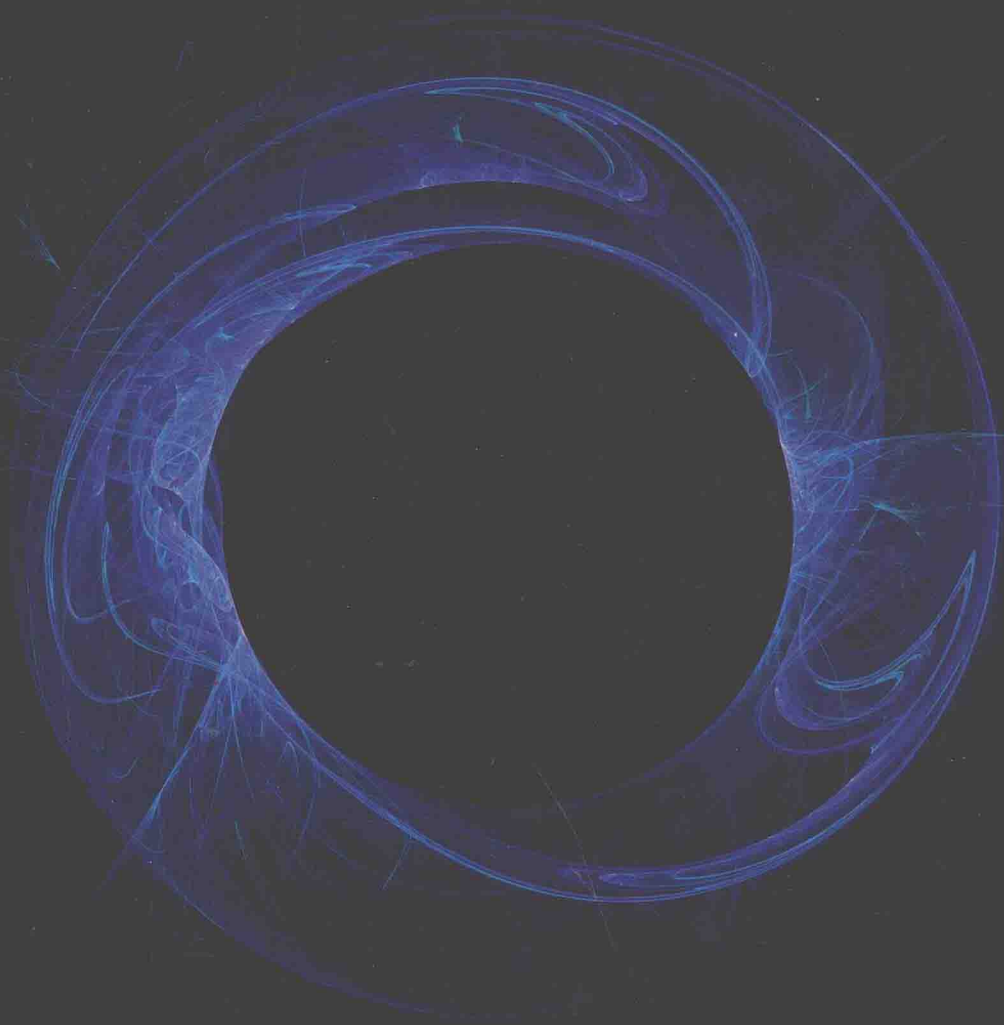


**ANNIE MILLS
PETER HAINES**



**ESSENTIAL STRATEGIES FOR
FINANCIAL SERVICES
COMPLIANCE**
2ND EDITION

WILEY

Essential Strategies for Financial Services Compliance

Second Edition

ANNIE MILLS
PETER HAINES

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Foreword to the First Edition

Anti-money laundering and counter-terrorist financing programmes operating inside UK financial institutions today must rely upon the skills of their in-house compliance officers. These individuals are the gatekeepers of our financial world, and they must have the tools to allow them to properly discharge their duties and responsibilities. They must also promote an ethical compliance culture that seeks solutions.

Unfortunately, most compliance manuals in the marketplace today are outdated upon publication, and are generally uninspiring, as well as difficult, especially to the novice compliance trainee. This book seeks to demystify the complex world of anti-money laundering compliance by detailing for the reader the procedures and skills one must master, as well as to offer practical business solutions for regulatory problems. It is the reference guide we always wanted to have when the tough questions arose.

The first-person stories demonstrate that the author has clearly been a front-line compliance professional, and her positive approach to coping with the day-to-day tactical problems of compliance should be an example to the readers.

