



PURPOSEFUL FINANCIAL CRIME CONTROLS:

Mitigating the Risk of a Skilled Person Review (s166)

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Contents

EXECUTIVE SUMMARY	3
BACKGROUND	4
SECTION 1: S166 OVERVIEW	5
Overview of The Tool	5
Possible consequences of a S166	6
SECTION 2: S166 PROCESS	7
S166 triggers	7
Process and experience of a s166	8
Receipt of a s166 requirement notice	8
Managing the s166 process	9
Findings, report, and action plan	11
SECTION 3: S166 MITIGANTS	12
Approach, preparation, and response to an FCA visit	12
Implementing and maintaining a robust financial crime framework	13
SECTION 4: Looking forward	16
How Plenitude can help	17



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EXECUTIVE SUMMARY

Since 2021, the Financial Conduct Authority (FCA) has shifted its focus towards a more assertive yet agile response. As the proportion of s166 reviews related to financial crime risks has remained steady between 2021 and 2023, it is clear that financial crime has and will remain a key concern for the regulators, with fraud and sanctions emerging as key areas of focus. According to the FCA 2022-23 annual report, the FCA commissioned a total of 47 Skilled Person Reports into firms, of which 10 pertain to failures in financial crime compliance, resulting in a total cost incurred by regulated firms of £35.1m. Over the past 12 months, the FCA has continued to issue finer to firms over failures under the anti-money laundering rules, with more attention paid to the role of intermediary and brokers. These trends are early indicators of how the FCA's assertive stance will shape up in the coming year.

As activity of the FCA's enforcement arm has increased, so has that of the supervision arm in the form of the number of Skilled Person Reviews under section 166 of the Financial Services and Markets Act 2000 (FSMA), also known as a "Section 166" or "s166". The FCA Handbook refers to a s166 in the following way: "Skilled person reviews are considered to be an effective regulatory tool and have a good record of mitigating risks to consumers." Essentially, this means that Money Laundering Reporting Officers (MLROs - also known as the "SMF 17") and senior management, including at board level, must ensure they implement a robust financial crime framework, systems and controls to effectively mitigate financial crime risk, taking into consideration the broader context of the FCA's aims. These aims can be determined by examining feedback from the FCA previously provided to the firm, publicised FCA speeches, "Dear CEO" letters, and root cause issues highlighted in FCA notices.

In light of the current supervisory and data-led intelligence approach taken by the FCA, firms also need to be aware of the typical factors which might trigger a s166 and if a firm may become the subject of a Section 166, have a thorough understanding of the process and experience, including the oft-overlooked 'human factor'. Ultimately, what it comes down to is the culture of compliance - all the way from board-level down to the employee ('tone from the top'), and the tone from all employees themselves ('tone from

within'). This entails an understanding of the financial crime risks the firm faces, ongoing monitoring and testing to ensure the controls remain appropriate, and a commitment to meet regulatory obligations effectively and sustainably as part of a risk-based approach. However, the complex nature of the UK's legal and regulatory framework, evolving regulations and the methods by which criminals seek to commit financial crime, all present significant challenges to firms in terms of their ability to effectively detect, deter and prevent financial crime. This then opens the door to potential regulatory scrutiny from the FCA.

In order to understand the pain points of a s166, it is useful to examine what steps might be taken to manage the process, such as how to deal with information requests, how to conduct meetings with a skilled person, and the governance, resource requirements and logistics involved. Due to the complex and onerous undertaking of a skilled person review, this paper will focus not only on the process of a s166 in terms of how to approach and prepare for the initial FCA visit, and how to approach feedback received following a FCA visit or publication of general observations pertinent to a firm's activities, but will also provide advice on measures to put in place to mitigate the risk of a s166 from arising in the first place.

BACKGROUND

In 2022/23, the Financial Conduct Authority (FCA) continued to take a tough stance on firms' regulatory obligations in line with Anti-Money Laundering (AML) and Counter Terrorist Financing (CTF) risk, as well as in response to concerns over financial crime risk management. This stance is reflected in the more than doubled financial penalties imposed by the FCA during the [financial year 2022/23](#), totaling [24 fines](#). The fact that the total cost of fines for firms declined from [£215m](#) to [£52m](#) from 2023 to 2024 should not be mistaken for a relaxation in the FCA's enforcement actions. In fact, the percentage of Skilled Person Reports (SPR) targeting financial crime compliance failures increased in 2022, with financial crime risk remaining amongst the top three triggers of SPRs. The spotlight on financial crime compliance was evident in a number of keynote speeches, including Joint Executive Director of Enforcement and Market Oversight Therese Chambers' [speech](#) at the FCA in June 2023, and Executive Director of Markets and International Sarah Pritchard's [address](#) at the Financial Crime Summit in September 2023. The FCA's publications of three "Dear CEO" letters in [January](#), [March](#), and [November](#) 2023 outlined weaknesses identified in financial crime controls, conduct and culture of wholesale broker firms, payment firms, and wealth management firms.

