CASE STUDY 1: Managing AML risk

Brownhill & Co. LLP is an FSA authorised boutique corporate finance firm which specialises in providing advice to companies in the biotech and other similar sectors. It is approached by a private biotech company, Anglofranco Technologies Limited ("Anglofranco") who are looking for corporate finance advisory services. Anglofranco is a UK company.

Anglofranco has been run by its owner shareholders for some years and is doing well. However they have decided that in order to increase its profile in the market and to expand, the company needs to bring in new management with previous Board experience from other specialist companies in the biotech sector. Anglofranco also consider that the company will need to raise new finance via a rights issue. The Members of Brownhill are delighted with the new client and their Chief Executive Officer gives the day to day running of the matter to corporate financier Abel Greenstock with a warning that this is an important piece of business they have won and that it and its keymen need to be handled very sensitively.

Abel hands the due diligence side of things over to his junior, Jeanne while he gets on with the initial meetings with the keymen and shareholders, James Smith and John Brown. James is known to Abel from his time at pre-eminent corporate finance firm Silverman Brothers, where they worked in the same team 10 years ago.

After an initial few meetings, Anglofranco is ready to sign up to an engagement letter with Brownhill and they do so. Abel suggests that they ought to finalise the AML paperwork before signing up but James and John scoff and suggest that they can dot the i's and cross the t's later because it is not as if any transaction has taken place or money passed hands yet. Abel is encouraged by the fact that James is an ex colleague and was formerly registered with SFA (i.e. pre N2).

Jeanne runs a check at Companies House and, as part of the search, obtains the usual constitutional documents and last filed annual return. This shows the following shareholders and their addresses:

- James Smith – 15%
- John Brown- 20%
- Caroline Brown 5%
- Lucy Smith 5%
- Fondation pour l’ Investissement Biotechnique, in Monaco 10%
- GM Holdings (Cayman) Limited. 35%
- Abdul Rahman 10%.

Each of the individual shareholders has a UK address, with the exception of Abdul Rahman who is resident in Iraq.
The principal directors of the business are James Smith and John Brown. Abdul Rahman is a non-executive.

Brownhill’s procedures need upgrading as they were prepared as a draft by a firm of lawyers when the LLP first sought FSA authorisation in 2001. Brownhill has been advised that they need tailoring to the firm but the MLRO has little time, also being a full time corporate financier. However Abel has heard that a risk based approach what is now required in the UK guidance notes and has asked Jeanne to take a risk based approach, bearing in mind that this is an excellent new client the firm has existing contacts with, so there is no need to go overboard on the due diligence.

**Questions/discussion points**

What issues are raised by this scenario? Discuss, considering in particular:

- What further information should Jeanne ask for in order to fully understand the ownership structure?
- Discuss the risk that the proposed client presents based on its ownership/business?
- What customer due diligence (CDD) information should Jeanne request and in respect of which persons, legal or natural, depending on the risk factors? Prepare a concise checklist of the information and documents required.
- What additional checks should Jeanne undertake?
- The difficulty of allowing subjective judgement about risk to come into individual decisions on clients.

Jeanne’s further requests for information identify that GM Holdings (Cayman) is owned via a series of holding companies. The ultimate controller of these appears to be a Liechtenstein Stiffting, a trust vehicle. Jeanne’s requests for further information about the trust’s beneficiaries are met initially with refusal and then subsequently with the explanation that the trust beneficiary is a very rich and important Frenchman. He particularly wants to keep his identity confidential as he assesses there to be some risk to his family if he is identified by radical environmental activist groups in France and the UK.