Keep this book handy, for there will be times when, at 4:30 on a Friday afternoon, you require the right answer, on a real-time basis, to a major compliance problem; Depend on it.

Kenneth Rijock
Financial Crime Consultant for World-Check

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First and foremost, my most grateful thanks must go to Gordon McLean whose dedicated and tireless assistance played a major role in the successful completion of this text.

A man should choose a friend who is better than himself.

There are plenty of acquaintances in the world; but very few real friends.

—*Chinese proverb*

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List of Abbreviations

The following provides a list of the main abbreviations used in this book.

3ML	Third Money Laundering Directive 2005
ABFA	Asset Based Finance Association
ACD	Authorized Corporate Director
ADR	American Depositary Receipt
AIC	Association of Investment Companies
AIM	Alternative Investment Market
AML	Anti-Money Laundering
APER	The FSA's Approved Persons Sourcebook
ARA	Asset Recovery Agency
ARROW	Advanced Risk Response Operating Framework
ATCSA	Anti-Terrorism, Crime and Security Act
ATS	Alternative Trading System
Basel I	BCBS Capital Accord 1988
Basel II	BCBS Revised Capital Adequacy Framework 2004
BBA	British Bankers Association
BCBS	Basel Committee on Banking Supervision
BCD	Banking Consolidation Directive
BCSB	Banking Code Standard Board
BIMBO	Combination of a management buy-in and buy-out
BIS	Bank for International Settlements
BOE	Bank of England
BVCA	British Venture Capital Association
CA 06	Companies Act 2006
CARD	Consolidated Admissions and Reporting Directive 2001
CASS	The FSA's Client Assets Sourcebook
CC	Competition Commission
CCA	Consumer Credit Act 1974 or 2006
CCARs	Consumer Credit (Advertisements) Regulations 2004
CD	Certificate of Deposit
CDS	Credit Default Swap
CEBS	Committee of European Banking Supervisors
CEO	Chief Executive Officer
CESR	Committee of European Securities Regulators

CFO	Chief Financial Officer
CI	Compliance Institute
CJA	Criminal Justice Act 1993
COAF	The FSA Sourcebook for Complaints against the FSA
COBS	The FSA's Conduct of Business Sourcebook
COLL	The FSA's Collective Investment Scheme Sourcebook
COND	The FSA's Threshold Conditions Sourcebook
CP	Commercial Paper
CPD	Continuing Professional Development
CRD	Capital Requirements Directive 2006
CTF	Counter Terrorist Financing
CTF	Child Trust Fund
DBERR	Department for Business, Enterprise and Regulatory Reform
DEPP	The FSA's Decision Procedure and Penalties Manual
DGS	Deposit Guarantee Schemes Directive
DIE	Designated Investment Exchange
DISP	The FSA's Dispute Resolution: Complaints Sourcebook
DMD	Distance Marketing Directive
DMO	Debt Management Office
DPA	Data Protection Act 1998
DTR	The FSA's Disclosure and Transparency Rules Sourcebook
EA	Enterprise Act 2002
EAW	European Arrest Warrant
EBRD	European Bank of Reconstruction and Development
ECAs	Export Credit Agencies
ECD	E-Commerce Directive 2000
ECHR	European Convention on Human Rights
ECN	Electronic Communication Network
EEA	European Economic Area
EFP	International Uniform Exchange for Physical Transaction Agreement
EG	The FSA's Enforcement Guide
ERA	Employment Rights Act 1996
ESC	European Securities Committee
ESD	European Savings Tax Directive
ETFs	Exchange Traded Funds
EU	European Union
Euronext LIFFE	London International Financial Futures Exchange
FAIFs	Fund of Alternative Investment Funds
FATF	Financial Action Taskforce
FCA	Financial Conduct Authority
FCD	Financial Collateral Directive 2002
FCPA	Foreign Corrupt Practices Act 1977
FEOMA	Foreign Exchange and Options Master Agreement
FINRA	US Financial Industry Regulatory Authority
FIT	The FSA Sourcebook containing the Fit and Proper Test for Approved Persons
FIU	Financial Intelligence Unit