The FCA's forewarnings are not just an important indicator of its enforcement approach but should also be considered as an early warning in the context of the direction of travel for regulatory supervision.

To reinforce this, over the past 18 months the FCA has issued significant fines, including in December 2022 the [£107.3m fine to Santander UK Plc](#) for repeated failures to rectify deficiencies in its AML framework. The FCA's increasing use of its regulatory powers has not been the only action. Following the example it set in 2021 with its enforcement action against [NatWest bank](#), in October 2022 the FCA began criminal proceedings against [16 individuals](#) at other firms for a range of offences including insider dealing, money laundering and fraud.

Finally, at the end of the 2022/23 financial year, the FCA's enforcement team had [closed 22 cases](#), and continued to pursue an [additional 30 cases](#) focused on financial crime compliance failures against firms and individuals, involving, for example, systems and controls over Politically Exposed Persons (PEPs), cash intensive businesses, correspondent banking and trade finance, and transaction monitoring. The eventual outcome of these investigations will enter into the public domain through the publication of FCA notices.

Increased supervision: developments and statistics

The increased signalling by the FCA's enforcement team is important because the FCA's supervision and enforcement teams work hand in glove. It comes as no surprise, therefore, that as activity of the enforcement team has increased, so has that of the supervision team, in the form of skilled person reviews, for example, under s166 of the [Financial Services and Markets Act 2000 \(FSMA\)](#).

In March 2019, an [independent review](#) into the regulators' supervision of The Co-Operative Bank Holdings Ltd. (although not focused on financial crime) recommended that more use be made of skilled person reviews. Against this backdrop, the number of FCA skilled person reviews tackling financial crime has remained high, with 17 out of 68 cases opened by the FCA in 2020/21 addressing financial crime concerns (25%), 11 out of 38 cases in 2021/22 (29%), and 10 out of 47 cases in 2022/23 (21%).¹ The use of the s166 related to financial crime systems and controls frameworks is the focus of this paper.

¹ Based on data from: <https://www.fca.org.uk/publication/annual-reports/2021-22.pdf>; <https://www.fca.org.uk/publication/annual-reports/annual-report-2022-23.pdf>; <https://www.fca.org.uk/publication/annual-reports/annual-report-2020-21.pdf>

SECTION 1: S166 OVERVIEW

Overview of the Tool

A s166 is an independent review by a third party (a “skilled person”) about aspects of a regulated firm’s activities where the FCA has concerns or requires further analysis. The FCA Handbook observes that: “Skilled person reviews are considered to be an effective regulatory tool and have a good record of mitigating risks to consumers.” A s166 can have [various purposes](#), including to identify new risks, to monitor known risks, as a form of preventative action, or as a form of remedial action.

Essentially, a s166 is a written notice from the FCA or the Prudential Regulation Authority (PRA) to a regulated firm requiring specified documentation to be produced to the [skilled person](#) for review and assessment on matters that are a cause for concern. For the purposes of this paper, however, we will be considering notices issued by the FCA only.

The FCA has the power to appoint a skilled person of their own choosing (the direct appointment power is often referred to as the “nuclear option” and one which is rarely used). The most likely outcome is that the firm identifies three skilled persons who could be appointed, and with the FCA’s agreement, one of the three is chosen. The skilled person is generally identified from the [FCA’s Skilled Persons Panel](#) which covers 14 areas or ‘Lots’ of expertise, one of which is financial crime ([Lot E](#)). Because the FCA views the s166 as a supervisory rather than enforcement process, which is designed to allay the FCA’s concerns about the firm’s systems and controls, the cost of the skilled person falls on the firm to discharge.

The objective(s) of the s166 review will vary depending on the scope of the review. In broad terms, however, the skilled person will assess the adequacy and effectiveness of the financial crime control environment. If an attestation has been completed, the skilled person may also seek to test whether the issue has been effectively remediated or implemented to meet UK regulatory standards, and in either case that no further gaps exist.





Possible consequences of a S166

Outside of the remediation costs which can be significant, the imposition of a s166 is likely to consume a significant amount of time, energy and effort in the firm absorbing the focus of the Money Laundering Reporting Officer (MLRO), senior management (including at board level), as well as necessitating the redeployment of resources away from the Business As Usual (“BAU”) activity. If the Section 166 is accompanied by an FCA enforcement notice, it can also have a detrimental impact on reputation, investor confidence and, therefore, the valuation of the firm.

A s166 can also include the imposition of restrictions on business which might either be voluntary in nature (for example, a firm might take a decision to suspend the onboarding of new relationships in the business areas that are a cause for concern), or it could be imposed on the firm (meaning the FCA restricts, or adds further conditions to, the firm’s license to operate). These restrictions can be imposed for extended periods of time, particularly where the firm is unable to allay the FCA’s concerns, which will have a direct impact on revenue and profitability.