Jeanne and Abel arrange a meeting at which the important Frenchman is due to attend but on the day it is attended by his French personal financial advisor who makes the proposal that he can vouch for the individual and will disclose the individual’s name and supporting paperwork if this is required from Brownhill by the competent authorities as part of an money laundering investigation. Eventually the name of the individual, Gabriel Marlier, is disclosed. Jeanne decides to accept an introduction certificate from the financial advisor since, although she is not familiar with the advisor, he appears to be well acquainted with Gabriel Marlier and he or his company are presumably regulated in France. Jeanne later decides to google the name and finds that a Gabriel Marlier recently stepped down from the Chairmanship of Caisse des Depots et Consignations, a state owned French bank.

Jeanne is also advised by the personal financial advisor that the Fondation is a charitable organisation which sponsors the development of biotechnologies and operates worldwide, particularly in developing nations where it is hoped to spread the technology.

**Discussion points/questions**

What further issues are raised by the new information Jeanne obtains? What further action should Jeanne and Abel take/consider?
Abel has identified a 3 strong potential management team for Anglofranco. On the authority of John and James, Abel commences negotiations with them and venture capital firm, Greenslade Venture Capital Limited. It is confirmed that the management team individuals will want to take a significant equity stake in Anglofranco.

Discussion points/questions:
Discuss the issues raised by the additional information about the management team, including in particular considering:

• Does Brownhill need to undertake formal AML CDD on the potential management team members?
• What approach could Brownhill take if it concludes that CDD is required?
• What additional information might Brownhill want to obtain in relation to the management team?
• How would the issues differ if the equity stake to be taken by the management team is not likely to be sufficient and a rights issue is planned with shares to be offered to existing contacts of Brownhill that it knows may be looking for opportunities in small biotech companies such as Anglofranco.

2 CASE STUDY 2: Managing AML risk - CDD and monitoring

HF Securities Services Limited is a UK authorised broker which specialises in providing prime brokerage services to hedge funds. It is approached by Merlin Asset Management (a hitherto unknown company) with a view to establishing a prime brokerage relationship with a start up Cayman hedge fund for which it is to be manager. The Merlin representatives hand over business cards to HD Securities Services which indicate that Merlin is authorised in the UK by the FSA. The fund’s administrator is based in the Netherlands Antilles. The account executive of HF Securities Services Limited instructs Legal to get drafting the prime brokerage agreement and for Roger, one of HF Securities Services’ accredited front office account openers to get on with the customer ID.

Discussion points/questions:

• Who is HF Securities Services’ customer for AML purposes?
• What further information does Roger need to be able to determine what further information and documentation the company will require in relation to the fund/Merlin and in order to make its risk assessment?

Discussion points/questions:

• Discuss what might be an appropriate risk assessment of the fund as client?
• Discuss the likely CDD requirements in relation to the fund, investment manager and, in the future, relevant investors.

3 CASE STUDY 3: Reporting suspicious transactions

HNW Bank Limited is a specialist private bank which provides high end banking services to wealthy clients resident all over the world. Rupert Hebblethwaite is an account executive for the bank and is contacted by a Cypriot client, a Mr Lakka, asking to open an account as
soon as possible. Mr Lakka is an ultra wealthy business man who has made his money with nightclubs and associated entertainment businesses and wishes to use the account for the limited purpose of paying his children’s private school fees and for servicing their credit card accounts.

Rupert is very impressed and rushes to open the account on the basis of paperwork sent through by Mr Lakka’s lawyer, an associate at a high street firm of Solicitors in Pinner, London. He does not check the account opening proposal against the firm’s AML procedures or worry about the documentation too much because Mr Lakka will be coming in for his first relationship meeting in a few weeks and he will be able to get the proper documentation and meet the client then. As it happens Rupert is not very familiar with the firm’s procedures because over the last few years the bank’s AML training has always coincided with client lunches and meetings and he has not wanted to miss those.

The account is opened with the required minimum balance of £50,000 which is transferred by way of a SWIFT payment from Cyprus Bank. This balance is more than adequate to cover the school and university fees for Mr Lakka’s 2 children for the first year. Miss Lakka, Mr Lakka’s oldest daughter is a joint account holder and entitled to draw on the account.