FOA	Futures and Options Association
FOIA	Freedom of Information Act 2000
FOS	Financial Ombudsman Service
FOTRA	Free of Tax to Residents Abroad (relating to securities)
FRNs	Floating Rate Notes
FSA	Financial Services Authority
FSAP	Financial Services Action Plan
FSCS	Financial Services Compensation Scheme
FSMA	Financial Services and Markets Act 2000
FSSC	Financial Services Skills Council
FTSE	Financial Times Stock Exchange
FX	Foreign Exchange
FXJSC	Foreign Exchange Joint Standing Committee
GDR	Global Depositary Receipt
GEN	The FSA's General Provisions Sourcebook
GMRA	Global Master Repurchase Agreement
GMSLA	Global Master Securities Lending Agreement
GP	General Partner (in a limited partnership)
GTMA	Grid Trade Master Agreement
HMRC	Her Majesty's Revenue and Customs
HR	Human Resources
HRA	Human Rights Act 2000
ICA	International Compliance Association
ICC	International Chamber of Commerce
ICD	Investor Compensation Directive 1997
ICMA	International Capital Market Association
ICO	Information Commissioner's Office
ICOM	International Currency Options Master Agreement
ICVC	Investment Company with Variable Capital
IEC Act	Investment Exchanges and Clearing Houses Act 2006
IEEPA	International Emergency Economic Powers Act
IFEMA	International Foreign Exchange Master Agreement
IFXCO	International FX and Currency Option Master Agreement
ILSA	Iran and Libya Sanctions Act
IMLPO	Institute of Money Laundering Prevention Officers
IOSCO	International Organization of Securities Commissions
IPO	Initial Public Offering
ISA	Individual Savings Account
ISD	Investment Services Directive 1993
ISDA	International Swaps and Derivatives Association
ISMA	International Securities Markets Association (now ICMA)
ISP 98	International Standby Practices issued by the ICC and the Institute of International Banking Law and Practice
IT	Information Technology
JMLSG	Joint Money Laundering Steering Group
KPI	Key Performance Indicator
KYC	Know Your Customer

L/C	Letter of Credit
LBMA	London Bullion Market Association
LIBOR	London Interbank Offered Rate
LMA	Loan Market Association
LME	London Metal Exchange
LP	Limited Partner (in a limited partnership arrangement)
LSE	London Stock Exchange
MAD	Market Abuse Directive 2003
MAR	The FSA's Market Conduct Sourcebook
MBIs	Management Buy-Ins
MBOs	Management Buy-Outs
MEFISLA	Master Equity and Fixed Interest Stock Lending Agreement
MiFID	Markets in Financial Instruments Directive 2004
ML	The FSA's Money Laundering Sourcebook (no longer in force)
ML Regs	UK Money Laundering Regulations, as updated from time to time
MLA	Mandated Lead Arranger
MLRO	Money Laundering Reporting Officer
MPBR	More Principles Based Regulation
MTF	Multilateral Trading Facility
MTNs	Medium Term Notes
N2	The date the FSA became the UK's 'single financial services regulator' and the date on which FSMA took effect (1 December 2001)
NASD	US National Association of Securities Dealers (now merged into FINRA)
NASDAQ	National Association of Securities Dealers Automated Quotations
NCA	National Crime Agency
NCIS	National Criminal Intelligence Service (replaced by NCA)
NDF	Non-Deliverable Forward
NIPs	Non-Investment Products Code
NPL	Non-Performing Loan
NUR	Non-UCITS Retail Scheme
OEIC	Open-Ended Investment Company (also known as an ICVC)
OFAC	Office of Foreign Assets Control in the US
OFT	Office of Fair Trading
OSLA	Overseas Securities Lending Agreement
OTC	Over the Counter
PA dealing	Personal Account Dealing
PACE	Police and Criminal Evidence Act 1984
PEP	Personal Equity Plan
PIBS	Permanent Interest Bearing Shares
PIDA	Public Interest Disclosure Act 1998
POCA	Proceeds of Crime Act 2002
PRA	Prudential Regulation Authority
PRIN	The FSA's Principles for Businesses Sourcebook
QIS	Qualified Investor Schemes
RAO	Regulatory Activities Order
RDC	Regulatory Decisions Committee
REITs	Real Estate Investment Trusts