One example of this is Santander UK Plc, who was the subject of a [fine](#) of £107,793,300 in December 2022, for failing to properly oversee and manage its AML systems between December 2012 and October 2017. The adverse action was not only a fine in respect of the historic breaches, but the final notice published in 2022 revealed that in 2019, in order to mitigate AML risk, Santander UK voluntarily ceased the onboarding of Business Banking Customers through online and telephone channels, and in 2021 it voluntarily restricted the onboarding of Business Banking customers deemed to be high-risk. Santander also was subject to an additional financial crime s166 review in 2021, well after the relevant period (2012-2017) covered by the 2022 fine.

SECTION 2: S166 PROCESS

S166 triggers

It is unlikely that the FCA would initiate a s166 without prior engagement and feedback to the firm, as typically it arises out of the coalescence of a number of different indicators and factors over the passage of time. The following is a breakdown of those typical indicators and factors, and where one or more come together, it may trigger the initiation of a s166:

- The FCA uses [thematic reviews](#) to assess a current or emerging AML and CTF risk regarding an issue or product across several firms in a sector or market. Previous thematic reviews have resulted in a number of firms becoming the subject of a s166, with some of them turning into enforcement action;
- The FCA's [Firm Systematic Framework \(FSF\)](#) has been established to assess whether a firm is being run in a way that aligns with regulatory expectations. The intention is for the FSF to look more closely at a firm's business model and strategy, and ensure that customers and the integrity of the market are not placed at undue risk;
- Financial crime focused supervisory work streams such as the Modular Assessment Proactive Programme (MAPP), Proactive Anti-Money Laundering Programme (PAML) and Focused Supervisory Interventions (FSI);
- [Principle 11](#) of the FCA's Handbook sets out that: "a firm must deal with its regulators in an open and cooperative way." [The FCA expects](#) to be told about any significant failure in a firm's AML and CTF systems and controls as part of the disclosure;
- The FCA encourages employees and ex-employees of firms to report potential wrongdoing through [whistleblowing reports](#). FCA whistleblowing comes over and above standard supervisory and enforcement work and can, therefore, mean the FCA's attention is drawn to a firm where further enquiries will begin, or the FCA's view of a firm is confirmed;
- [Suspicious Activity Reports \(SARs\)](#) - whilst the National Crime Agency (NCA) will be focused primarily on the contents of the report it receives, the NCA may also become concerned about the way in which a firm's systems and controls have been operating. As a result, the NCA might draw its concerns to the FCA's attention which could trigger an enquiry;
- Certain types of firms must submit annual financial crime report ('[REP-CRIM](#)') to the FCA, which provides the FCA with information on a range of indicators that reflect the potential AML and CTF risks of a firm based on its activity. The information contained in a REP-CRIM, therefore, needs to present an accurate and complete picture to avoid potential scrutiny.

In the light of the current supervisory and data-led intelligence approach, the FCA would examine one or more of the above indicators and factors in conjunction with other parties, and typically, this process would include discussion with the firm as well. Should the FCA reach the requisite threshold to initiate a s166, the FCA will identify the particular areas that cause its concern.



Process and experience of a s166

Receipt of a s166 Requirement Notice

To initiate a S166 review, the FCA will issue a Draft Requirement Notice (DRN) which outlines the requirement to appoint a skilled person, background and concerns which have led to the S166 review, scope and key requirements of the report, alongside contractual arrangements and reporting requirements. If the firm is in agreement with the proposed scope of the S166 review in the DRN, the next step is to appoint the skilled person. Typically, the FCA will ask the firm to select a shortlist of three skilled persons and cite their preferred supplier – generally firms choose to select suppliers from the FCA’s list of approved [Skilled Persons “The Skilled Person Panel”](#). The FCA will then provide approval on the preferred supplier and the contract will be finalised between the firm and the skilled person. The Final Requirement Notice from the FCA will then be issued.

The human reaction - ‘What does it actually mean?’

The initial anxiety and general corporate and business concerns should not be underplayed at this point. In many cases firms are aware of the approaching s166 notice, but the potential impact of the review can still be unnerving. Senior executives and board members will be briefed, who could in turn be held accountable. Worries about morale, profit, share price and reputation will naturally follow. Not to mention, how much the remediation effort and review will cost the firm since the skilled person’s fees are the responsibility of the firm to discharge.