A week later Mr Lakka’s account has an amount of money remitted to it from an account in the Marshall Islands. The transfer is to the tune of £1.5m. Rupert contacts Mr Lakka to arrange the preliminary relationship meeting. Mr Lakka is not available but his secretary advises Rupert that he is away on business and the meeting needs to be postponed indefinitely. Rupert asks what the transfer is for. The secretary rings later and advises that it is for an important and urgent transaction. However she gives no further details and Rupert decides not to press for further detail.

The next day the bank receives a payment instruction to transfer £1.5m to a clearing bank in the UK in a week’s time.

Then:

(a) HNW action

Rupert confirms that the £1.5m payment should be made and the money is remitted to the account in question. OR

(b) Alternate HNW action

Suspicious of the circumstances of the payment into the account and the immediately following payment instruction, Rupert decides to talk to John Thorogood the MLRO who, having been briefed by Rupert, weighs up the position and decides to make a Suspicious Activity Report (SAR) to SOCA and not to make the payment out until consent has been received for this. He starts drafting a report to SOCA based on the available information from Rupert but then remembers he has been invited to attend a 2 day corporate marketing event watching cricket at Lords and decides to leave the report until his return.

On his return to the office John Thorogood makes the attached report to SOCA. SOCA advises him that consent to the transaction is refused and John therefore advises operations that the account is frozen until further notice.

The next day a cheque is presented by Miss Lakka in the amount of £250. John Thorogood tells operations that the cheque can be settled.
On the day after the payment transfer was due, Rupert receives a telephone call from Mr Lakka’s lawyer asking why the payment has not been made. Rupert advises him that he will look into it and get back to him shortly. He does not.

The following day Rupert receives 2 calls from Mr Lakka himself who is furious that the payment still has not gone through and wants to know why.

Rupert says that between him and Mr Lakka the payments in and subsequent payment instructions looked a bit ‘fishy’ and the MLRO was looking into it but he was sure the payment would be made soon. Mr Lakka advises Rupert that the money is for a property transaction that will fall through if the money does not go through. He will be furious if they lose the property because it is on the market at a price significantly lower than its real market value. When pressed on the details of the property he seems vague but says to contact his lawyer for further details. He finishes the call threatening to go to court if the payment does not go through imminently. Rupert realises his mistake and advises the MLRO of the conversation and the threats being made by Mr Lakka.

Discussion points

• What issues are raised by this scenario for (a) Rupert; (b) HNW Bank Limited if the firm takes the action in (a), in particular: would you consider the fact pattern demonstrated “reasonable grounds” for suspecting Mr Lakka is involved in money laundering?

• What issues are raised by this scenario if the alternative ending is applied as per (b) above? Discuss, considering in particular:
  • Has Rupert acted appropriately?
  • Has the MLRO acted appropriately? Should he have asked for more information about the property transaction before making an SAR? What if the property transaction turns out to be genuine?
  • How should Rupert and the MLRO have handled Mr Lakka’s furious phone calls and the threat of legal action?
  • Review the SAR prepared and submitted by John Thorogood: Has the right approach been taken?

• How would the issues raised by the case study differ if:
  • HNW Bank is a UK branch of HNW Bank Inc. (a US bank)-what additional steps might the bank have to take when taking on Mr Lakka’s account?
  • The MLRO lets the transfer go ahead and makes an “after the event” disclosure of suspicion?

4 CASE STUDY 4: AML systems and controls

John Thorogood decides that it is time to undertake a review of the firm’s AML procedures because he is concerned at Rupert Hebblethwaite’s conduct in the Lakka matter and his claim that he did not receive any training.

