FCA FINANCIAL CONDUCT AUTHORITY

12 Endeavour Square
London
E20 1JN

Tel: +44 (0)20 7066 1000
Fax: +44 (0)20 7066 1099
www.fca.org.uk

Rt Hon Mel Stride MP
Chair
Treasury Select Committee
House of Commons
SW1A 0AA

4 July 2022

Our ref: C220620B

Dear Mel,

Re: Treasury Committee's Inquiry on 'Russia: Effective Economic Sanctions

Thank you for your letter of 20 June.

The Office of Financial Sanctions Implementation (OFSI) is in charge of investigating and prosecuting breaches of the sanctions regime. The FCA's remit is to help ensure firms we regulate have appropriate systems and controls to comply with the sanctions regime established by the Government. We also provide technical input (for example, in relation to potential market impact) when requested by the Government as part of its consideration of possible future sanctions.

We have also taken steps to ensure that regulated financial services firms are aware of, and are responding appropriately to, sanctions and that the legal and accountancy sector professional body supervisors, whose Anti Money Laundering ('AML') supervision we oversee, are taking similar steps with their supervised populations.

In addition, we work closely with a range of external partners including Her Majesty's Treasury (HMT) and other Government departments, National Economic Crime Centre (NECC) and National Crime Agency (NCA), all of which have an important role to play regarding economic sanctions.

We have set our responses to your specific questions below.

Responsibilities regarding financial sanctions

1. What is the current level of awareness and compliance at authorised firms of their obligations under UK sanctions legislation?

(a) What is the overall adequacy of firms' systems and controls in this area?

Assessing the adequacy of regulated firms' sanctions controls forms part of our assessments of firms' wider financial crime systems and controls.

Our work in prior years has uncovered varying levels of adequacy of firms' sanctions screening systems and controls. We have asked firms to remediate material weaknesses. That action includes, but is not limited to, the use of independent skilled persons, interventions such as imposing business restrictions on firms and enforcing against firms where there is serious misconduct (see response to question 3 for our role in enforcement).

As part of our initial response to the recent Russia sanctions, we communicated with firms and their trade bodies about our expectations (see response to question 7 below) and engaged with our partners. Through this engagement we have not been made aware of material deficiencies in firms' sanctions systems and controls. We have generally found that boards and executive teams of affected firms have sought to be proactive in ensuring sanctions compliance and seeking clarity where needed. However, the recent sanctions are unparalleled in volume, were introduced in a short period and are wide in scope. Having given firms a reasonable period to respond to the sanctions, and having set out our expectations, we have now increased our assessment work on sanctions controls to pro-actively test compliance. If issues are identified through this work, we will liaise with OFSI and other government partners as appropriate.

(b) Does this vary by sector or firm size?

We have not identified any difference in the adequacy of firms' sanctions controls based on their size or sector. However, as we continue our work in this area, we will identify any differentiation we find in our communications to firms on the results of our work.

There are however differences in firms' approaches to screening, particularly whether they operate manual or automated sanctions screening systems. On that basis we sent a tailored communication to those firms that operate manual screening processes to ensure that that approach remained appropriate in the context of the rapidly evolving Russian sanctions regime.

We have taken steps to ensure professional body supervisors understand our expectations of their supervision of their sectors. If deficiencies are identified within those sectors, we have been clear that professional body supervisors must inform OFSI and other partners. If issues are found, supervisors should consider what further steps they are required to take to address those deficiencies.

(c) Are there areas of particular concern?

Issues we have identified tend to be around the effectiveness of firms' customer sanctions screening processes, at onboarding and on an ongoing basis, with some weaknesses also found in firms' approach to real time payment screening. Our interactions with firms also highlighted that the implementation of sectoral sanctions can often be challenging for firms. Our proactive sanctions supervisory work will look at this in more detail and test the steps that firms are taking to meet their obligations in this area. We have also issued a joint statement alongside other UK financial regulatory authorities on sanctions and the cryptoasset sector here (see our response to question 10 below).

2. Prior to Russia's invasion of Ukraine, what recent work had the FCA undertaken in this area?

As mentioned above, the assessment of regulated firms' sanctions controls has formed part of the FCA's assessments of firms' wider financial crime systems and controls. In addition, in June 2022 we rolled out a new analytics-based tool to test firms' implementation of the sanctions against Russia. This more data-led approach is part of the FCA's broader transformation and allows us to test firms' implementation of automated sanctions screening on a much wider scale.