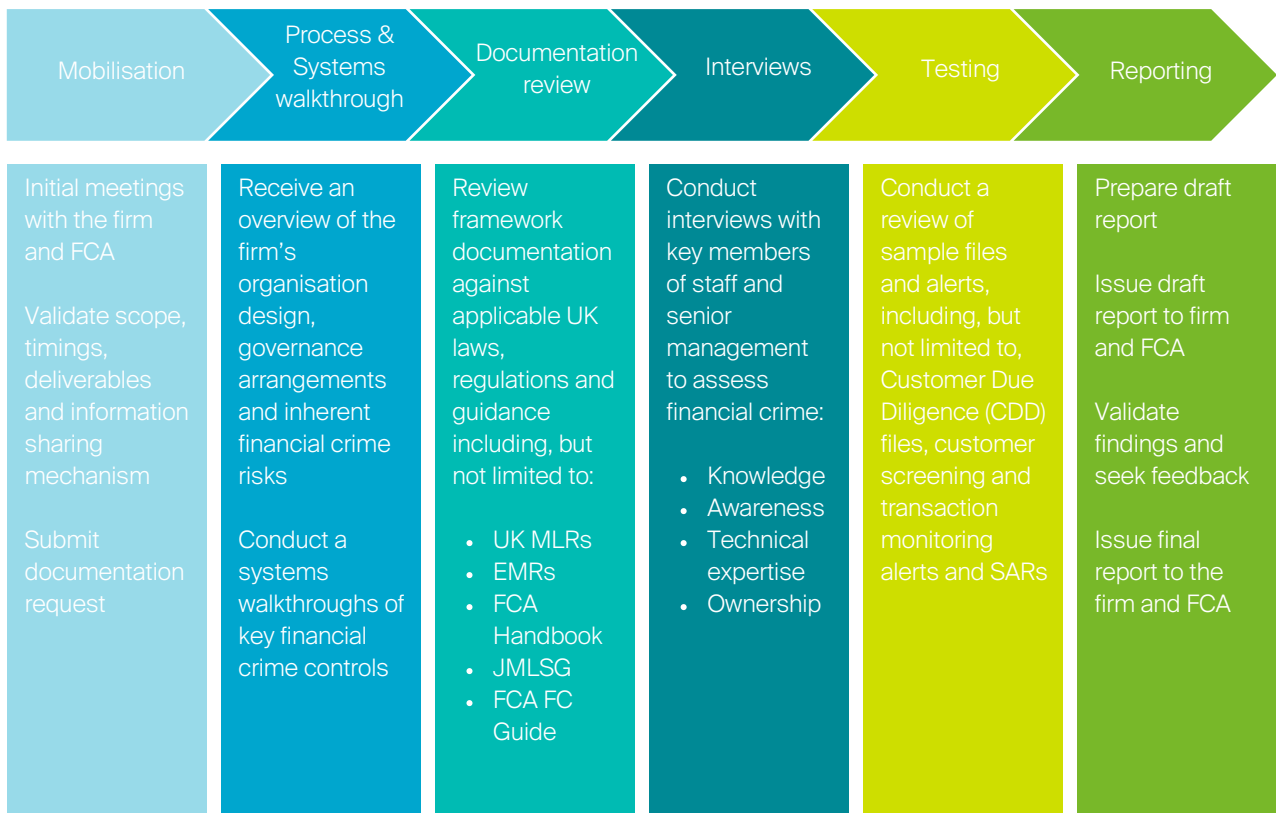
Managing the s166 process

S166 reviews are typically intensive and intrusive, involving a wide-ranging review of the firm’s financial crime controls, covering firm-wide governance arrangements through to detailed analysis of customer files and alert decisioning. Outlined below is a broad overview of the stages of a skilled person review, although not all of the activities will be applicable as they are subject to the size and scale of the review. Each review differs and may also involve a review by the skilled person of the remediation effort undertaken by the firm, or an ongoing engagement by the skilled person to oversee and assure the effectiveness of the firm’s remediation effort.

Summary of the s166 approach

Most reviews will likely include some or all of the “Stages of Review” set out below. The ‘Preparation’ and ‘Execution’ activities outlined provide an indication of activities which may be initiated or completed prior to the respective review stage, although subject to the review’s scope some activities may not be applicable.

Stages of the Review





Scoping of the review

At the outset of a s166, the FCA will define the intended scope of the review which is typically framed by the areas of concern. Where the FCA has conducted previous reviews or there is an open and ongoing dialogue with the firm, there is the possibility of discussions that will help the FCA to finalise the scope of the skilled person review. Part of the scoping exercise may also involve the firm presenting an overview of its business activities, functions and processes, which may take the form of a briefing pack or formal presentation. If not offered, this should be requested, as it enables the firm to provide important context prior to the scope being finalised or the commencement of the s166.

However, it should be noted that the skilled person may recommend to the FCA that the scope of the review be extended if they identify further areas of concern during their engagement. It is important, therefore, that firms have a clear understanding of the intended scope at the outset in order to focus their efforts, and identify the employees, business areas, systems and controls which will be the subject of the review.

Governance, Resourcing & Logistics

During a s166 review, firms should take guidance and advice from senior management on the required governance arrangements to direct and oversee the review. For shorter or less complex reviews, existing forums may be leveraged, although more complex, multi-jurisdiction or multi-business unit reviews may require a formalised project team and a bespoke governance framework. It is critical to clarify the roles and responsibilities of individuals who are collecting or providing information and minimise multiple touchpoints or hand-offs to reduce duplication of effort and maintain clear oversight. Whilst the time-consuming process of a s166 is underway, firms will clearly need to continue to run their day-to-day operations. This will

invariably present a challenge in balancing resources with the skilled person review, as the latter poses a highly stressful and pressurised environment with a large amount of scrutiny on particular individuals. As a result, firms and individuals should not underestimate the effort required to successfully manage a s166; indeed, some firms engage external support during the course of the review.