RIE	Recognized Investment Exchange
RIPA	Regulation of Investigatory Powers Act 2000
Sarbox	Public Company Accounting Reform and Investor Protection Act of 2002, also known as the Sarbanes–Oxley Act
SFO	Serious Fraud Office
SHCOG	Securities Houses Compliance Officers Group
SIFMA	Securities Industry and Financial Markets Association
SII	Securities and Investment Institute
SMMLG	Sterling Money Markets Liaison Group
SOCAP	Serious Organised Crime and Police Act 2005
SRO	Self-Regulatory Organization
SUP	The FSA’s Supervision Sourcebook
SYSC	The FSA’s Senior Management Arrangements, Systems and Controls Sourcebook
TACT	Terrorism Act (2000 or 2006)
T-Bills	Treasury Bills
TBMA	The Bond Market Association (now part of SIFMA)
T&C	Training and Competence
TCF	Treating Customers Fairly
TRUP	Transaction Reporting User Pack
UCITS	Undertakings for Collective Investment of Transferable Securities
UCP 600	ICC’s Uniform Customs and Practices for Documentary Credits
UCPD	Unfair Commercial Practices Directive
UCR rules	ICC Uniform Rules for Documentary Collections
UNCITRAL	United Nations Commission on International Trade Law
URC 522	ICC’s Uniform Rules for Collections
UTCCRs	Unfair Terms in Consumer Contracts Regulations 1999
VAT	Value Added Tax
VCTs	Venture Capital Trusts

Preface to the First Edition

(Or, How Not to be an Execution Officer)

Long ago, when the finance world appeared as weird and as unfamiliar to me as life on another planet, I applied for my first job in banking. I didn't know anything about broking or investments and found the interview a little daunting to say the least. Amidst all the confusion, what really stuck in my mind that day was my interviewer – someone with the curious job title of 'Compliance Officer'. In my bewilderment I found that by the time I returned home, with quite uncanny perception many might still say, the personage of 'Compliance Officer' had become in my mind the 'Execution Officer'. And a very sinister sounding person this seemed to be.

Fast forward a couple of months . . .

Amazingly I got the job (I wasn't even quite sure what it was at that first interview!) and started work as a junior on a team of stockbrokers. But some higher power had plans for me and a few months further down the line the firm was restructured. The broking team that I worked for was 'demerged' and became an entity in its own right. As that was a time when both regulator and regulated had a rather more cavalier attitude towards Compliance than they do today, I, as a financial services fresher, was informed that I was to be the new entity's very own 'Execution Officer'.

By now, I had more of an idea of what Compliance was all about and I must admit that I was not too thrilled to have landed this role – it was not an area that sent even the faintest shiver of excitement down my spine. The idea of having a job that involved learning lots of rules simply to 'get people into trouble' for not obeying the regulator's every command did not seem like my idea of fun. But, being young and somewhat ambitious, I was not immune to the career potential of having what I considered to be such an important sounding job title embossed on my business cards. So I went for it and suddenly . . . I was a real, live Compliance Officer! Or to be correct, I was a very confused and bewildered individual, *masquerading* as a Compliance Officer, who at intervals of scary regularity was required to sign off as such on official documents that were despatched to the regulator of the day, the Securities and Futures Authority.

I was armed with my fantastic new business cards and my shiny new rulebook, but what was I actually meant to do with them? I was aware that a rule breach was bad, and I knew that there were many, many rules out there that could be breached. But I was not very familiar with these rules or the legislation that had given rise to them; nor, being a relatively new recruit, did I know my firm very well, and I certainly wasn't very familiar with the finance industry.

I was simply not well placed to apply the few rules I did know to the business activities in which my firm engaged, and I regret to say that I was guilty of making more than a few of the classic mistakes:

- I'd select a rule, jump out from the rulebook behind which I had laid my ambush, and tell some poor, unsuspecting sales person that he was doing it all wrong, and that he'd better stop it pretty sharpish, with all sorts of threats of what would happen if he didn't. I don't think it occurred to me to propose an alternative approach to the one I was banning.
- I spent too much time with my head buried in rulebooks and regulatory notices, but I did not share my knowledge by providing training. How could I complain about someone doing something he did not know he should not have done because I had not given him proper guidance?
- I told the business what not to do without giving a reason why, or the consequences if they continued to do it.
- I worried more about keeping the regulator happy than I did about practical business solutions to regulatory problems.

Not surprisingly, my efforts were about as welcome as the news that we all had the Black Death! It simply seemed that, at every move I took, I was going to prevent some sort of business initiative or other. I'd be met with the resentful cries of my colleagues that things weren't done that way where their pals worked, or the rule I was quoting simply did not apply to their type of business. I was completely at a loss. Were *they* right? Was *I* right? I didn't know and, equally, I didn't know how to find out.

I felt that someone's head was going to roll; either mine, my colleagues' (or the regulator's!) and I began to be haunted by my old visions of the Execution Officer. In fact that's very much what I must have been perceived as being. I was scary. The whole thing was scary, and what was most scary was that my name was on that all-important dotted line that led straight to the regulator's door.

