

# **Annex 1 firms should mind the gaps when assessing their AML frameworks**

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## **Introduction**

The six month deadline to complete a gap analysis has now passed for Annex 1 firms, following the FCA's publication of the 'Dear CEO letter' on anti-money laundering (AML) failings in March. By now, the regulator expects firms to have completed a gap analysis against the common weaknesses identified in the letter and to have started to remediate any gaps.

While not otherwise regulated by the FCA, Annex 1 firms must register for compliance with the Money Laundering Regulations (MLRs), meaning that the practice points raised by the letter are worth consideration by any other firm that must comply with the MLRs.

Pathlight Associates regularly sees firms fail to action responses to weaknesses, or fail to internally evidence those responses to an appropriate standard. There can be serious consequences for these failings, which often lead to s165 requests for more information, restrictions on business activity, or being placed into a s166 (Skilled Person Review) process.

## **What should firms expect from the FCA?**

In the coming months, Annex 1 firms should expect the FCA to specifically ask how they responded to the 'Dear CEO' letter as part of any requests for information under s165, or other supervisory interactions. When responding, firms should be able to demonstrate appropriate governance and oversight of financial crime risk as part of the broader Governance Risk Compliance (GRC) framework.

The FCA expects firms to understand the gaps in their AML framework, and have a detailed action plan in place to remedy shortfalls. Annex 1 Firms who can evidence a proactive, thorough and detailed internal response to the 'Dear CEO' letter from March will be seen positively. Those who fail to adequately answer how they have mapped gaps in their risk assessments, due diligence and monitoring, or demonstrate poor scrutiny by senior management can expect to see further action from the regulator.

## **What should firms do now?**

Through our skilled person review work, Pathlight has seen how the FCA is increasingly focussed on the steps senior managers and compliance teams are taking to document the effectiveness of their AML controls. We regularly see how generic, outdated or non-existent documentation is an immediate red flag to the regulator and invites further scrutiny.

Documentation is especially important for firms that are implementing 'tech-led' monitoring systems, or relying heavily on systems and controls they have designed themselves. We often see clients with otherwise good technological solutions fail on having adequate and up-to-date records.



Not thoroughly evidencing the effectiveness of automated monitoring systems consistently ends up creating more work for firms. Poor documentation and evidence of 'know your customer' and thorough due diligence checks can lead to manual reviews of thousands of customers and transactions, leaving firms with vast amounts of remedial work to rectify their data.

Another red flag for the regulator is a high turnover of SMF16/17 holders and second-line compliance staff. In a market where there is fierce competition for skilled compliance professionals this can often be a challenge for firms. Those using consulting or third parties to support remediation work should be aware that the FCA is increasingly inclined to probe the governance of these arrangements. A common issue we see in skilled person reviews is that organisations become over reliant on third-party AML support and senior management do not provide appropriate supervision

## **Time to take action**

If they have not done so already, Annex 1 firms need to finalise their internal response to the requirements set out in the Dear CEO Letter documenting their findings, using the letter as an opportunity to enhance their AML processes. This can be done as part of a current/upcoming annual AML BWRA review and/or MLRO annual reporting processes.

When the regulator starts approaching firms for evidence of their response to the Dear CEO letter, central to any strong response will be accurately documenting the gap analysis process, and what was done in response to any weaknesses that it uncovered.