
National Risk Assessment on Money Laundering and Terrorist Financing

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- The Association for Financial Markets in Europe (AFME) welcomes the opportunity to respond to the HM Treasury and Home Office consultation on the National Risk Assessment on Money Laundering and Terrorist Financing. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.
- AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia. AFME is registered on the EU Transparency Register, registration number 65110063986-76.
- AFME represents the wholesale capital markets, and therefore we have undertaken to provide answers to the questionnaire from this specific perspective. Throughout 2017-2018, AFME hosted the member-led drafting group which undertook to update the Joint Money Laundering Steering Group (JMLSG) Guidance – Sector 18 – Wholesale Markets¹. This sectoral guidance was published with ministerial approval on 5 March 2018 and outlined an updated view of the ML/TF risks in the wholesale market sector (please see sections 18.10 – 18.15 for specific reference²). The development of Sector 18 took into consideration the UK's 2017 national risk assessment of money laundering and terrorist financing³. On this basis, AFME does not seek to duplicate information which has already been reviewed by HMT as part of this exercise but wishes to highlight any changes and areas of potential vulnerability identified since publication of the JMLSG guidance approved on 5 March 2018.
- In general, most of the products within wholesale capital markets represent lower risk for ML/TF. There are only limited areas that pose higher ML/TF risks which we have discussed in our response. Please find below answers to each individual question.

1. *What do you believe to be the ML and TF risks in the products and services you offer? For each, please explain why you think this is a risk.*

The key ML/TF risks within wholesale market businesses lie (i) in the cross-border nature of products and services that are offered; and (ii) the predicate offence of market abuse. This includes characteristics such as the global flows of funds, speed of transactions and potential ease of converting holdings to liquid currency.

¹ [Please see Ministerial approval of December 2017 revised Guidance \(5 March 2018\)](#)

² [Guidance for the UK Financial Sector Part II: Sectoral Guidance](#)

³ [National risk assessment of money laundering and terrorist financing 2017](#)

The inherent ML/TF risks may arise in the following areas:

- Customised Settlements and Third-Party Payments - Clients may request that their trade settlement be paid to third parties rather than to themselves. Although there may be legitimate reasons for such a request, third party payments could, in fact, be used to internationally layer and/or integrate the proceeds of crime. In addition, there may sometimes be limitations to performing risk-based due diligence on payment beneficiaries, as third parties are not customers of the wholesale market firm, and therefore may not be obliged to provide requested information.
- Visibility to Monitor – Clients of the wholesale markets commonly seek to utilise multiple international wholesale market firms to execute and clear a wide array of transactions. This is due to the fact that certain firms have specific competitive advantages over certain activities and/or markets, and, as such firms may only have partial visibility of the holistic activities of a client which may limit one firm's ability to monitor for client's unusual activity. This may therefore potentially create a ML/TF risk.
- Customised structured solutions/products – These products can be bespoke, involve multiple 'bundled' products/underlying assets and concern multiple related parties to meet client and/or bank objectives. Although these products are in general structured for genuine economic/commercial purposes, their complexity may lend itself to creating opacity and obfuscation of information. Our members mitigate these ML risks by having adequate understanding of the nature of such products and putting controls in place.
- Instruction Amendments - The ability to make unexpected amendments and cancellations of trade/transaction instructions (across various communication platforms) may give rise to ML/TF risk if not adequately explained and managed.

Please note that TF risk is considered to be relatively limited within the wholesale markets businesses.

2. *Which categories of jurisdiction, person, business relationship or product do you consider pose the greatest level of ML or TF risk?*

We would like to stress that wholesale market traded products are usually traded on regulated markets, or between regulated parties, or with regulated parties involved acting as agent or principal, therefore these products generally pose a lower ML/TF risk. Having said that, there are certain business relationships involving certain categories of legal persons, jurisdictions and use of products which pose an increased ML/TF risk.

- Offshore Shell Companies - Within the context of wholesale market products, the use of offshore passive shell companies, special purpose vehicles or other legal arrangements to transact/trade may, in certain scenarios, increase the inherent ML/TF risk. The ML/TF risk increases when these entities are organised to include nominee directors/legal representatives and/or nominee beneficial owners ('straw-people'), which can obfuscate the controlling actors instructing and/or economically benefiting from commercial/trading business. The same obfuscation risk arises in the context of intermediaries in situations where the firm has no visibility (without enquiry) as to who the intermediary is acting for and on behalf.

