

ANTI-MONEY LAUNDERING

Russia and Eastern European clients in the AML/Sanctions crosshairs... again!!

The UK's apparent willingness to do business with individuals and their companies from Russia and Eastern Europe makes life difficult for Money Laundering Reporting Officers (MLRO). The UK government recently indicated its intention to clamp down on real estate and complex structures, but will those intentions stick?

Here, we explore the challenges of doing business with 'persons' originally from those jurisdictions.

Mitigating the risks

Identify Russian and Eastern European PEPs in your customer base

Determine increases in new customers from the region

Examine transactions for any payment trends

Plan to resolve deficiencies or omissions on any of the above

MLRO under fire

The recent case in Jersey, AG v Jardine, in which a MLRO was prosecuted for failing to report potential money laundering suspicions, has brought into sharp focus some core AML compliance challenges.

The Jersey legislation under which this prosecution was brought is consistent with the UK Proceeds of Crime Act. The case involved the handling of an application on behalf of a Ukrainian Politically Exposed Person (PEP) and funds indirectly routed through a company incorporated in Belize via a trust company based in Cyprus. The prosecution argued that as the application and funds originated from a PEP the application should have been treated as suspicious – not just high risk and subject to monitoring. Mrs Jardine was the MLRO of the Jersey-based financial institution where the application was made and which received the funds in question. Mrs Jardine and her employer undertook a risk-based assessment of the application but with no clear connection between the applicant and the source of funds, they were returned and the application did not proceed further. It was argued that in the circumstances, there were reasonable grounds for suspicion and the MLRO was therefore obliged to make a report to the authorities, which she failed to do.

In this case, the authorities were potentially setting an alarming precedent by signalling that the thresholds for suspicion needed to initiate a report are extremely low. In fact, going as far as proposing that PEP status, especially in an Eastern European context, is sufficient.

The Dangers ahead

It is an ongoing challenge to identify potential money laundering and other financial crime risks when taking on new customers, as well as in existing customer bases. The Financial Conduct Authority is particularly keen for firms to establish how individuals have become wealthy, especially high profile and high-risk customers, including PEPs.

As London is an attractive destination for wealthy Russians and Eastern Europeans, banks will be competing to tap into this lucrative market. However there are dangers for those banks that are less than diligent in evaluating the risk of a client and monitoring ongoing business done by those clients.

A major issue regarding the Eastern European market is the lack of transparency surrounding the whole-scale transfer of state assets into private ownership after the end of communism. This was a concern for UK banks approached by the first wave of oligarchs in the late 1990s. A number of these original oligarchs have since developed a significant media presence in the press, TV and online, which has made due diligence seem easier, even if the original source of wealth is unclear.

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However, any further influx of wealthy Eastern Europeans is likely to increase the due diligence challenge because they are almost unknown in the West at present. The career histories of the new breed of oligarch are remarkably consistent - an obscure academic or technocrat rises rapidly through the ranks of the emerging economy accumulating significant wealth along the way.



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There are hurdles to be overcome when remitting funds to the UK, particularly as anti-money laundering checks have become far more stringent in recent years and are no longer perceived to be merely a tick-box exercise. Hidden amongst the wealthy Eastern Europeans will be money launderers, tax evaders and sanctions violators. However, determined criminals will not be deterred by the Banks' new customer checks and will readily provide plausible information and credible information.

Anyone conducting background checks may be directed to the oligarchs' company websites, intended to create a veneer of legitimacy and respectability, whilst leaving questions about the origins of their wealth unanswered. Anecdotal evidence suggests that some oligarchs routinely sweep the internet and “sanitise” their profiles, and the recent rulings regarding the “right to be forgotten” are likely to increase the effectiveness of this activity. The absence of a meaningful profile for a supposedly wealthy and prominent individual can present a warning sign.

Verifying client information

Against this background, it is a challenge for banks to obtain independent and credible verification of customers. A range of data sources exist and the volume of public information accessible via the internet is growing exponentially. There are verifiable and useful sources of information from corporate registries, commercial research and data providers. Banks will need to consider the legitimacy of information obtained from the internet, and carefully assess what is credible and relevant to the subject of their enquiries. When appropriate they should not hesitate to conduct detailed reviews of potential customers, from on-the-ground information sources.

Organising your defences

As money laundering methods are becoming more sophisticated, firms (first and second line staff) will need to take rigorous steps to mitigate the risks of doing business with ‘persons’ from these regions/countries. These include:

- identifying any Russian and Eastern European politically exposed persons, their connections and other high risk customers amongst the existing customer base as a priority, checking whether adequate enhanced due diligence has been undertaken on all high risk customers. In particular this involves establishing source of wealth, checking for adverse media and obtaining senior management approval for account opening and continuance of the customer relationship

- reviewing management information about new customers to determine if there has been an increase in the number of new customers from Russia and Eastern Europe. If this is the case, seek an understanding as to why this has happened. For instance, is your front office actively targeting this population?
- reviewing whether reporting of new and existing client domiciles/nationalities is provided to the Executive Committee and/or Board. Does business from these jurisdictions fall within your bank's risk appetite?
- examining transactions to determine if there are any payment trends (e.g. funds originating from Eastern Europe remitted to the UK via circuitous routes or vice versa)
- considering staff refresher training covering the due diligence requirements / background of anti-money laundering and regulatory consequences
- devising a plan of action to resolve any deficiencies or omissions on any of the above, including remediating any lack of due diligence information.

Understanding the risks

Your bank's board and senior executives need to understand the increased risks and requirements which arise from doing business with 'persons' from Russia and Eastern Europe. As MLRO you need to be confident that your bank has the right systems and controls in place to mitigate those risks and that appropriate reporting is provided. Decisions and processes should also be evidenced robustly.

Failure to address these issues means the financial sector, and especially MLROs, will continue to fall foul of anti-money laundering regulations and put their firm's reputations at risk.

Fortunately for Mrs Jardine and her former employer, the Jersey Court acquitted them of the charges brought by the prosecuting authorities. Her defence successfully argued that Mrs Jardine, by undertaking a risk assessment, had taken into account the information available to her and had considered whether or not there was a risk of money laundering. She concluded there was no money laundering but only an unresolved question about the source of funds received by her employer. The verdict in *AG v Jardine* suggests that PEP status does not automatically give rise to a suspicion of money laundering provided a risk-based assessment is carried out.

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