Freshfields Bruckhaus Deringer

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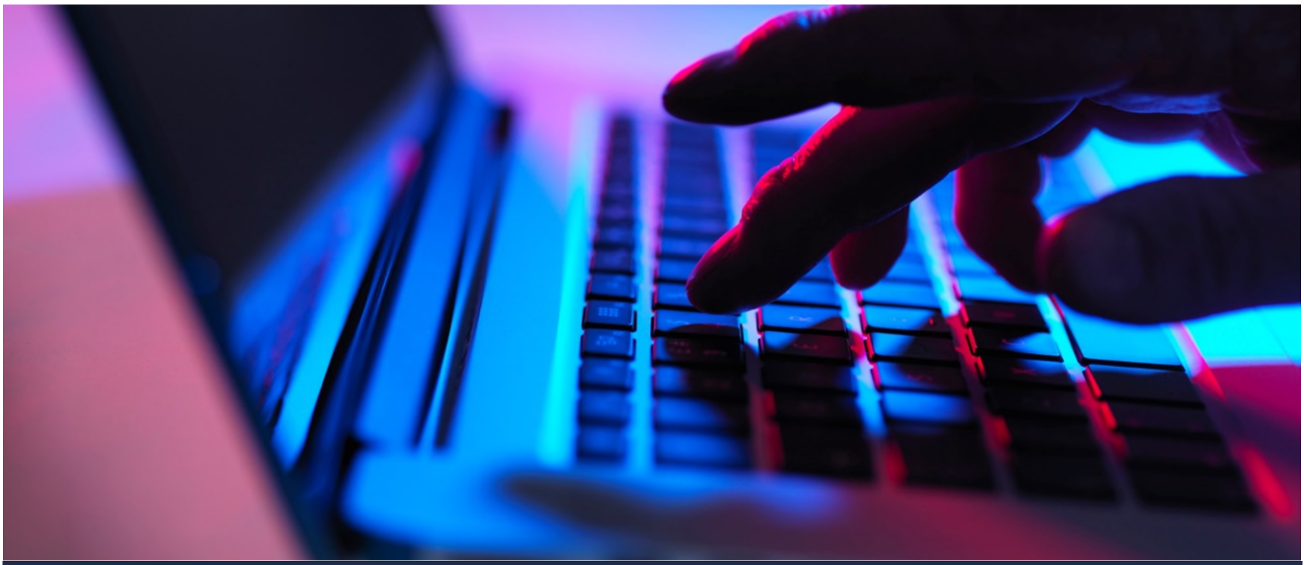

# Freshfields FS insights

## The challenge of combating financial crime

The need to combat financial crime remains at the top of the agenda for governments, regulators and financial sector firms. In this month's edition, we outline key developments in this area and assess the potential risks arising from the pandemic, expected enforcement trends (particularly the greater use of new powers to combat systems and controls failures), and the use of Reg Tech to offer potential solutions.

### Pandemic exposure

As economies emerge from the pandemic, regulators will turn their attention to pandemic era conduct. We predict that there will be significant regulatory focus on fraud relating to government support programmes, which may present higher risks given the speed of implementation of these programmes and the quantum of support offered to smaller businesses. In addition, regulators may ask whether remote working arrangements have impacted firms' oversight and surveillance capabilities and evaluate firms' approach to managing risk in this context.

Emerging evidence suggests that the pandemic has seen an increased focus on financial crime, with the UK NCA reporting record numbers of SARs from banks. The Archegos Collapse, triggered by recent market instability, has seen concerns around credit exposure, involving past regulatory stumbles and a lack of transparency in SEC filings. The incident followed earlier accusations of insider trading by U.S. securities regulators and wire fraud linked to the related Tiger Asia incident in 2012. FATF research shows an increase in money laundering and the FATF has produced an update on combating evolving threats ; Europol has issued warnings on emerging investment scams and the UK NCA has published a threat assessment and advice on the risks of Covid-19 fraud. The US DOJ has reported that, as of late March, it had brought criminal charges against 474 defendants based on fraud schemes connected to the pandemic and that, among other things, the Department has provided assistance to foreign counterparts to help detect, investigate, and prosecute fraud. These trends, in turn, have implications for money laundering compliance.

**Regulatory scrutiny**

Even without the impact of the pandemic, we would expect an uptick in enforcement efforts over the near term. In the US, there is likely to be greater attention to enforcement under the Biden administration than under the prior administration. For example, the Senate recently confirmed Gary Gensler as Chair of the SEC. (Mr. Gensler was confirmed to serve the remainder of the prior Chair's term, until June 5, 2021; the Senate will need to vote again to confirm Mr Gensler's next term). Mr. Gensler led the CFTC during the Obama administration and said in his confirmation hearing that he will seek greater transparency and accountability in the financial markets to protect investors from fraud and manipulation. Based on recent case law, SEC enforcement under Chair Gensler may extend to offshore banking activity. In addition, the passage of the Anti-Money Laundering Act of 2020, as part of the US National Defense Authorization Act for fiscal year 2021, expanded subpoena powers on the US Departments of Treasury and Justice for banking records held overseas. Moreover, recent enforcement actions such as FinCEN's action against Capital One, show that FinCEN is likely to pursue enforcement actions based on AML compliance issues. Similar proceedings can be expected in other jurisdictions.

