

Consultation Response: Review of the UK's AML/CTF Regulatory and Supervisory Regime

OCTOBER 14, 2021

Introduction

Our purpose in submitting this response is to offer key considerations for HM Treasury (HMT) to assist with the review of the effectiveness of the current regulatory and supervisory regimes in the UK. In support of this submission, ACAMS worked in collaboration with our UK Chapter to host a dedicated cross-industry roundtable that examined the key themes raised by the review. We have additionally drawn upon ongoing dialogue within our global network on the effective implementation of regulations and best practices. Our submission reflects a consolidation of the insights and themes discussed both within the roundtable and through related global dialogue. We thank HM Treasury for advancing this important review and strongly believe it can pave the way in terms of real opportunities for transformative change.

About ACAMS

ACAMS is the largest international membership organization dedicated to enhancing the knowledge, skills, and expertise of anti-money laundering (AML)/counter-terrorist financing (CTF), sanctions, and other financial crime prevention professionals through training, best practices, and professional development. We have over 86,000 members present in 180 countries/regions and regularly work with governments, global think-tanks, and other like-minded organizations in the prevention of financial crime.

Review of the UK's AML/CTF Regulatory and Supervisory Regime

Key Themes for Consideration

As a significant player in the global financial market, the UK is vulnerable to financial and economic crime on a domestic and international level. The 2020 National Risk Assessment highlights that the threats facing the UK are evolving and adapting, due to a new wave of technology, capitalizing on new payment channels, and the rise of digitalization. We have seen a dramatic shift in society following the impacts of COVID-19 and organized criminals have responded in tandem. Increased use of social media platforms, cyber-enabled fraud, and the rise of cryptocurrency are just some of the mechanisms used to commit serious crime and launder money in the UK.

With this evolution of financial crime, the public and private sectors must be agile and dynamic in their fight against illegal activity, and seize the opportunity presented under this review to determine how best to tackle this global issue. In support of this, ACAMS has identified some priority areas that should be considered as part of the broader review. We have not responded to the individual questions posed in the Call for Evidence, but instead have consolidated our response under six thematic areas:

- 1. Effectiveness**

The need for defined and measurable outcomes of effectiveness, driven by national priorities, to focus directly on activities to stem illicit finance.
- 2. Use of a Risk-Based Approach**

There are elements of the UK regime that are not operating in the true spirit of a risk-based approach (RBA). To more effectively stem illicit flows, some readjustment will be required to ensure compliance is driven by outcomes, and not predominately focused on process or reliance on controls that are deemed ineffective. We must ensure the right controls, underpinned by technology, are driving the right outcomes.
- 3. Financial Inclusion**

Supporting the dialogue that high risk is not bad risk, the regime needs to better support pockets of customers, industry sectors, and countries to have legitimate access to the financial system, without fear of exclusion or shifting this activity to non-regulated sectors.
- 4. Intelligence-Led Information Sharing**

The use of public-private partnerships across all sectors in the anti-financial crime (AFC) ecosystem to support sharing of meaningful information linked to national priorities.
- 5. Global Divergence**

There is a real risk that the UK diverges from other global partners, which would cause conflict and challenges for multinational firms to navigate.
- 6. Structure of Supervisory Bodies**

Consistency of approach is needed to create a degree of certainty and expectation for market participants, raising the standards for supervision and thus confidence in supervisors.

1. Effectiveness

It is recognized that measuring effectiveness is inherently challenging. While the UK arguably has one of the more robust AML regimes globally, this consultation provides a unique opportunity for all stakeholders in the AFC ecosystem to take a step back and assess what effectiveness means for the UK. This should be undertaken at two levels. Firstly, how well supervisors are performing at effectively supporting the objectives of the Money Laundering Regulations (MLRs) and secondly, how firms are performing against these objectives.

Measuring Effectiveness

An initial observation from our members is that focus should be on how the public and private sectors are contributing meaningfully to effective outcomes of the objectives, rather than purely complying with regulation and supervisory expectations. Without defined and measurable outcomes, based on empirical evidence, we do not have a meaningful basis to determine if today's regime, and its gatekeepers, are operating effectively. Having a regulatory and supervisory environment that supports this will enable firms to direct resources and effort into activity that meets the objectives of the MLRs. Assessment of control frameworks should be tied in a measurable way to desired outcomes of the MLRs.