In terms of the effort, key considerations include: resources needed to interface with the skilled person; organisation of meetings; triaging and managing information and sample file requests; verification and quality assuring information and documentation; preparing for interviews; and ensuring (where possible) minutes are taken of the interviews so the firm has its own record. Not to mention the logistical challenge of additional desk space, computers, security passes, and where to locate the skilled person team if they are required to be onsite.

Finally, thought will need to be given on how to communicate to employees that the s166 is underway, group reporting (where applicable), and to have reactive press lines should the s166 become publicly known.

Information Request

At the commencement of a s166, the skilled person will provide the firm with a list of information and documentation they require, and an agreed timeline of activity for the initial material. The request can include an overview of the firm's business activities, governance arrangements, policies, standards, procedures, details on systems and controls, and sample files.

The information and documentation provided should be complete and validated by the firm before it is handed over to ensure the information requirement is met. Transparency and the quality and presentation of the material is also critical to avoid creating further concern. In addition, the firm should ensure that when handing over information containing personal data (or sensitive personal data), that this clearly falls within the information requirement. This is to ensure that the firm is protected from future claims, such as those arising under data protection and customer confidentiality. Further, the skilled person may also ask that senior employees in the firm provide attestations that the firm's systems and controls are working as they should and to identify areas

where they are not working effectively.

Onsite Visit and Interviews

The skilled person review of the firm will consist of a comprehensive process and systems walkthrough, interviews with individuals, and the consideration of material, to understand the firm's systems and controls. As a result, the skilled person will ask for scheduling dates for the system walkthrough, as well as for names and the scheduling of meetings with relevant individuals. These interviews can be meetings from the CEO to the CDD analyst or junior member of staff, as well as former employees. Hence, firms need to provide organisational structures, team names, team charts and other related information. Ahead of those meetings, and in general having engaged in a dialogue with the FCA, the firm should consider orientating relevant individuals by: (a) providing them with an explanation of the review process; (b) setting out what types of information they will need to provide to the skilled person in an appropriate manner; and (c) assessing whether further support is needed for them to ensure they discharge any duty of care to an employee.

Sample files, alerts, and SARs may also be assessed by the skilled person against applicable laws and regulations, as well as policies, standards, procedures and industry guidance. Sourcing, preparing and quality assuring of the files can involve extensive effort, and timelines for presenting the files for review should be agreed with the skilled person. In some instances where the production of material within a defined time period is a regulatory requirement (e.g. testing of the record retrieval process), timelines will be predefined.

Findings, report, and action plan

Post completion of a s166 review, the skilled person will issue a draft report and findings to the FCA and the firm. Depending on the nature of the review, this could be an assessment as to whether the firm has addressed the FCA's concerns or satisfied the attestation made by senior management. Based on the outcome of the review, the report could also highlight further areas for attention and recommendations to address them, or otherwise confirm that

remediation work has been carried out satisfactorily. It is important for firms to ensure that the findings on which the recommendations are based are factually accurate and help to identify the remedial activities required as part of the overall action plan.

Where required, the committed action plan should be realistic and achievable. Analysis should be conducted to determine both the effort required, and key dependencies to deliver the required enhancements, in particular where technology and systems changes are required. Overcommitting the firm can have negative consequences and create further perception issues with the FCA. Depending on the scope and magnitude of the action plan, a dedicated programme of work or project may need to be established with committed budget and resources from senior management, including at board level. Again the effort involved can divert valuable time and attention away from BAU activities and firms may need to consider external support for a period of time.

Ultimately, the s166 will not be complete until the areas that have been a cause for concern are rectified and validated. If the FCA becomes aware of further areas of concern, it may expand the scope of the skilled person's review. Similarly, if the FCA is of the view that further measures or actions are required, these will be put in place, such as business-wide restriction (voluntary or imposed) and enforcement action.

International Uncertainty

S166s are challenging enough, but recent world events, such as the wars in Ukraine and in Gaza and regional political reshaping, such as Brexit, are generating rapid changes in regulations, posing an additional challenge to firms. Notably the rapid increase and global nature of the rise in sanctions has added further complexity to compliance requirements. Furthermore, the paradigmatic shift in work culture that followed the COVID-19 pandemic has given rise to new operational challenges, such as how to share significant amounts of information securely and expeditiously, which could weaken firms' compliance efforts if not tackled effectively.

SECTION 3: S166 MITIGANTS

In general, in order to help prevent a s166 from arising, and especially in light of how the FCA's recent ["Dear CEO" letter](#) identified preventing financial crime as a top priority for the wealth management sector, firms should consider conducting a gap analysis or independent review of their control environment as a priority.

Furthermore, an action plan with appropriate prioritisation of work should be instituted to deal with the potential gaps identified through the analysis or review. This action plan, containing clear deliverables, needs to be endorsed and monitored by senior management, including at board level.