In Asia, the Hong Kong SFC launched a consultation on proposed changes to the Guidelines on Anti-Money Laundering and Counter-Financing of Terrorism. If the proposals are implemented, this will expand the range of enforcement tools available to the regulator to act in a wider range of circumstances. The SFC has also sought to address evolving pandemic threats, carrying out a joint operation with the Hong Kong police targeting suspected online scams related to 'ramp and dump' activities.

AML is also an area of focus for scrutiny in the EU and UK.

The EU AML regulatory framework is changing at pace. The Commission's Action Plan for a comprehensive EU AML policy encompasses the recast AML Directive (AMLD6), the establishment of a new AML authority and a single rulebook on money laundering in the EU. This could come into force as early as 2022 and will allow greater coordination across the EU to combat money laundering. In practice, this should harmonize money laundering requirements in the EU in the long term, making it easier for financial institutions to implement EU-wide AML processes.

Today, however, some member states go (in some cases far) beyond the EU's minimum requirements. Expanded criminal liability for AML violations under new German legislation has introduced a criminal statute that follows the UK and US in criminalising even reckless behaviour. The bill adopts an all-crimes approach; whereby every offence, even crimes involving low financial values, may constitute a predicate offence for money laundering, making it illegal to handle the proceeds of any crime. In light of the proposals, we explore how GCs and compliance officers must thoroughly assess their company's AML risk profile.

The UK is likewise stepping up activity in this area. The FCA has announced criminal proceedings against NatWest for systems and controls failings in monitoring suspicious activity; a significant landmark, representing the FCA's first criminal prosecution under money laundering regulations. As we have explored, financial institutions are asking whether this is a one-off or the shape of things to come. The FCA's Business Plan, that will be published in July 2021, is likely to continue to place combating financial crime as a priority area for firms. The UK Treasury Select Committee is also conducting an Economic Crime Inquiry covering reforms to AML and sanctions policy, which may overhaul bank reporting via SARs.

The finance sector is driving the success of RegTech in helping to fight financial crime.

**Creative solutions from RegTech**

As the financial services sector faces the increasing challenges of financial crime, technology offers developing solutions.

RegTech may present a useful way to resolve the challenges. As part of the HKMA's overall RegTech push and against the backdrop of a proliferation of remote services offered by financial institutions, the HKMA has published a report on banks' experience with adopting RegTech for AML/CFT purposes. This is a useful resource for planning RegTech management, getting data and the process ready, and defining and

tracking value and performance. Similarly in the UK, a recent City UK report illustrates how the finance sector is "*driving the success of RegTech in helping to fight financial crime*". The report shows how technology can "*significantly enhance the detection of suspicious activity*, *analysing customer behaviour and multiple data sets to identify anomalies*", with notable successes by some banks, through working with organizations such as Quantexa. In the US, regulators continue to focus on internal surveillance efforts, including the use of technological solutions. For example, the DOJ and the CFTC issued compliance guidance last year stating that, in evaluating a financial institution's compliance programme, the agencies will consider compliance personnel's level of access to data and other internal surveillance and monitoring efforts.

From a regulatory perspective, the UK FCA and the Bank of England are at the vanguard in their support of technology innovation. From its inception in 2014, FCA Innovate has been providing support to both FinTechs and RegTechs to assist the development of novel ways to use technology for solving intractable problems. For example, seven FCA 'Techsprints' conferences have been held to date to explore how the sector can use technology to combat challenges faced by financial services, the 2019 meeting centering on AML.

US regulators have also substantially enhanced their market surveillance capabilities in recent years. In particular, the CFTC now uses an analytical tool that provides it with futures trading information, including the identity of traders, directly from exchanges, and a team of analysts reviews the data to detect suspicious activity. The SEC has also developed its own analytical tools, and the DOJ has partnered with private firms to review large volumes of data for potential AML violations.

**Looking ahead**

It is clear that 2021 will remain a year where financial crime remains important for stakeholders in the financial services industry. In our forthcoming editions, we will be assessing the wider fallout from recent developments, including the crystallization of UK and EU approaches post-Brexit; the focus of the new Biden administration following the first 100 days; and, the implications of worldwide efforts to achieve the IMF’s Great Reset for finance and to Build Back Better.

If you would like to provide feedback on this or other editions, please contact Laura Feldman.