Supervisors should also be measured against a clear definition of what effective supervision is, and how it is consistently applied across the sectors. Whether this be number of investigations, actions taken against firms with persistent failures in the same areas, or types of enforcement action, it should be defined and measurable. Having the right measures to define supervisory effectiveness will drive up performance, and consequently confidence in their abilities, and in turn improve standards in the respective sectors.

National Priorities

The challenge often raised is that the MLRs are less effective in operation. Current implementation of regulation means firms are often extending effort in conducting low impact activities, because they believe this to be the expectation, rather than contributing to meaningful activity in tackling illicit crime. Transaction monitoring and screening are good examples of this; firms often deal with high volumes of alerts on activity that is not linked to money laundering or areas perceived as higher risk.

Introducing concise national priorities could help firms address how resources are pointed to tackle the most pressing issues of economic crime. Private and public sector firms should be able to make a proportionate reduction of activity in areas of lower impact. This will enable them to channel the right response and action in areas that will have more impact on current threat assessments and national priorities. At present, firms do not feel they can stop or reduce activity without an acceptance that some residual risks may get into the financial system.

Complexity of the UK Legal Framework

The evolution of the UK legal framework has meant that we have a complicated legal and regulatory system for our members to navigate. This includes: MLRs, the Proceeds of Crime Act (POCA), and the Sanctions and Anti-Money Laundering Act (SAMLA); many prosecutors and different law enforcement bodies; international standards; and various industry guidance. This makes meeting the expectations and requirements of the end-to-end system extremely complex for firms. No one body has the clearly defined authority or leadership to take collective decisions on what is needed to address the national objectives in stopping illicit finance.

Given the complexity of how the legal and regulatory framework is established, consideration needs to be given as to how firms can balance compliance with the letter of law and the spirit of what it sets out to achieve, i.e. stopping illicit funds. Measurable outcomes, linked to national priorities that set out the key areas of economic crime with support from all factions of the AFC community, are needed to address the true purpose of the MLRs.

2. Use of a Risk-Based Approach

The RBA is widely seen as the most effective way to manage and mitigate AFC risks. Its purpose is to enable countries, authorities, and firms to identify and assess their money laundering risks and determine appropriate strategies to mitigate them. However, the practical application remains predominately focused on process and principles rather than outcome. This means firms become overly focused on whether controls are compliant with regulatory principles, rather than the outcomes. For an RBA to be applied in the manner intended, firms should be able to demonstrate that the right controls are driving the right outcomes.

To support an RBA, firms need a baseline of good practice. If individual firms decide to deviate from good practice, they should be able to evidence that these alternative controls are delivering the right outcomes. Those controls should then be considered compliant, and therefore allow firms to remove inefficient processes that tend to cast the net too wide and create burdensome practices.

As per The Wolfsberg Group's recent paper on effectiveness¹, firms should be able to remove controls if they are deemed ineffective, rather than point resources and time at activity that does not mitigate risk. Through effective use of risk assessments, supported with a clear, documented, and well communicated risk appetite, which is subject to robust governance, firms should have the capacity to dispense of ineffective controls.

Supervision should then focus on whether outcomes have been effectively managed rather than whether firms have followed the usual prescriptive formulae to get there. The actions taken by firms should be influenced individually by type of firm, industry that they operate within, and size of firm. Therefore, areas such as the cadence of customer due diligence (CDD), or transaction monitoring (TM) scenarios and calibrations, could be guided by individual risk assessments rather than industry guidance.

To support an RBA as set out above, our members indicate that the MLRs should not be prescriptive; they should be proportionate, flexible, and dynamic. We should look to use public-private partnerships (PPP) to engage market participants, encouraging them to work together to develop basic principles on non-prescriptive legislation. This should show how compliance can be managed in an effective manner, taking away the need for companies to always chase a tick box approach and focus on mitigating risk.

The reality is that applying RBA effectively means there will not be a complete elimination of risk. It has to be accepted by all parties that with the application of risk-based controls, illicit funds may still get into the system.