We have also referred to sanctions related controls in our communications on wider financial crime issues, for example in our letter to the Chief Executives of Retail Banks in May 2021 [Retail

Bank Dear CEO][1]. The UK's 2020 National Risk Assessment of money laundering and terrorist financing[2] (the NRA) raised the risk that criminals may be attracted to the fast onboarding process that challenger banks advertise, particularly when setting up money mule networks[3]. We have conducted a review in 2021 of challenger banks' financial crime controls and published our findings and expectations on firms in April 2022. We also took action with the relevant banks to remediate identified weaknesses [Challenger Banks Comms[4]].

3. How does the FCA feed into the design, implementation and enforcement of financial sanctions?

The Foreign, Commonwealth and Development Office ('FCDO') is responsible for issuing sanctions and maintains the UK Sanctions list, which covers all the measures in place in the UK. As the Russian sanctions regime evolved and was put in place, steps were taken to consult with the FCA as appropriate on cases where there may be significant market impact. Along with other authorities, we provide technical support and guidance on their potential impact on markets and firms. We act on an advisory basis only and are not involved in the decision to implement sanctions. Once they have come into force, the operation of sanctions compliance is overseen by the Office of Financial Sanctions Implementation (OFSI) in HMT[5]. They maintain the consolidated list of all financial sanctions[6] in the UK and provide guidance[7]. They are also able to enforce for breaches of financial sanctions.

For the FCA, as stated above, and as part of our supervisory approach we assess the adequacy of firms' systems and controls to ensure they comply with the UK sanctions regime. While we do not enforce the sanctions regime in the UK, when a firm has breached the sanctions regime, or there are indications of a potential breach, it can indicate material weaknesses of a relevant financial crime system and/or control. If that is the case, the FCA would consider taking action outside of any potential enforcement action taken by OFSI.[8]

4. Does the FCA share intelligence with OFSI where it identifies potential breaches of financial sanctions? Does the FCA receive referrals from OFSI where authorised firms have been involved in sanctions breaches?

FCA and OFSI have a Memorandum of Understanding, which sets out the arrangements for co-operation and the exchange of relevant information. OFSI and the FCA have regularly shared information on specific suspected breaches cases, and we are seconding an employee from our Financial Crime Department to OFSI to further develop the flow of information between our organisations. This will further improve information sharing, in particular around identifying cases where potential weaknesses exist and any potential trends.

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1 https://www.fca.org.uk/publication/correspondence/dear-ceo-letter-common-control-failings-identified-in-anti-money-laundering-frameworks.pdf

2 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/945411/NRA_2020_v1.2_FOR_PUBLICATION.pdf

3 Money mules are people who, potentially without knowing it, have been recruited as money laundering intermediaries for criminals and criminal organisations.

4 https://www.fca.org.uk/publications/multi-firm-reviews/financial-crime-controls-at-challenger-banks

5 https://www.gov.uk/government/organisations/office-of-financial-sanctions-implementation

6 https://www.gov.uk/government/publications/financial-sanctions-consolidated-list-of-targets/consolidated-list-of-targets

7 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1062452/General_Guidance_-_UK_Financial_Sanctions.pdf

8 Recent examples where we identified poor AML and sanctions systems and controls and taken enforcement action include Ghana International Bank (https://www.fca.org.uk/publication/decision-notices/ghana-international-bank-plc.pdf), Standard Charted Bank (https://www.fca.org.uk/publication/decision-notices/standard-chartered-bank-2019.pdf) and Canara Bank (https://www.fca.org.uk/publication/final-notices/canara-bank-2018.pdf).

In addition, as part of our recent communications to firms (as outlined in our answer to Question 7 below), we asked all regulated firms to also notify the FCA when they make submissions to OFSI in respect of suspected breaches, the identification of designated persons or asset freezes.

<u>Response to Ukraine</u>

5. Please provide an overview of the FCA's response to the recent expansion of financial sanctions against Russia.

The FCA has an established crisis management framework that ensured a coordinated cross-FCA response to the crisis, enabling the FCA to act at pace and efficiently in dealing with the fast moving and evolving situation.

Our response, coordinated with our partners, included communications to firms, trade bodies, and professional body supervisors, as well as more tailored engagement with firms and round tables with trade and professional bodies. It also enabled us to identify potentially sanctioned firms and individuals authorised or registered with the FCA to ensure appropriate steps were taken. Our work also involved monitoring the effect of sanctions and the invasion more broadly on issuers of listed securities, taking action to encourage disclosures and intervene via a suspension of listing where necessary and working closely with the relevant exchange. We also carried out market monitoring with daily reporting - further details on our engagement, monitoring and work can be found in questions 7 and 8 below.

Our engagement with other authorities also allowed us to support Government in the design of sanctions (see question 6 below).

