

Financial Crime – Are you prepared?

Key message

The FSA has a stated objective of reducing the extent to which the companies it regulates can be used for a purpose connected with financial crime. Whilst it has always had this objective, it has, until recently, tended to focus its attention on anti-money laundering ('AML'). However, at the FSA's recent conference on fraud and money laundering, Philip Robinson, Financial Crime Sector Leader announced a shift in focus and set out the FSA's vision on how it intends to address the wider aspects of financial crime in the companies that it regulates. The platform was shared by Leigh Lewis, Permanent Secretary, Crime, Policing, Counter Terrorism and Delivery and other key Home Office officials, who emphasised the seriousness with which the Government was treating financial crime. The message that the Government and the FSA delivered was that:

Financial crime is a serious matter that can undermine the safety and security of the country. Senior management of financial services companies are responsible for ensuring that their companies are sufficiently well controlled and structured to prevent them being used by criminals or terrorists. Companies that are found not to have appropriate controls will be investigated and action may be taken.

In light of this change in focus by the FSA, management must ask the following questions:

- Are you and your staff aware of your personal obligations under the Proceeds of Crime Act?
- Is fraud on the Board agenda and is it properly discussed?
- Is there a properly disseminated fraud policy, which has board approval, and a whistle blowing hotline that works effectively?
- Do you receive reports on the fraud costs and risks within your organisation on a regular basis?

You may be surprised by the responses that you receive.

Background

The FSA's fourth statutory objective is to "reduce the extent to which it is possible for a business carried on by a regulated person to be used for a purpose connected with financial crime". In December 2003 the FSA published Discussion Paper 26 (DP 26) entitled 'Developing our policy on fraud and dishonesty'. The aim of the paper was to stimulate discussion around the FSA's role in reducing fraud and dishonesty in the financial services industry. The FSA has now published its approach to the supervision of financial crime and announced its initiatives at a conference at which senior members of government and law enforcement agencies were present.

Pushing fraud up the agenda

The concept of financial crime and the controls required to address it should not be new to senior management. Although fraud has not had the profile that other types of financial crime have had in recent years, the FSA Handbook nevertheless requires firms to establish and maintain systems and controls to counter the risk that their business may be used to further financial crime. Senior management are required to report 'significant' frauds, errors and irregularities to the FSA. The FSA has noted that very few reports are made to them and are querying why – is it because there are inadequate controls in place to identify such reportable events?

FSA's approach to monitoring financial crime

The FSA delivered a strong message that senior management are responsible for ensuring that there are adequate systems and controls around financial crime within their organisations under Senior Management Systems and Controls ('SYSC').

The FSA expects

- Senior management to take responsibility for managing fraud risks; and
- Firms to have effective systems and controls in place that are proportionate to the particular risks they face.

The FSA has not changed its focus in this regard - it is the supervision of those controls that is going to have an impact on firms. Over the coming months the FSA will be paying more attention to a firm's arrangements for managing its fraud risks as part of its general supervisory and other regulatory activities: and depending on what they find, and the circumstances surrounding it, they have not ruled out taking action against those found to be deficient.

Financial crime and operational risk

Whilst not given prominence by the FSA in their announcement, the FSA's redirected focus could be used to the advantage of financial services firms. Those entities impacted by the US Sarbanes-Oxley Act should already be aware of the impact that fraud and other aspects of financial crime can have on their operations and the risk of a material misstatement therein. With the anticipated adoption of Basel II, financial services companies who want to adopt the Advanced Measurement Approach ("AMA") would be remiss if they were not in a position to measure and control fraud risk as an operational cost. Thus the FSA's initiative should create an opportunity for an organisation to consider its overall fraud environment, identify its risks, assess its controls and measure its losses. If appropriate systems are in place to allow the control of this operational cost then this should provide a company with an advantage in respect of the amount of required capital as well as defending its reputation and complying with the requirements of the FSA Handbook.

Financial crime risk management

A company that does not have sufficient and appropriate controls in place to address the risks of it being exposed to financial crime may therefore suffer not only the cost of losses through frauds perpetrated against it but also regulatory action for failures in SYSC and possibly a capital cost. As a result of the FSA's initiative, firms should therefore assess their financial crime prevention environment and the controls that they have in place to prevent them from being used for a purpose connected to financial crime. They should also assess

their own and their staffs' level of awareness regarding their personal legal obligations and those of the company. To do this effectively, management should:

- Ensure that financial crime is on the Board agenda, that there is a fraud policy with appropriate senior management support and an effective whistle blowing hotline;
- Undertake a financial crime risk assessment and define the risks; and
- Define how they are going to value and record fraud risks and create a monitoring and recording system. Prepare appropriate MI and disseminate it, reporting the results to the Board.

A number of companies may not currently meet these benchmarks, however taking appropriate steps to do so will ensure not only regulatory compliance, but meet the legal obligations of management and enable the risks of financial crime within the company to be better known and controlled.

Contacts

At PricewaterhouseCoopers our teams are specialised in assisting firms with financial crime risk management. Our areas of expertise include:

- Fraud risk management reviews;
- Corporate governance reviews in relation to financial crime risk management (including S404);
- Regulatory compliance reviews (e.g. money laundering, market abuse); and
- Regulatory and forensic Investigations (e.g. fraud, accounting irregularities, money laundering, market abuse).

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