The FCA's ["Dear CEO" letter](#) to payment firms last year, also highlighted renewed concern towards the effectiveness, oversight, and maintenance of existing financial crime compliance policies and procedures. Similarly, the recent ["Dear CEO" letter](#) to wholesale broker firms underscored the importance of fostering a culture of integrity and compliance. However other sectors should take note of these letters and consider the FCA's concerns in the context of their financial crime oversight framework, systems and controls.

On an ongoing basis, investment in a robust monitoring, controls testing, and assurance framework is critical to proactively self-identify and mitigate gaps and issues, supported with robust and effective Management Information (MI) which is actively discussed and minuted at risk governance forums. Policies, standards, procedures and supporting controls should also be regularly gap assessed against new regulations or risk indicators identified by regulatory and trade bodies.

Essentially, MLROs and senior management, including at board level, must have a clear understanding of the broader context of the FCA's aims, which can be determined by examining feedback from the FCA previously provided to the firm, publicised FCA speeches, "Dear CEO" letters, and root cause issues highlighted in FCA notices.

It is against this backdrop that the following sections address the ways a firm may reduce the likelihood of it becoming the subject of a s166:

- ▲ Approach, preparation, and response to an FCA visit;
- ▲ How to approach feedback received following a FCA visit, or following the FCA publicising general observations pertinent to a firm's activities; and
- ▲ Measures in place to try and avoid a s166 from arising.

Approach, preparation, and response to FCA visit

Firms need to have a broad understanding of the reasons for the FCA visit and should already be considering solutions or mitigating actions to known gaps or potential issues.

Being able to demonstrate the firm has proactively self-identified issues and has a committed plan to address them is a key success factor in mitigating the risk of a s166. Potential gaps and issues can be identified by front running an independent review of the firm's systems and controls, or by leveraging the outputs of the financial crime risk assessment, monitoring and controls testing, assurance reviews, MI or open audit, and financial crime issues. While it might not be feasible to address known gaps and issues ahead of the visit, highlighting the gaps and supporting plan will provide assurance to the FCA and mitigate the perception that senior management, including at board level, have been 'asleep at the wheel'.

In summary, firms who are proactive, transparent, and able to demonstrate they are actively seeking to address known gaps and deficiencies with the support from the senior management, including at board level, are less likely to face a s166.

FCA feedback

While the temptation may be for firms to conduct a quick gap analysis, it is far better and prudent to take the time to step back and consider the areas that the FCA has focused on and the ancillary issues linked to them - which admittedly requires an element of 'reading in between the lines'.

Strategic mindset

Now the FCA is expressing its observations and concerns in the public domain, firms should be

sitting up and taking them into account. For example, firms should examine their REP-CRIM (see above in Section 2) to get a better idea of the areas the FCA may focus their attention on, and can, therefore, examine the robustness of their own internal systems and controls, and related risks, accordingly. In addition, firms should carefully consider the FCA's speeches, including on purposeful AML controls and the "Dear CEO" letters.

Ultimately, what it comes down to is a culture of compliance - all the way from board-level down to the employee ('tone from the top'), and the tone from all employees themselves ('tone from within') - in the form of understanding the financial crime risks the firm faces, why a control is in place, and a commitment to meeting regulatory obligations effectively and sustainably as part of a risk-based approach. If there is a clear commitment to proactively self-identify issues and enhance the control environment, and that the firm has a demonstrable plan to address any known gaps, there is a greater chance that a firm will be successful in mitigating risk and avoid a s166, or more quickly extract itself from a s166.

Implementing and maintaining a robust financial crime framework

There are a number of measures that should be implemented to self-identify potential issues and mitigate the risk of a s166 from arising, such as Governance, oversight and MI, effective policies and procedures, a comprehensive risk assessment (BWRA and CRA), transaction monitoring and screening, quality assurance and testing (including comprehensive MLRO and REP-CRIM reports), appropriate backlog management, and training.

Risk appetite, risk assessment & policies, standards & procedures

Ensure firms have up-to-date and mapped risk appetite, risk assessment, policies, standards and procedures, which are supported by a robust compliance culture and Three Lines of Defence (3LOD).

Risk-based policies, standards and procedures - the FCA's expectation

The FCA has been explicit about its concerns that firms' lack of adequate risk-based implementation of existing systems for addressing AML and CTF. Sarah Pritchard, Executive Director at the FCA, stated in her September 2023 [speech](#):



Firms should calibrate their financial crime fighting systems to the right risk level – whether that be high or low - and expect spot checks by the FCA.

Pritchard then continued:

[...] Never be afraid to question if your firm has the right risk calibration – checking if it is proportionate – whether it is too high or too low. If you're working in financial crime in the first line of defence, you should be able to see the golden thread between your activity and protecting the public from serious crime [...] Our recent testing of firms' compliance with sanctions was driven by data and tech. When we did this testing, we found good practice and bad. Good firms knew their client base, knew who they were dealing with and calibrated their sanctions alerting systems to UK as well as international sanctions lists. Bad firms didn't.