6. What involvement or support has the FCA provided to the Government in designing the Russia sanctions? (a) What steps has the FCA taken, for example engaging with firms in advance, to understand the potential impact of these sanctions on UK financial services?

While the FCA does not lead on sanctions policy (design or implementation) we have worked closely with relevant government bodies to support their effective implementation. We have done so by seeking to ensure the firms we regulate understand what is required, expressing a view on market issues where those views have been sought, and raising any challenges or queries firms have on implementation on their behalf with OFSI.

We have coordinated our actions with our partners, including establishing or participating in several working groups. One of these focuses on assessing the potential financial impact of proposed new measures and brings in experts from across the authorities. This group's role is not to advise Government on whether to impose sanctions, rather it is to assess and prepare for the impact of those decisions. The sensitive nature of some of these proposals has meant that engagement with firms we regulated while decisions are taken has not always been possible. However, our experience and ongoing engagement with firms around current sanctions and sanctions introduced by other jurisdictions have helped to inform our advice to Government. In addition, with OFSI we co-chair the Financial Sanctions Implementation Senior Group, which is attended by representatives from financial services industry trade bodies and professional body supervisors. This group is helping to identify challenges in implementation of any sanctions and where additional guidance may be useful.

7. Following the implementation of sanctions, how has the FCA engaged with firms to improve their awareness of their obligations and ensure they have adequate systems and controls in place?

Following the implementation of new sanctions, starting in February 2022, we wrote to approximately 10,000 firms within the retail banks, payments, cryptoassets, wholesale banks, wealth management, wholesale markets, insurance and asset management sectors. We also wrote to a targeted group of firms. For example, those that use manual sanctions screening tools and those operating under the Temporary Permissions Regime. We reminded firms that we expect them to have established and well-maintained systems and controls to counter the risk of their business being used to further financial crime, including evading sanctions, and to ensure that their financial sanctions systems and controls are robust to identify and prevent exposure to designated persons in compliance with the new sanctions.

We also created a dedicated section on our website to provide firms with information related to the Russian invasion, including sanctions [https://www.fca.org.uk/russian-invasion-ukraine]. The site includes a statement to all regulated firms reminding them of our expectations in relation to their sanction systems and controls and that where we identify failings, we can impose restrictions and/or take enforcement action. We have also published a joint statement from UK financial regulatory authorities on sanctions and the cryptoasset sector, setting out our expectations clearly.

We have also started assessments of firms' sanction controls, which will involve on-site reviews. In the past, we have used a traditional face-to-face and document-led approach to determine how effective firms' systems are. This approach is, however, resource intensive and difficult to do at scale. We have developed, and are now starting to roll out, a new analytics-based tool, which objectively tests how effective firms are at identifying sanctioned parties using test data we generate. As part of the assessment, we send firms a list of approximately 100,000 entities which tests if their systems can identify sanctioned entities effectively.

Alongside this we are increasing our focus on information that can support the identification of firms that may be at risk of breaching sanctions, those that may attempt to circumvent sanctions and those breaching sanctions. We are also working closely with a range of external partners, including OFSI and the National Economic Crime Centre (NECC), to support intelligence gathering and enforcement efforts against attempts to circumvent financial sanctions. Additionally, those with concerns about possible sanction breaches can report them to us via a dedicated tool on our website[9] we have recently put in place. We are also providing support to the new National Crime Agency (NCA)'s Combating Kleptocracy Cell.

Through the work of the OPBAS, we have also ensured that Professional Body Supervisors (PBSs) have acted to oversee compliance of their supervised populations with sanctions and manage the associated risks, including by sharing relevant information and intelligence. OPBAS emailed the CEOs of the PBSs in February, setting out expectations following the imposition of sanctions and later followed this up with an information request to understand what activities had been undertaken by the PBSs with their members. With OPBAS we hosted two roundtables of all 25 PBSs at which we set out expectations and requirements and the PBSs shared the work they were undertaking. OPBAS continues to follow up to ensure PBSs maintain a proactive approach to testing understanding and compliance, as well as working closely with other relevant regulators. OPBAS is also facilitating ongoing information and intelligence exchange, for example through Intelligence Sharing Expert Working Groups (ISEWGs) held in Edinburgh and Belfast, which discuss the threat landscape in Scotland and Northern Ireland.

[9] https://www.fca.org.uk/firms/financial-crime/reporting-sanctions-evasions

8. Following the implementation of financial sanctions, what steps has the FCA taken to identify and monitor potential conduct and prudential risks arising in regulated firms and markets?

As sanctions are designed and implemented, the FCA conducts analysis to identify the potential impact on markets and firms. This regular market monitoring and tailored engagement with firms, trade bodies and professional bodies, allows us to identify and monitor potential risks.