Divergence on RBA

One area of concern is the divergence of RBA between supervisors and the industry. Proportionality is important; there needs to be an acceptance that risks will exist even with an effective RBA. Supervisors' focus should be on whether the issues identified are systemic, and if they impact on firms' ability to stop criminals and terrorists. Due to current detailed industry guidance and supervisory expectations, some firms have shied away from an RBA, often resulting in "gold plated" standards, and in some cases no adoption of an RBA. This may lead to overcomplicated policies that are difficult to operationalize, and procedures that staff cannot follow.

Tensions between RBA and the Need for Certainty

An area of active debate is the inherent tension between a risk-based approach versus the industry requiring guidance and certainty on the parameters of operation. This is not unique to the UK and is an issue that is being seen globally. Given the reported £28.7 billion² spent on compliance in the UK in 2020, the industry is seeking assurance that considering the vast sums of money spent to tackle criminal activity, and the apparent lack of impact it is having on the overall level of criminal flow, resource and money is targeted in the right place.

Tensions also exist on RBA versus the case-by-case legal framework which contributes to operational issues in implementing MLRs. The industry needs a degree of certainty as to the regulatory expectations in scenario x, that ties to law enforcement's expectations in scenario x, and what banks should do in scenario x. If there is a degree of certainty as to what is expected, it helps firms adjust their own control environments and allows alignment across the industry.

¹ The Wolfsberg Group (2021), Demonstrating Effectiveness ([wolfsberg-principles.com](https://www.wolfsberg-principles.com))

² Lexis Nexis (2021), Cutting the costs of AML compliance (solutions.risk.lexisnexis.co.uk)

Achieving this balance is difficult, and the sophistication of a regulatory framework to support an RBA needs a shared understanding of what good looks like, with regulators who clearly set out what is guiding their analysis of best practices.

3. Financial Inclusion

Due to the challenges raised above, there is a fundamental issue on appetite for managing risk which can often result in a conservative risk appetite. The effort of managing risk, the cost of compliance, and the cost benefit analysis of this often leads firms to consider if access to a particular market or sector of customers is worth the risk of getting it wrong. This can mean firms exclude customers from their risk appetite resulting in “de-risking” for pockets of customers.

It must be highlighted that criminal actors are a minority of the customers the industry serves, and while “de-risking” may catch them, it can often have a disproportionately larger impact on legitimate actors. We must recognize that the AML ecosystem will not be effective if it excludes legitimate customers. Consequently, a substantial challenge that now needs to be addressed by the UK regime is how to promote “re-risking” by firms. Where relationships have been closed due to perceived risk factors and/or compliance costs, the question is: what action can be taken to voluntarily encourage the inclusion of higher risk relationships?

A good step forwards would be a concerted public-private sector dialogue, to address the uncertainty about exposure to certain higher risk groups and the resources needed to comply with compliance obligations. Overcoming this risk-reward dilemma will require collective thinking on sustainable and effective solutions that are based on a shared view of appropriate mitigation strategies.

At a macro level, we need an AML regime that stops illicit flows and protects the vulnerable, while providing a positive customer experience that does not force both legitimate and illegitimate actors into other areas outside of the regulated space. In considering this, the regime needs to look to obtain data to better understand how ineffective control frameworks are leading to the exclusion of good actors.

4. Intelligence-Led Information Sharing

To help law enforcement obtain evidence on illicit activity, the private sector needs to provide highly useful, relevant information. The UK's highly complex regime, with inflexible mandatory requirements, means activity is often concentrated on complying with regulation and guidance, rather than evaluating if information submitted is effectively stopping criminals abusing the system. It has been raised that due to lack of national priorities, and a lack of clear ownership of decision making on these priorities, there is in turn a lack of understanding of what information law enforcement are truly interested in.

To aid sharing the right information, public-private partnerships (PPPs) are key. To date the industry has seen many great examples of criminals being stopped using information shared, but this needs to increase. While this is very established in the banking system – through the Joint Money Laundering Intelligence Taskforce (JMLIT) – there needs to be a cross-sector approach to information sharing. Money laundering is not limited to financial services and transcends many sectors. A mechanism for information sharing in private-private sectors would be welcomed by our members. The aim should be to provide firms with a more holistic view of potential illicit activity, thus facilitating a more informed approach to information submitted to law enforcement.

To support building effective intelligence, relevant and quality suspicious activity report (SAR) submissions are fundamental. Supervisors can support this by contributing to what effectiveness means in terms of outbound information flows, by way of quality review and input. One of the core objectives of the MLRs is the provision of quality SARs, and supervisory bodies can add practical support to the industry through sample testing and evidencing what good looks like (albeit additional resources would be needed to support this).