In desperation I headed to the City Business Library to find a reference book to help me, but unfortunately, when I reached the section that should have been marked 'Handy and User-Friendly Guidebooks for Compliance Officers', the shelf was bare. My kindly and more seasoned Compliance industry colleagues had omitted to provide me with any guidance about what I was meant to be doing or how I was meant to be doing it.

To be fair to them, however, I'm sure they had neither the time nor the energy to consider writing about what they were doing: most of them were too busy fire fighting, like me. Back then, there were far fewer Compliance professionals than there are today, and from the dealings I had with my peers it seemed that I was not the only scary member of the fraternity. Everyone seemed to be faced with much the same problem: Compliance had zero 'street cred'! The profession was new and suffered from an extreme lack of respect. It was often deemed worthy only of staff who had failed in all other areas. Or it was used as a cosy final resting place for elderly grandees of the firm who were gently being eased into retirement.

Many Compliance Officers had inadequate resources and undeveloped Compliance infrastructures. And so many of the new Compliance initiatives that they did take were met with such resentment and resistance that the easiest option was often to scare people into submission by threatening them with the regulator, who, in those days, seemed much less focused on what was good for business than it is today. It's not surprising that we earned the nickname of 'Business Prevention Officers'.

But all that was a few years ago. Today the regulator would never (we hope!) allow that type of worst case scenario in which a totally novice Compliance Officer is left in charge of a

regulated firm. Both the Compliance profession and the regulator have moved on since then, and so have I. I soon realized that ‘being scary’ was not what it was all about. I began to wake up to the fact that . . .

COMPLIANCE OFFICERS ARE GREAT!!!

In fact, far from being their worst nightmare, we deserve to be every financial services practitioner’s best friends! This view may not sound particularly familiar but it’s true. Think about it. There are massive benefits to be gained from a Compliance function that is operating to its full potential and is properly aligned with the business. Just stop for a second and remind yourself of all the many benefits you bestow on your colleagues. If you need a little help thinking of why you should be the very light of their life, then just turn to Chapter 2, Section 2.4.1 (‘What are the Benefits of Compliance, Regulation and the Compliance Officer?’) to get some ideas.

Luckily many business managers are also beginning to wake up to all the benefits that a good Compliance department can bring to a firm. Of course the regulator and we Compliance professionals realized this quite some time ago and have done everything we can to move things forward. But there’s still a lot of bad reputation to cut through – which is not surprising considering that there are still a few rogue Compliance Officers engaging in all the no-nos that I referred to earlier. The shadow of the dreaded ‘Execution Officer’ still looms large.

So, how can we ensure that we practise ‘successful Compliance’, execute the ‘Execution Officer’ and become the type of asset to the business that any chief executive would be pleased to have on board?

Well, it’s no mystery, we simply have to equip ourselves to do the job. What is more complex is the equipping process itself. Unless you are a very unusual person indeed, you were not born with the skills or knowledge that will enable you to apply regulatory requirements and best practice in any meaningful or useful way to the firm you work for. And that’s where this text comes in.

I’ve attempted to provide a straightforward, easy to read, and above all practical guide to the work of a Compliance Officer. This text is not simply about summarizing legislation or regurgitating regulations. If that’s what you need, then there are already plenty of books on the shelves. Instead, this text is about what to do once you have your source material and you’re not quite sure what to do next. It’s the sort of guide that shows you how to roll your sleeves up, get stuck in and start to deliver ‘successful Compliance’.

The text covers the basic areas of knowledge and competence with which Compliance Officers should feel comfortable if they are even to dream about gaining the respect of their colleagues by giving constructive advice, steering their firms away from regulatory pitfalls or proposing ways in which processes and procedures can be streamlined.

SCOPE, COVERAGE AND READERSHIP

Jurisdictional Focus

In this world of globalization and international conglomerates, much of the text is of relevance irrespective of the jurisdiction in which you work: after all, a bank is a bank and a loan is a loan no matter whether you are based in Peru or Kazakhstan. Where more detail is required, the focus is generally on the regulatory system in place in the UK but to a certain extent, detailed rule references are irrelevant: what is important is to get to grips with the issues at the heart of a particular regulatory concept. It does not matter how that concept is translated into rules from one jurisdiction to the next, what does matter is whether we are following the spirit of the

requirement, delivering good value to our firms, protecting customer interest and working to maintain the integrity of the financial system. These concepts do not know national boundaries.

