June 18, 2019

UK financial services regulators lay down a marker on money laundering in the capital markets

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In a report published on 10 June, the Financial Conduct Authority has set out its assessment of the money laundering risks and vulnerabilities in the capital markets. The report recognises that this is an area that historically may not have been specifically addressed by firms' systems and controls. Although it is aimed at helping firms with developing appropriate compliance arrangements rather than formally assessing or criticising firms' systems and controls, it identifies some areas in which the FCA has found a lack of awareness of risks and provides firms with clear reminders of their obligations under UK financial services and wider anti-money laundering ("AML") legislation. Some of the FCA's largest fines to date have been imposed for AML related shortcomings in relation to wholesale markets activity. The report reminds firms and individuals in all sectors that enforcement in this area is a priority.

Which areas has the FCA identified as problematic?

The FCA has found variations in the AML arrangements in place in the 19 firms it examined, including examples of good practice in some areas. It is clear, though, that systems and controls in this area are not as developed as the FCA considers they should be. It has identified a number of areas in which improvements are required. An overarching theme is that firms are not as aware of the risks of money laundering as they are of the risks of market abuse and that many firms have not addressed the potential linkages between the two. The report outlines that this means that measures directed specifically towards preventing and detecting money laundering in the capital markets are typically limited. It states that training of staff on when and how AML issues may arise and how to respond to them, including obtaining and maintaining appropriate information in relation to customers and assessing the risks associated with particular activities or transactions and submitting Suspicious Activity Reports ("SARs") is not sufficiently tailored or comprehensive.

The report points to shortcomings in customer due diligence (and in particular in identification of ultimate beneficial owners) undertaken in firms involved in capital markets transactions and a lack of understanding in some firms about which level of due diligence is required and when it is necessary to submit SARs. In particular, it highlights concerns about the amounts and quality of information shared between firms in transaction chains and, in some cases, a lack of understanding of the differences between SARs and Suspicious Transaction and Order Reports ("STORs") (which are completely separate mechanisms for reporting suspicions of market abuse and which do not discharge the money laundering reporting obligations of firms or individuals within them).

Practical points: How should firms respond to this review?

The FCA has not prescribed which steps firms should take to appropriately acknowledge and address money laundering risks in the capital markets. It has however sought to assist firms with recognising and dealing with such risks by setting out several illustrative typologies of money laundering likely to be found in the capital markets context – namely "free of payment" movement of securities and mirror trading. Supplementing advice it has already issued in its Financial Crime Guide and that published by the Joint Money Laundering Steering Group, it has also identified a non-exhaustive list of red flags, including remote booking of trades between group entities, pre-arranged trading, instructions or involvement from third parties and uneconomic or irrational trading strategies. Firms (and individuals within them, particularly those with specific AML responsibilities) should take careful note of this guidance and the FCA's expectations set out in the paper and ensure that their systems and controls reflect them.

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