The following actions should be proactively undertaken by firms to ensure a robust financial crime framework is in place. This in turn will reduce the risk of the firm becoming subject to a s166:

- ▲ Ensure the Board has clearly articulated its risk appetite in line with its business activities and key inherent risk drivers, ensuring risk exposure is regularly monitored through agreed metrics and Key Risk Indicators linked to risk appetite statements;
- ▲ Conduct and evidence a formal annual review and gap analysis of the current financial crime risk assessment and, in particular, ensure that the methodology meets regulatory requirements with respect to risk factors (customer, products & services, jurisdiction, transactions, and delivery channels) and consider control effectiveness and quality incorporating consideration of its third party or in-sourced providers;
- ▲ Ensure and evidence that financial crime policies, standards and procedures fully reflect applicable laws, regulations and guidance by conducting a formal gap analysis across each of its product offerings and across delegated activities such as third party or in-sourced providers;
- ▲ Conduct and evidence a formal review and gap analysis of the customer risk-rating methodology to ensure it meets regulatory requirements and, in particular, ensure the methodology reflects all risk factors (including customer characteristics, countries/locations, products, distribution channels and transactions/operations, as well as having appropriate weightings applied to determine the overall risk score). Supporting risk lists should also be reviewed on a regular basis to ensure they meet regulatory requirements and evolving risk indicators;
- ▲ To mitigate the risk associated with perceived vulnerabilities in relation to Customer Due Diligence (CDD) (including ongoing monitoring), conduct and evidence a review of the first-line controls assurance process, and/or the second-line monitoring and controls testing plan, to ensure that they provide appropriate coverage across all customers, beneficial owners and related AML and CTF controls. Determine whether current testing is appropriate and meets regulatory expectations;

- ▲ For ongoing monitoring of transactions, ensure that the related controls are effective by (amongst other things) including mechanisms to identify and implement relevant risk typologies into the ongoing monitoring of transaction, and calibrate and test any transaction monitoring systems and screening systems on an ongoing basis so that they remain aligned to AML and CTF risk assessments and regulatory requirements.

In addition, it is important for firms to have a clear position on the following matters which have been the subject of the FCA's focus:

Backlogs

Where backlogs occur, monitor them and understand the effect and potential risk

The creation of a backlog of periodic, 'Customer Due Diligence' (CDD) file refreshes, or transaction monitoring and customer screening alerts, creates concern with the FCA on the basis that it highlights the firm is unable to manage its controls effectively and might be exposed to unidentified financial crime risks. An effective risk-based approach needs to be applied to manage any backlogs. For example, if work in relation to the alerts has been delayed, rather than addressing each case based solely on the aging of the alert, alert backlog clearing should be prioritised according to risk and aging within business or customer segments. In other words, high-risk groups are identified, and within the higher-risk groupings, the highest-risk cases are then identified. In addition, consideration should be given to deploying the most experienced employees within the firm to review the high-risk cases or augmenting the team with further support to resolve the high-risk cases, with the medium- to low-risk cases being dealt with on a BAU basis.

New Technology

When using new technology, tailor it to address the risks

It is important to test (through sampling) and tailor (through calibration) out-of-the-box software solutions to ensure the software performs as expected and aligns with the risk appetite of the firm. For instance, transaction monitoring and customer screening solutions can generate an unmanageable number of automated alerts, or

miss screening transactions or customers. If this situation were to occur in a live environment, deleting the excess alerts would not be an option because once an alert has been created, it cannot be undone and needs to be reviewed and closed, which creates scope for a backlog being generated. When implementing a new technology, firms must demonstrate they understand how the system is configured and operates. Relevant senior management should also consider and sign-off whether further employees are needed to work any expected increase in alerts. This approach to the tailoring of new technology is in keeping with the FCA's expectations.

Management Information

Ensure Management Information (MI) is robust, accurate and complete with senior management oversight, including at board level

Management Information (MI) needs to be effective, and to achieve this it must be understood by senior management, including at board level. This understanding helps establish a 'purposeful' culture, where in addition to the compliance team, senior management can constructively challenge the information being given to them because there is a greater understanding of what should be presented to them and what it means.

Accuracy in MI is also crucial. For example, an update to a database could cause a link to break, which could potentially mean either a loss of customers that were being screened, or that an out-of-date sanctions list is used instead of the latest version. Quality in MI must enable senior management to effectively understand the AML and CTF risks the firm faces, as well as the effectiveness of any controls implemented to manage the related risks.

REP-CRIM reports, SARs and STORS

Quality of REP-CRIM reports, Suspicious Activity Reports (SARs), and Suspicious Transaction Order Reports (STORS) are gaining increasing significance

According to the "[Extension of Annual Financial Crime Reporting Obligation](#)" Consultation Paper of March 2021, the FCA increased the number of firms that need to submit a REP-CRIM return from approximately 2,500 to approximately 7,000. This applies to all firms under the Money Laundering Regulations (MLRs).

