

THE FSA'S THEMATIC REVIEW ON ABC SYSTEMS AND CONTROLS IN INVESTMENT BANKS, ARE WE HEADING IN THE RIGHT DIRECTION?

In March 2012 the FSA published the outcome of its thematic review on anti-bribery and corruption systems and controls in investment banks. At the same time, it published a consultation document on proposed changes to its regulatory guide "Financial crime: a guide for firms".

Consistent with previous thematic reviews, the FSA has identified examples of good and bad practice amongst the firms it regulates. The risk going forward is that the examples of good practice become normal expectations of the FSA with regard to anti-bribery systems and controls. As a result, any failure in the future to implement the examples of "good practice" will need to be justified on a risk based approach, absent which a firm could face enforcement action.

Whilst the FSA's approach to widen appreciation of what some firms are doing is, in our view, to be recommended, we are concerned that the proposed amendments place a very high regulatory burden on firms and may not be necessary to comply either with the Bribery Act 2010 or to ensure compliance with the FSA's financial crime objectives, which by necessity flow from an understanding of what constitutes financial crime.

Below are the areas which we have identified, based on the thematic review and our own experience on advising clients, where practical issues are likely to arise when firms attempt to re-model their systems and controls with reference to the areas of good practice put forward by the FSA.

Governance

It is generally accepted that the board and senior management need to understand the bribery and corruption risks faced by the business and to lead by example. However, the FSA effectively requires the board itself, rather than the sub-committee responsible for the systems and controls, to receive "management information" about higher risk third party relationships and payments, as well as information about the effectiveness of the controls around those areas. This requires the board to get into a level of granular detail which typically they would not do, having delegated responsibility to a committee, an approach which the FSA condones. In discussions we have had, they have proposed, for example, a list of third parties be provided to the board, the level of business generated by those high risk third parties and the payments they receive for so doing. This may be difficult to extract from the firms systems and may still be meaningless to the board, they cannot be expected to second guess the use of particular third parties.

We would have thought that it would be more proportionate for the board to receive a report on the principal risks and how effective the systems and controls are in mitigating those risks.

Risk Assessment

The FSA has given a number of examples of good and bad practice. Two of which worth noting are:

- risk assessment is a continuous process based on qualitative and relevant information available from internal and external sources. Whilst we agree that risk assessment is not a one-off exercise, to say it should be continuous based on specific types of information is a very high standard;
- the firm takes steps to identify the bribery and corruption risk including using both internal and external expertise. Whilst in some cases, external help may be beneficial, particularly if the staff in question are not that experienced in identifying bribery and corruption risks, we are concerned that inclusion of this comment could result in firms feeling obligated to bring in external resources when it is not necessary.

Third Party relationships and Due Diligence

Again, a number of comments are made about examples of good and bad practice. One of these suggests that Compliance should have oversight of all third party relationships, the list of which should be monitored to identify risk indicators e.g. the third party's political or public service connections. This suggestion would mean that business units would have to involve Compliance in the appointment of any third parties, not just those which are high risk but those which are low risk or not even "associated persons" for the purposes of s.7 of the Bribery Act e.g. the paper supplier. We can see no reason why non-high risk third parties need to be reviewed by Compliance, as such an approach would be inconsistent with a risk based approach. It would also suggest that for every third party, the information provided to Compliance would have to include political or public service connections, again in our view, this is a step too far.

The burden placed on Compliance would be significant if this statement of good practice were to become the regulatory requirement.

Third Party Payments

A number of examples are given of good practice in relation to third party payments. However, a number are not qualified by reference to a risk based approach. For example, the requirements to:

- check third party payments individually prior to approval to ensure consistency with the business case for that account;
- carry out regular and thorough monitoring of third party payments to check, for example, whether a payment is unusual in the context of previous similar payments;
- ensure the reasons for third party payments via Accounts Payable are clearly documented and appropriately approved; and
- be able to produce accurate MI to assist effective payment monitoring.

In our view, the examples of good practice should be quantified by reference to the risk in question.

Gifts and Hospitality

Gifts and hospitality are obvious areas of risk, if they are excessive. However, whilst individual gifts or hospitality may be straightforward to control, monitoring such issues cumulatively as the FSA and good practice suggests is much more complicated and may require changes to IT systems. We agree that it is sensible to monitor such issues cumulatively, at least on a business unit basis. Otherwise, regular hospitality just below the threshold, or even above it, may not be re-considered when combined it gives rise to an inference of corruption. However, once you go outside the business unit and start to look at monitoring across the firm, much greater complexity arises. The issue is whether such levels of monitoring are necessary or proportionate to the corruption risks. That of course will depend on the client and the other risks present. However, we do not think it is necessary to monitor everything cumulatively across business units. For example, if two parts of the bank take different people out for lunch, will one recipient be influenced by the lunch given to the other to award business? On the other hand, an event for the top twenty managers of a client should be looked at cumulatively, not as twenty pieces of separate hospitality.

The FSA also propose that cash or cash equivalent gifts should be prohibited. Whilst a number of institutions take this approach, it can cause difficulties for those in Asia, where “red envelopes” at New Year are expected to be given, but which are unlikely to improperly influence someone to award business etc, as these are customary and given without the expectation of any quid pro quo. In our view, the FSA’s guidance is sufficiently inflexible in this area.

Conclusion

Whilst firms may consider that the examples of good practice will not be binding, and a number of them, including some of those referred to above will not result in amendments to the FSA’s guide “Financial crime: a guide for firms”, in our experience, based on other FSA enforcement action, the FSA has used the examples of “good practice” to support their views that a firm’s systems and controls are not effective. They therefore need to be taken into account where practicable.

If our clients have any comments on the issues raised above, we would be grateful to receive them and pass them on anonymously or otherwise to the FSA as part of the consultation process.

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If you have any questions regarding this memorandum, please contact Peter Burrell (+44 207 153 1206, pburrell@willkie.com) or the Willkie attorney with whom you regularly work.

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