The bank’s procedures were issued by the last MLRO in 2001. John has had little time to review them since his starting as MLRO since he is unsupported by any team since his one assistant left 6 months ago. He focuses instead on dealing with the day to day issues and
concerns. John has, in any case, assumed that the firm’s procedures are reasonably robust, because as far he is aware, the firm makes SARs very infrequently (although there are no firm statistics). John Thorogood has repeatedly asked for additional resource but the bank’s directors have said there is to be no additional spend this year because the firm is upgrading its new Knightsbridge premises. However the Board indicates that internal audit could do a review (where it has not in previous years).

John Thorogood and internal audit find the following:

• AML CDD is undertaken by the banker handling each new account and the account opening application is approved by that banker’s immediate line manager. The paperwork is then submitted for filing and kept under lock and key in the Chief Executive’s office (customer confidentiality is very important at HNW Bank Limited). Account executives make trip reports when visiting their clients and if information is provided about client’s business this will be logged. However the firm’s informal policy is to respect the client’s need for privacy and not to issue questionnaires about source of wealth etc.

• The firm procedures require AML CDD before an account can be opened. In practice however many accounts are opened before all paperwork is completed in full, for example accepting faxed copies of constitutional documents and illegible photocopies of passports. The rationale for this is that many of the clients in the bank are contacts of the account executives or are high ranking prestige individuals (either with titles or high up in government and similar bodies).

• Undertaking a file review has been impeded by the fact that some of the records his secretary was keeping and preparing for removal to a storage company have been lost in the recent office move.

• Although there are written customer identification procedures in place from 2001, interviews with staff suggest that in reality they still follow policies and “waivers” set out in a number of e-mails which the last MLRO issued and when in doubt they often discuss their concerns with their line report.

• Many of the bank’s corporate customers are personal holding companies/"family companies”. The firm’s procedures provide that “in the main it is not necessary to look into the company structure because our client companies are usually owned by the client contact himself”. The MLRO finds that the bank has opened accounts for a number of international business companies based in tax havens but there is no information on file which confirms the identity of the beneficial owners at the time of the account opening or subsequently.

• Some files appear to be missing almost all the expected CDD and client ID documentation. When quizzed about this, the MLRO is advised that these are probably cases where his former assistant gave a complete compliance waiver. There are no records of this.

• Most staff have been advised of the training sessions organised by Human Resources but there is no record of who attended and who did not. The training session is usually watching a 1 hour training course on a video cassette. The bank acquired the tape in 1999.

• A re-papering exercise was commenced for pre April 1994 clients in 2000 but this was never completed. Many of the clients on the pre-April 1994 list have since
opened new accounts or been offered and accepted the firm’s new wealth management service but without additional information being sought.

• The firm’s investment in IT has been very limited in the past and discussions about new monitoring systems, particularly to pick up unusual patterns of transactions, has not been followed through as this has been rejected at Board level for cost reasons. Exception reports are generated by back office systems to some extent however and these are reviewed by compliance.

• The firm has no systems for undertaking names list checks on customers, whether manual or automated. The MLRO is advised, in response to his questions of back office, that the firm does not need a PEP procedure because these have been replaced by cash ISAs and HNW Bank Limited is not a cash ISA provider.

• The bank has a number of correspondent relationships and operates a number of vostro accounts for banks in a wide range of jurisdictions outside the EU, including in Russia, Latvia and Israel.

Discussion points:

• What issues are raised by the above scenario, in particular under:
  • The FSA’s high level systems and controls rules in SYSC;
  • The Money Laundering Regulations 2003.

• In what aspects of the firm’s systems and controls is remedial action required?

• Should senior management have any concerns about the MLRO’s training/competence?

• What current and pending developments in AML law and regulation should the MLRO bear in mind given the above. (Risk based AML/new senior management role/Directive requirements on correspondent banking)

• Should the MLRO or compliance officer make a report to FSA about the state of the firm’s anti-money laundering systems and controls? Discuss what approach to take.

• What strategy should the MLRO take with senior management to ensure that they are on-side and aware of the problems and, if you think is likely, potential for enforcement action?

• Identify the critical issues which the MLRO must raise in the MLRO’s annual report for the year in question.