally fall within this category.

The geographical location of a financial institution's customer base will also affect the money laundering risk analysis. Financial institutions that have a significant proportion of their customer base,i located in countries

- without equivalent anti-money laundering strategies for the financial sector; or
- where cash is the normal medium of exchange; or
- where there is a politically unstable regime with high levels of public or private sector corruption; or
- that are known to be drug producing or drug transit countries

will need to consider what additional due diligence procedures are necessary to manage the enhanced risks of money laundering. Additional monitoring should also be considered and appropriate measures put in place to manage the enhanced risk of money laundering in respect of funds received from such countries.

The FATF Recommendations also recognise that a risk-based approach is necessary

in relation to business with countries that have insufficient anti-money laundering strategies.

FATF Recommendation 21 states that:

> *Financial institutions should give special attention to business relations and transactions with persons, including companies and financial institutions, from countries which do not or insufficiently apply the FATF Recommendations. Whenever these transactions have no apparent economic or visible lawful purpose, their background and purpose should, as far as possible, be examined, the findings established in writing and be available to the competent authorities., Where such a country continues not to apply or insufficiently applies the FATF recommendations countries should be apply to apply appropriate countermeasures.*

10.3 Appointment of Money Laundering Reporting Officer

Financial institutions, professional firms and other designated businesses will find it helpful to establish a central point of contact with enforcement agencies in order to handle the reported suspicions of their staff regarding money laundering. This person, for the sake of simplicity, is referred to as the 'Money Laundering Reporting Officer' (again, this may be a legal requirement). Relevant businesses should:

- Introduce procedures for the prompt validation of suspicions and subsequent reporting to the central reporting agency;
- Provide the MLRO with the necessary access to systems and records to fulfil this requirement;
- Establish clear accountabilities for the design and delivery of necessary education and training programmes; and
- Establish close co-operation and liaison with the enforcement agencies.

The MLRO should normally be a person who is employed within the institution or firm as a member of senior management and the role may be combined with that of money laundering compliance officer (see section 10.1). Where there are business operations over several jurisdictions, a separate MLRO should be appointed within each jurisdiction.

(The role of the MLRO is discussed in Chapter 12.)

10.4 The Objectives of a Compliance Policy

Before drafting detailed procedures, it is beneficial for a financial institution, professional firm, or other relevant business to address the key policy issues which impact on compliance, and within which the detailed procedures will operate.

The objective of the policy is two-fold:

- To communicate the institution's intent to managers and staff internally; and
- To provide evidence to an external party (such as a supervisor) of the institution's intent to comply.

The policy should be endorsed at senior level and should include:

- A statement of intent to comply with the spirit of domestic legislation;
- An explanatory statement of requirements of compliance in overseas subsidiaries/ branches, or how compliance requirements from an overseas parent will be reconciled with domestic legislation;
- A statement of intent to comply with domestic/overseas guidance notes issued by supervisors, regulators or representative bodies;
- An explanatory statement of acceptable criteria (if any) for accepting business from a customer whose identity cannot be verified in accordance with the letter of the law. If there is to be any discretion, it should be stated who may exercise it;
- An explanatory statement of criteria for continuing, accepting or declining business when suspicious. Again, if there is to be any discretion, it should be stated who may exercise it;
- Definitions of responsibilities, covering compliance, reporting, education and training and audit (see below);
- A statement of the institution's disciplinary attitude to an employee's willful non-compliance.

10.5 Compliance Monitoring and Auditing

A sound anti-money laundering compliance policy should be established at board and senior management level. Management need to be satisfied that the risk of their institution being used for money laundering has been minimised and that any requirements under money laundering regulations to maintain such procedures has been discharged.

To enable the Board to assess compliance by the financial institution with the national legislation and strategies, it is good practice to commission an annual report from the money laundering compliance officer/MLRO. An annual compliance report might cover the following:

- Any changes made or recommended in respect of new legislation, rules or industry guidance;

- Any compliance deficiencies that have been identified relating to current policies and procedures, and either the action taken or recommendations for change;
- A risk assessment of any new products and services and the compliance measures that have either been implemented or are recommended;
- The nature of the review taken out on jurisdictions placed on the FATF NCCT list, the results of that review and the measures taken to close out, monitor or block further business with that jurisdiction;
- The number of internal reports that have been received from each separate division, product area, subsidiary, etc.;
- The percentage of those reports that have been submitted to law enforcement;
- The number and nature of enquires or court orders received from law enforcement either arising out of the reports or otherwise;
- Any perceived deficiencies in the reporting procedures and any changes implemented or recommended;
- Information concerning which staff have received training during the period, the method of training, and any results or observations arising out of the training;
- Any additional information concerning communications to staff;
- Any recommendation concerning additional resource requirements to ensure effective compliance.

As good practice, internal audit or the external auditors should be asked to verify, on a regular basis, compliance with policies, procedures and controls relating to money laundering prevention.

10.6 Communication of Policies to Staff

The communication of an institution or firm's policies and procedures to prevent money laundering, and training in how to apply those procedures, underpins all other anti-money laundering strategies. Staff who are meeting with customers or handling transactions or instructions will either be a firm's strongest defence against money laundering or its weakest link. The means by which their obligations are communicated to them, and the effectiveness of the associated training, will determine the success of the institution's anti-money laundering strategy.

It is also important that the procedures and responsibilities for monitoring compliance with, and the effectiveness of, money laundering policies and procedures are clearly laid down by all financial institutions and communicated to management and staff.

As stated in section 10.2, the variety of products and services that may be offered by firms, and the nature and geographical location of the customer base, carry with them different money laundering risks and vulnerabilities. Institutions and firms will therefore need to determine their strategy and communicate to staff any types of business that will not be accepted, or the criteria to be used either for rejected transactions or for closing out a business relationship that has deemed to have become too high a risk.

The means of delivering information to staff are considered in Chapter 14

10.7 Group Policies

Many financial institutions or professional firms are branches or subsidiaries of a group with its head office in a different jurisdiction which may require adherence to a group policy in respect of money laundering procedures.

FATF Recommendation 22 states that:

> *Financial institutions should ensure that the principles applicable to financial institutions mentioned above are also applied to branches and majority owned subsidiaries located abroad, especially in countries which do not or insufficiently apply the FATF Recommendations to the extent that local applicable laws and regulations permit. When local applicable laws and regulations prohibit this implementation, competent authorities in the country of the parent institution should be informed by the financial institutions that they cannot apply the FATF Recommendations.*

A group policy might require that all overseas branches and subsidiaries undertake identification and record-keeping procedures at least to the standards in the home country or, if standards in the host country are more rigorous, to those higher standards. When complying with a group policy, a financial institution should ensure that its own policies in respect of verification of identity and record keeping do not fall below those recognised in the host state.

Even where a group policy exists, the offences to which the money laundering legislation in the host country relates must be adhered to in accordance with local laws and procedures to ensure that any local confidentiality requirements are not breached. Suspicions of money laundering must therefore always be reported within the jurisdiction where the suspicion(s) arose and the records of the related transaction(s) are held.