- Introducers of structured products contracting via custodians – This example relates to introductory business, with an independently commissioned professional introducer, who introduces business of structured financial instruments/securities products on behalf of the firm, to be purchased by underlying counterparties which contract via their custodian bank. This custodian bank purchases financial instruments from the firm, settling with it as principal. The firm may, therefore, be potentially exposed to receiving high value funds transfers from foreign jurisdictions to purchase financial instruments, with at times (without further enquiry) limited visibility into the true beneficial owner and source of funds, as the firm may only deal directly with the custodian as principal. There is an increased ML/TF risk in certain situations of this correspondent relationship between the firm, the custodian bank and the custodian bank's underlying client; where the custodian bank resides in an offshore jurisdiction associated with heightened barriers of legislative secrecy and/or generally resides in a higher risk jurisdiction.

3. *On what scale have you seen ML or TF activity through the products or services you offer?*

Capital markets activity is lower risk from both a ML perspective and, especially, from a TF perspective, when compared to higher risk parts of financial services (such as trade finance, payments and correspondent banking).

Moreover, as noted by the FCA's⁴ review of capital markets "[t]he money-laundering risks we have identified are mitigated to an extent by the nature of the firms in the market; most are regulated, institutional firms, and the nature of some of the products and markets may be less attractive to launderers, given barriers to entry, levels of scrutiny or complexity of the product."

Although financial markets can be used for layering and integration of funds, it is generally difficult to identify ML/TF through monitoring product activity alone in financial markets. The most typical and reportable activity is suspicion of market abuse – for example, insider trading, which can be recognised when a client has undertaken unusual activity just prior to a public announcement that is material to the price of the product transacted.

4. *Please tell us about trends in the ML or TF activity you have seen.*

Our members have not reported seeing any recent trends in this area. However, AFME, and some of its members, are actively involved in the Joint Money Laundering Intelligence Taskforce (JMLIT) which, as trends become visible, facilitates the sharing of such intelligence across the industry.

5. *In your view, to what extent would it be possible to use products and services other than those you've flagged in questions 1-4 to mask the source or ownership of funds or assets, or mask the destination or purpose of funds or assets?*

Investors commonly utilise investment managers, agents or intermediaries to undertake transactions on their behalf which reduces the transparency of the source or ownership of funds or assets. However, these risks are

⁴ [FCA's paper on Understanding the Money Laundering Risks in the Capital Markets](#)

at least partially mitigated by the fact that other entities involved in the process tend to be regulated entities with their own ML and TF obligations.

In addition, it may not always be apparent but as a result of the use of special purpose vehicles and legal entities to hold assets, which can have unspecific and generic legal names and complex ownership and control structures, a firm could have exposure to the same underlying investor via multiple seemingly unconnected relationships.

6. *To what extent does your organisation have the resource to ensure compliance with AML/CTF regulations? Does your organisation have confidence in its understanding of the risk?*

For clarity, the obligation on firms is to “...take reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements and standards under the regulatory system and for countering the risk that the firm might be used to further financial crime”⁵.

Our members have not reported any cases of inadequate resources or an inadequate understanding of the risks. However, this latter area is clearly one where our members recognise the need to be vigilant and to that end AFME, and some of its members, are actively involved in JMLIT which, as trends become visible, facilitates the sharing of this intelligence across the industry.

7. *How do you think the risks identified in your sector in the 2017 NRA have changed since?*

There have not been any material and new inherent risks identified in the Financial Services sector since the 2017 NRA.

The risks have not changed but the industry has moved forward and developed its understanding of ML/TF risks and is working with JMLIT to enhance risk mitigation capabilities.

8. *Have you recognised any emerging risks, that have not previously been identified? Are there any future risks you may foresee?*

Financial Services firms are increasingly looking at digitisation as means to increase efficiency, reduce cost and service customers.

Digitisation may therefore bring a range of innovations, such the emergence of new market actors (e.g. fintechs), new ways of delivering services (e.g. electronic trading, algo-trading) or new products (e.g. crypto-assets), which could in turn create new types of ML/TF risks if not managed appropriately.

In particular, unregulated entities or activities could exacerbate ML/TF risks.

It is therefore of crucial importance that regulators stay abreast of market developments to ensure regulatory requirements for ML/TF are fit for purpose in the context of new financial innovations.

⁵ [FCA's Systems and Controls Sourcebook \("SYSC"\)](#)

9. *Please provide your assessment of any further factors contributing to the vulnerability of the sector, the likelihood of threats materialising in the sector or anything mitigating the risk within the sector.*

AFME members fulfil their obligations under the Proceeds of Crime Act 2002 (POCA), including the submission of Suspicious Activity Reports (SARs) to the National Crime Agency, when it comes to dealing with suspicions of insider dealing and market manipulation (which are both recognised as predicate offences to money laundering).

As noted earlier, the FCA's⁶ review of capital markets noted: "[t]he money-laundering risks we have identified are mitigated to an extent by the nature of the firms in the market; most are regulated, institutional firms, and the nature of some of the products and markets may be less attractive to launderers, given barriers to entry, levels of scrutiny or complexity of the product."

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⁶ [FCA's Understanding the Money Laundering Risks in the Capital Market paper](#)