This means that there will be increasing significance for annual financial crime reports, as well as the quality and quantity of SARs and STORS. These reports need to be accurate and valid, yet wider objectivity in this exercise can also be helpful. Therefore it is useful to have an idea of where a firm stands relative to its peers because, at the very least, the firm will wish to avoid being inadvertently perceived as an outlier in the FCA's collated data.

Three Lines of Defence (3LOD)

An effective 3LOD model should be implemented

The 3LOD is an industry-wide approach for ensuring the effective management of risk, which the FCA expects firms to adopt as part of their risk management arrangements. The 3LOD model requires firms to clearly define and implement responsibilities and accountabilities across 'the three lines' (the business, risk and compliance, and internal audit) in order to ensure there is clear separation of responsibilities, effective oversight, monitoring and challenge.

The lack of an effective 3LOD model is regularly highlighted by the FCA as part of their regulatory review on firms, in particular risk ownership and acceptance not sitting firmly in the first line, or control activities being performed in the second line.

In a FCA "Dear CEO" sent to retail banks, the letter outlined common shortfalls seen in AML frameworks. The FCA explained that:



Firms often blur responsibilities between the first line business roles and second line compliance roles. We have identified circumstances where compliance departments undertake first line activities, for example completing all due diligence checks or all aspects of customer risk assessment. The implications of this are that first line employees often do not own or fully understand the financial crime risk faced by the firm, impacting their ability to identify and tackle potentially suspicious activity. It also restricts the ability of compliance personnel to independently monitor and test the control framework, which can lead to gaps in the understanding of risk exposure.



Firms should, therefore, proactively implement the 3LOD model in full. However, it is not just the case of clarifying roles and responsibilities because there are a number of practical implications when transferring risk ownership and controls into the first line, such as giving careful thought to people, process and technology. For large firms this can be a multi-year journey in order to fully implement and effectively embed the 3LOD model.



SECTION 4: Looking Forward

Although the number and proportion of s166 reviews related to financial crime had held steady in recent years, the FCA's approach to the use of this tool has recently evolved. The FCA's [strategy](#) looks towards a more 'innovative, assertive and adaptive' application of regulatory instruments, having declared their intention to '[supercharge](#)' their fight against financial crime.

This means, firstly, that s166 reviews are likely to arise even more frequently under this new strategy, further incentivising firms to focus on preventative action. This is underscored by the FCA's commitment to invest £120m in their data strategy over the next 3 years to [detect and deter](#) financial crime, with one example being the creation of a [synthetic dataset](#) available on the [Permanent Digital Sandbox](#). More public-private and private-private information sharing is likely to come, spearheaded by the FCA's renewed [focus](#) to collaboration and customer awareness.

Secondly, this also means that new areas of focus are emerging for the use of s166 reviews, which have historically predominately focused on AML controls. The FCA's [Business plan](#) singles out the need to drive down the incidence and impact of fraud. The FCA has also been [bolstering](#) its ability to combat sanctions evasion, as well as setting out [clear expectations](#) for firms' sanction controls. We can therefore expect to see more s166 requirement notices which encompass several financial crime risk areas.

Thirdly, the FCA has explicitly signalled that, in relation to financial crime controls, there will be greater regulatory oversight across all sectors, whilst traditionally it had focused on the banking sector. For instance, the FCA issued [warnings](#) to the wealth management sector that their supervision is becoming 'more assertive, intrusive, proactive and data driven' to identify firms with 'key fraud, scams or money laundering indicators.' Similarly, it [singled out](#) sanctions and fraud as key problem areas for payment firms, forewarning swift action against non-compliant firms.

How Plenitude can help

Plenitude is a niche consultancy, specialising in Financial Crime Risk and Compliance. Our focus is firmly on addressing the legal, regulatory, reputational and social imperative for financial institutions to take diligent and rigorous steps to mitigate financial crime risks. Appointed to the Financial Conduct Authority's Skilled Persons panel for Financial Crime (Lot E), we are authorised to conduct S166 reviews covering AML/CTF/PF, sanctions, fraud, anti-bribery and corruption, tax offences, and market abuse.

Our team of highly experienced FCC specialists have extensive working with a wide array of financial institutions, including retail, private, commercial and investment banks, insurance companies, asset management, FinTech, EMI's, PSPs and crypto firms.

As part of our advisory services, we are also able to conduct independent reviews of firms' financial crime systems and controls, adopting a structured and systematic approach which considers applicable UK laws, regulations, guidance and FCA expectations. These reviews can be conducted in short order and enable firms to proactively self-identify any issues ahead of a review by the FCA and to provide assurance to the board and senior management. We are also able to support S166 reviews 'firm side' in order to help guide clients through the potential pitfalls of a S166 review and execute a well prepared and efficient review.

To learn more about how we can help your firm, email us at enquiries@plenitudeconsulting.com

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