This approach has led to several interventions to mitigate risks, including but not limited to, our recent consultation on the use of 'side pockets' for retail funds with exposure to sanctioned and suspended Russian assets, our ongoing engagement with firms, trade bodies and professional bodies, as well as the communications we have produced on our website.
A small number of firms operating in Russian markets have failed as a direct result of sanctions or the self-sanctioning of them by their service providers. We identified these firms early, and we worked with them ahead of their failure, the insolvency practitioners subsequently appointed and, where appropriate, the Bank of England, to ensure harm is mitigated as far as possible.

So far, firms have generally managed the impact of sanctions well on their business, and the combination of transitional licences (by OFSI) and advance "self-sanctioning" (by firms) has made this a smoother process than might have been the case.

With previous refugee crises, we have given out strong messaging on the need for banks, particularly at branch level, to be helpful and flexible in assisting vulnerable customers get access to Basic Bank Accounts. Our recent engagement with banks suggests they have established more helpful, flexible approaches, noting Home Office guidance on due diligence under the Ukraine Immigration Schemes.

9. What steps has the FCA taken to monitor and mitigate the wider impacts of Russia's invasion (outside sanctions) on regulated firms and markets (for example, volatility in commodity prices)?

The impact of Russia's invasion has been far reaching and the FCA has worked with partner agencies to ensure our firms and markets continue to work well, notwithstanding additional volatility.

For example, we have worked closely with our partners, including the National Cyber Security Centre (NCSC) and Bank of England (BoE), in our shared interest of trying to prevent any cyber-attacks and operational resilience issues crystallising into major harm to consumers, markets or financial stability. We remain in a state of heightened vigilance.

The FCA has also closely monitored the impact of the invasion of Ukraine on markets and firms. We have been monitored closely in the additional volatility across commodity and other affected markets. We gathered extensive market intelligence through regular communication with regulated firms, including daily calls with a number of firms, which allowed us to implement close supervision of any identified as being in distress or at risk of failure. We have also communicated with domestic and international counterparts throughout the crisis to share experiences and to coordinate responses where appropriate. For example, the FCA participated in a working group with other UK authorities to monitor emerging risks within energy markets, including both firm-specific and wider financial stability risks. The group facilitated cross-authority information sharing and risk analyses and co-ordinated actions among regulators and government to address both current and potential future risks to our objectives.

10. What is the risk that cryptoassets can be used to evade financial sanctions in the UK?

We recognise that there are risks that cryptoassets could be used to circumvent sanctions, but we assess that the risks are much lower in FCA registered cryptoasset firms. We have 35 firms registered under the Money Laundering Regulations 2017 and we supervise these firms to ensure the adequacy of their control frameworks. The FCA has taken a robust approach to registering cryptoasset firms, making sure they have strong financial crime controls.

Every FCA-registered cryptoasset firm uses third-party blockchain analysis firms as part of their financial crime controls. These should be able to highlight exposure to sanctions evasion as well as other financial crime risks. The FCA supervisory team maintains frequent communication with key industry participants, including cryptoasset blockchain data providers, to ensure that we are aware of significant developments, including indications that the role of cryptoassets in sanctions evasion may be changing.

The FCA maintains a robust intelligence capability, which extends to scanning for indicators that our cryptoasset firms may be exposed to sanctions evasion risk. This is supported by our analytics capability to help us to identify significant changes in risk for our firm population.
We have identified a number of firms that appear to be active in the UK, but which have failed to apply for registration with the FCA. We make the names of these firms public to alert consumers and firms to their existence. We are acting against these firms and have recently issued specific updates to the market regarding cryptoasset ATMs. Since the FCA published its list of unregistered cryptoasset firms that have been continuing to conduct business, 110 have ceased operating.

You can see the Joint statement from UK financial regulatory authorities on sanctions and the cryptoasset sector here - Crypto Statement[10].

11. How many authorised firms, firms under the temporary permissions regime, electronic money institutions, payment services firms, cryptoasset businesses and Annex 1 financial institutions are subject to any sanctions (including their appointed representatives and agents)?

Our screening processes have not identified any entities within our perimeter that are directly designated by OFSI (i.e. are on OFSI's consolidated list). We have identified 13 firms where we have identified ownership links with entities or individuals that are on the consolidated list.
I hope the Committee finds this response helpful.

Yours sincerely,

Nikhil Rathi

Nikhil Rathi
Chief Executive

[10] https://www.fca.org.uk/news/statements/uk-financial-regulatory-authorities-sanctions-cryptoasset-sector