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Internal Controls, Policies and Procedures

9.1 Duty to Establish Policies and Procedures

No financial sector business 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, regardless of whether a criminal prosecution is brought against the business. Financial institutions should therefore be vigilant to guard against their involvement or misuse for money laundering activities.

Financial institutions 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.

Financial institutions may find it helpful to appoint a money laundering compliance officer to undertake this role. (This may in any case be a legal requirement.) This role may be combined with that of the Money Laundering Reporting Officer (see paragraph 9.3).

FATF Recommendation 19 states:

Financial institutions should develop programmes against money laundering. The programmes should include, as a minimum:

(i) the development of internal policies, procedures and controls, including the designation of Compliance Officers at management level, and adequate screening procedures to ensure high standards when hiring employees;

(ii) an ongoing employee training programme;

(iii) an audit function to test the system.

9.2 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 provided. 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 routinely received as credits 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 located in countries without equivalent anti-money laundering strategies for the financial sector, or where cash is the normal medium of exchange, will need to consider what additional due diligence procedures are necessary to manage the enhanced risks of money laundering. This is also true of institutions based in countries 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. 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:

> *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 these 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 help supervisors, auditors and law enforcement agencies.*

9.3 Appointment of a Money Laundering Reporting Officer

Financial institutions 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. (This may be a legal requirement.) Financial institutions 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;
- ❖ establish close co-operation and liaison with the enforcement agencies.

The MLRO should normally be a person who is employed within the financial institution, as a member of senior management. Where a financial institution operates within several jurisdictions, a separate MLRO should be appointed within each jurisdiction.

(The Role of the MLRO is discussed in Chapter 11.)

9.4 The Objectives of a Compliance Policy

Before drafting detailed procedures, it is beneficial for a financial institution 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 and 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.

9.5 Compliance Monitoring and Auditing

A sound anti-money laundering compliance policy should be established at board and senior management level. Management needs 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 following the publication of an FATF Recommendation 21 Notice concerning a non-compliant jurisdiction, 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.

9.6 Communication of Policies to Staff

The communication of a financial institution's policies and procedures to prevent money laundering, and the training in how to apply those procedures, underpin all other anti-money laundering strategies. Staff who are meeting with customers or handling transactions or instructions will 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 paragraph 9.2, 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. Financial institutions 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 is deemed to have become too high a risk.

(The means of delivering information to staff is considered in Chapter 13.)

9.7 Group Policies

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

FATF Recommendation 20 states:

Financial institutions should ensure that the principles mentioned above are also applied to branches and majority owned subsidiaries located abroad, especially in countries which do not or insufficiently apply these 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 mother institution should be informed by the financial institutions.

A group policy might require that all overseas branches and subsidiaries undertake identification and record-keeping procedures at least to the standards of 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 suspicions arise and the records of the related transactions are held.

9.8 US Anti-Money Laundering Strategy

Financial institutions should be aware that the USA will choose to apply its money laundering legislation with extra-territorial effect if an overseas institution conducting business in the USA moves criminally derived funds through the US clearing system. This can apply even where the overseas institution has no physical presence in the USA.

However, the fact that the US prosecuting authorities must prove knowledge of criminal origin of the funds, or that the member of staff undertaking the transaction was wilfully blind to the possibility that the funds were the proceeds of crime, does provide a significant defence for financial institutions that have anti-money laundering procedures in place which meet international standards.

Financial institutions should also note that US firms can be expected, from time to time, to examine their correspondent relationships to ensure that the risk of receiving criminal money through those relationships is minimised. Any financial institution acting as a conduit for funds flowing from higher risk countries to the USA via correspondent relationships should ensure that the necessary due diligence has been completed and that the beneficial owner of the funds has been satisfactorily identified.