Crucially important is the feedback loop from the public sector back to the private sector, addressing which information is important, what is adding value and what is not. By having effective channels of information sharing and communication across the industry, driven by an informed direction of strategic priorities, firms can add significant value as opposed to flooding law enforcement with less relevant information.

5. Global Divergence

An area that is not explicitly addressed in the consultation is the impact of firms which operate with an international footprint. For UK market participants operating within the international AFC system, conflicts and challenges exist, such as the level of due diligence or screening requirements. These cost money and resource, which may mean international business is less cost, and risk, effective.

There is a real risk of the UK having a divergence with other significant regulatory regimes. Firms who operate in multiple jurisdictions, or have overseas parents, run the practical issue of having to “level up” their AFC policies to address this. The UK should not sit in isolation in its regulatory framework. A parallel effort needs to be put in motion to ensure alignment globally on approaches to ensuring effectiveness and measurable outcomes.

In pursuing global effectiveness, there should be a concerted approach to streamline thinking on the benefits of technology in combatting financial crime. Our engagement globally notes that different organizations, regulators, and countries are at different stages of technological adoption. They have varying appetite for exploring how cutting-edge solutions can support the identification and reduction of financial crime. Given the globalized nature of risks facing the UK, we would encourage greater international dialogue on measures that could promote responsible innovation, in order to take the full advantage of the opportunities offered by new technology. To promote international innovation safely and securely, firms need coherence, consistency, and greater support from the regulatory and supervisory bodies. The UK would be well placed to lead this international dialogue.

6. Structure of Supervisory Bodies

The UK regime is comprised of several different supervisors. This has resulted in different regulatory priorities and varying approaches to the different sectors, and created a multibillion-pound industry of compliance. Today we see differences in guidance and advice on good practices across the sectors, along with variance to the extent of enforcement.

There is an active debate among our members as to whether the UK would benefit from one overarching supervisor, or if there is a need to streamline the supervisory bodies to drive up the consistency that the sector needs. Whatever direction the UK moves in, the priority should be to drive consistency of approach and oversight which would assist with driving up confidence in the supervisory regime.

It is recognized that the Office for Professional Body AML Supervision (OPBAS) is contributing to an improving supervisory environment for the professional bodies. However, their recent report on performance noted concerns with supervisory understanding of RBA and delays in taking action on issues with members, among other issues. Of additional concern is the recent Pandora Papers exposé, which highlighted the flow of activity linked to offshore companies, real estate, and misuse of legal entities. This must demonstrate that having a consistent and effective system of supervision of these sectors is fundamentally important in stemming illicit activity, particularly for a market such as the UK which sees significant risk linked to real estate and professional enablers.

Our observations highlight the need to focus on the strength and consistency of supervision of each sector, to ensure they have the same impact in containing financial crime. Raising the standards of supervision and providing more direction and support to the private sector requires a change in dialogue and engagement with the supervisors.

Conclusion

The UK AFC ecosystem is presented with a real opportunity for transformative change which is particularly important given the changes to financial crimes we are seeing, including the increasing digitalization of crime. The system is growing more and more complex, and it will be a significant challenge to reign this in. However, the use of technology, and the move away from traditional rules-based systems to a modern behavioral approach entrenched in AI and deep learning, are fundamental to tackling ever sophisticated criminal networks.

There is now a unique opportunity to move on from technical compliance to effective outcomes, which harness technology, share actionable intelligence, and use PPPs more broadly. Crucially, this needs to be underpinned by a true risk-based approach from the whole ecosystem across both the public and private sectors.

We must not forget the UK AML regime has one purpose – prevention, detection, and containment of financial crime. The aim within the UK, and indeed globally, should not be for firms to fulfil a tick box approach. Until we deliver measurable outcomes of AFC rather than the application of principles, we will not become fully effective. Let's grasp this opportunity to enhance the regime and make a significant difference.

We absolutely support that the UK's review of effectiveness should reflect a wider global dialogue on how to manage this, given the cross-border nature of illicit activity. ACAMS will draw from our engagement with global members to undertake specific work on effectiveness and global comparisons. We will further work in collaboration with our UK Chapter to build upon the themes set out in this paper.

ACAMS

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