Financial Services Regulatory Insights

FCA tells retail banks to address financial crime control failings

AT A GLANCE

July 2021

What's new?

- On 21 May 2021, the FCA wrote to retail banks in a Dear CEO letter detailing control failings across financial crime and anti-money laundering (AML) frameworks. The FCA published the letter on its website on 29 June 2021.
- The FCA has conducted assessments of retail banks' systems and controls and found weaknesses across governance and oversight, risk assessments, due diligence, transaction monitoring and suspicious activity reporting.
- These observations are based on a combination of desk-based and onsite assessments, as well as targeted supervisory interventions, and the FCA says it is 'disappointed' that significant weaknesses persist.

What does this mean?

- While the FCA recognises some good practice, common weaknesses were observed across:
- **Governance and oversight**: The FCA identifies a lack of distinction between first and second line of defence, with second line often carrying out first line activities such as due diligence. This results in a lack of financial crime ownership within the first line. The FCA particularly notes that UK branches and subsidiaries of foreign banks are often relying on the group to create and assure key controls. The FCA also identifies a lack of oversight of controls outsourced to third parties and lack of evidence of senior management approval in certain higher risk situations.
- **Risk assessments**: The FCA reviewed business-wide and customer risk assessments. Generally it finds that these assessments lack sufficient detail on financial crime risks and/or mitigating controls, with customer risk assessments often being too generic and/or showing discrepancies between rationale and documentation. Again, the FCA raises concerns over UK branches and subsidiaries of foreign banks which often rely on group-wide risk assessments which are not specific to risks within the UK branch/subsidiary.
- **Due diligence:** The FCA finds that Customer Due Diligence (CDD) processes are not adequately performed or captured, particularly in relation to purpose and intended nature of the customer relationship. There is also a lack of assessment of whether actual activity is in line with expected activity. When it comes to Enhanced Due Diligence (EDD), the FCA finds that EDD does not mitigate the risks identified in relation to customers, particularly in relation to Politically Exposed Persons. Finally, the FCA observes continued confusion between Source of Wealth and Source of Funds.

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- **Transaction monitoring:** The FCA finds that some firms are using 'off the shelf' transaction monitoring systems calibrated with arbitrary thresholds not specific to the firm's business activities, products or customers. The FCA notes that where group-wide systems are used, these are often not calibrated properly for activities within the UK branch or subsidiary. Overall, the FCA finds a lack of understanding of the technical set up of transaction monitoring systems, including data inputs, as well as poor rationale documentation.
- **Suspicious activity reporting:** The FCA identifies that processes for raising internal suspicions are often unclear and there is a risk of 'tipping off' due to lack of training. Finally, it finds a lack of evidence of investigation and the rationale for disclosure or non-disclosure isn't properly documented.

- Although the weaknesses reported are not exhaustive, firms will be expected to use them to form a basis to review their control environment against the FCA's financial crime handbook

What do firms need to do?

- The FCA expects firms to review the control weaknesses set out in the letter and carefully consider what steps can be taken to provide assurance across their financial crime control environment.
- The FCA also expects firms to complete a gap analysis against each of the common weaknesses by 17 September 2021 and create a plan to close any identified gaps in a reasonable time.
- Senior management, particularly those who are responsible for financial crime functions, should have the technical skills to be able to address the gaps identified in the gap analysis exercise. The Dear CEO letter issued in February 2021 already makes clear the responsibility for senior managers to disclose any financial crime weaknesses.

- While the letter is addressed to retail banking portfolio firms only, all firms can use the findings in the letter to consider the effectiveness of their own financial crime controls.

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