Industry Coverage

The scope of the financial services industry is too large to cover every aspect of each sector in one book. Much of the information and most of the guidance contained herein relate to a general regulatory framework that is of relevance to all sectors, but where there is a degree of specialization, the focus is on investment banking activity.

Readership

This text is targeted primarily at Compliance Officers but will also be of relevance to anyone who needs to find their way around some of the key concepts in financial regulation. This includes senior managers who need to get to grips with their Compliance responsibilities, regulators trying to find out how it really works in the firms they supervise, and students who have a regulatory component to their studies.

In short, this is the book I wish I had had on my desk when I first started out in Compliance and I hope you find it useful.

Annie Mills

ADDENDUM FROM PETER

I was delighted to be asked to work on updating this book. There are not too many books on Compliance that are worth reading, but Annie's book has set the bar very high. It is simply the best that I have seen. Annie and I first met properly when we worked on the development of BS 8453 on the Compliance Framework for Regulated Financial Services Firms. It was clear from that work that Annie has a fundamental understanding of Compliance. I hope that this revision does the original justice.

One of the downsides of updating a book on Compliance is that regulations change on a weekly, if not daily, basis. As this second edition goes to print, we have had confirmed rules relating to the new Senior Managers Regime. These changes have not been reflected in this edition, but will mean new categories of senior manager, new conduct rules, significant changes relating to statements of responsibility and responsibilities maps, as well as a major shift from the approved persons regime to that of certified persons. All of this will mean the usual amount of hard work whenever the regulators make fundamental changes, but greater focus this time from senior management – for obvious reasons. This means that Compliance Officers in 2016 and onwards will need to work so much harder to stay at the top of their game. Compliance Officers need to embrace this responsibility to become trusted advisors of senior management, assisting in developing and maintaining the right corporate culture and working hard to make sure that this culture achieves the right balance between revenue generation and customer service. Given the political will behind the new initiatives, it will be a challenging next decade facing the Compliance community. This book should help in that respect and I wish all Compliance colleagues the best of luck in their challenge, wherever in the world they face it.

Foreword to the First Edition

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The first-person stories demonstrate that the author has clearly been a front-line compliance professional, and her positive approach to coping with the day-to-day tactical problems of compliance should be an example to the readers.

Keep this book handy, for there will be times when, at 4:30 on a Friday afternoon, you require the right answer, on a real-time basis, to a major compliance problem; Depend on it.

Kenneth Rijock
Financial Crime Consultant for World-Check

Foreword to the Second Edition



Photo credit: Reuters/Kevin Coombs

It was on the morning of 15th September 2008 that it struck me. The Lehman Brothers management teams were informing London and New York employees that the company had collapsed, and I realised that the financial system as we had known it would change for ever. I was looking out at the scene unfolding in Lehman Brothers' London HQ, right opposite my window in Canary Wharf. It was clear to me that things were going to change significantly for our industry. Government would enter back into the financial system in strength. Regulation would increase and become highly politicized. And the role of compliance would need to change dramatically, from the back office to the front office.

All these things have since come to pass, and in the meantime financial services has faced further challenges to its reputation, from benchmark rigging in LIBOR and FX and market manipulation to money laundering scandals. The world's regulatory authorities are cooperating as never before. In the year that preceded publication of this book, they jointly levied \$65 billion in fines on the industry – a 40 percent leap on the year before – and have ended the careers of many CEOs and senior managers.

The regulatory environment has grown overly complex. From just 33 regulatory alerts per day in 2008 we now report some 150 daily on average – that is over 40,000 per year from over 400 regulatory bodies. This is just one indication of the complex regulatory challenge which financial institutions have to address. Dealing with Regulation remains the top agenda item for the leadership of our 50,000 customers around the world.

This book helps us to cut through this complexity, providing a unique, comprehensive and simple handbook for navigating a complex area. The authors stress the importance of understanding the regulatory environment, frameworks and intent. They outline what successful compliance can look like, enabling the business rather than curtailing its activities, and working constructively to build trust between the business and its regulators.

To some this might look like an aspiration rather than the current reality, but it is possible and the benefits are enormous – not only to the individual institutions but also to restoring trust in this industry, which employs more than two million people in the UK alone, according to TheCityUK, and directly contributes some 12 percent of the UK's economic output. And of course all this activity has a multiplier effect, providing the most fundamental services for our society's wealth creators and employers, our businesses, households and government.

Financial services businesses today need effective compliance strategies. Quite simply, the authors of *Essential Strategies in Financial Services* have created a unique book to show you how it is done.

David Craig
President of the global Financial and Risk business
at Thomson Reuters
August 2015