



News Alert 6 (July/August 2005)

Summary of recent financial services compliance and regulatory news

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- 1. IFSRA, the Financial Regulator, releases its Annual Report for the period May 2003 to December 2004**

The Financial Regulator has released its Annual Report for the period May 2003 to December 2004. The Report is available at www.financialregulator.ie. Compliance Officers should take particular note of pages 64 and 67 for an insight into the regulatory inspection regime and findings of recent regulatory inspections. Page 64 details what the Financial Regulator's on-site inspections seek to assess. The typical process involved:

- assessing the corporate governance system in place;
- evaluating the culture of compliance in evidence in the running of the organisation;
- assessing controls and risk management processes in each business area of the firm;
- verifying the accuracy of financial returns and other information which has been submitted;
- examining compliance with regulatory requirements imposed; and
- checking that anti money laundering procedures are in place.

So how did we do as an industry? Apparently not too well! The Financial Regulator's finding, see page 67 of the Report, states that the general types of issues which arose included:

- inadequate status of risk management committees;
- under-evaluation of operational risk issues;
- directors and senior management being appointed without prior approval;
- inaccurate computation of capital adequacy position;
- internal controls not aligned to business operations, e.g. lack of segregation of duties, procedures
- manuals out of date, business recovery plans not in place or insufficient;
- compliance officers, in certain sectors, falling short of the expected level of knowledge of our regulatory requirements;
- inadequate compliance with anti-money laundering obligations; and
- lack of clarity regarding the control / management and designation of client money.

Ok, so what was the result? – No imposition of regulatory sanctions are evident in the Report, rather, in the words of the Financial Regulator, "typically, following any necessary dialogue to outline our concerns and expectations, a programme to rectify any weaknesses identified is agreed for implementation by financial service providers". Although the Report states that 'there has been a very significant amount of planning involved in preparing to use the new regulatory powers in an appropriate and effective manner' nowhere in the Report is it evident that the new powers have been used.

Interestingly, the Financial Regulator filed 18 reports with the Garda Síochána and Revenue Commissioners under section 57 of the Criminal Justice Act 1994, primarily relating to the failure of financial service providers to adopt proper measures to prevent and detect money laundering (see pages 5 and 33 of the Report). This should mean that a number of financial and insurance institutions have been contacted by the Garda and/or Revenue enquiring of the robustness of the policies and procedures in place at the firm to detect and prevent money laundering. It is appreciated that the Financial Regulator cannot comment on the exact detail of the reports filed, however in response to an enquiry from **Compliance Ireland** the Financial Regulator indicated that the following items would be a fair representation of the nature of the activities reported:

- inadequate customer identity verification standards,
- inadequate documentation retention procedures
- lack of, or inadequate, anti-money laundering training;
- lack of, or inadequate, understanding of the requirements to report suspicious activity to the Garda and Revenue under section 57 of the Criminal Justice Act 1994; and
- more generally - inadequate internal policies and procedures to detect and prevent money laundering.

Although some firms might think the above is purely a procedural matter, their directors and senior managers should keep in mind that through section 59 of the Criminal Justice Act, 1994, they can be held criminally liable (i.e. the directors, officers, secretaries and senior management) where through their consent or neglect they allowed the firm to breach the law. The fact that the Financial Regulator filed reports based upon their suspicion that a firm breach the criminal law should be a cause for concern for such firms directors and management.

[Many thanks to the Financial Regulator for input on the above!]

PS: Our News Alert No. 5 also covered the topics of money laundering and financing of terrorism. A copy is available at <http://www.complianceireland.com/News.html> and do not forget to visit www.antimoneylaundering.ie for further AML coverage and copies of guidance notes.

2. FATF's evaluation of Ireland anti-money laundering and financing of terrorism standards

Following Ireland's Response to the FATF Mutual Evaluation Questionnaire dated 29 April 2005, last month saw the physical evaluation of Ireland by FATF.

Today (4 August), Eimer O'Rourke, Head of Member Service (Retail) at the Irish Banker's Federation (IBF) informed the IBF's members that feedback from the Financial Regulator and Department of Finance was broadly positive. The two areas upon which FATF focused were (i) the extent of reliance of the Irish system on non-statutory guidance notes and (ii) the application of anti-money laundering provisions to private gaming clubs/casinos.

At this stage it is probably does no good to over analyse these two specific points, other than to say that the Irish government should start contemplating a draft response should FATF make issue of either point. Although it is legally correct to say that no avenue exists in the Criminal Justice Act 1994 to codify the various sector anti-money laundering guidance (and financing of terrorism guidance) notes in the same way that codes of protection under Ireland's data protection laws can assume the force of law, this present arrangement has merits. Amendments to the guidance notes should (theoretically) be swift whenever a change is identified, since ministerial nor parliamentary process is required before the an amendment takes effect. However judging by the fact that some guidance notes were last updated as far back as 2003 and that certain guidance notes issued in 2004 did not reflect the then current list of 'prescribed countries', one could be forgiven for concluding that the non-government process is more efficient and responsive than a more formal regime. Further, the courts may take account of the guidance notes when deciding whether a 'designated body' complied with its requirements when reporting or failing to report a suspected section 31 or section 32 breach. This is not the same as 'judicial notice', but the fact that a judge may have recourse to then industry practice should be welcomed by anyone standing trial. Yet again the court's regard is limited to offences under section 57. This means that if a 'designated body' adhered to the verification of identity procedures contained in its sectorial guidance notes than notwithstanding that fact, the court does not have

to have regard to the guidance notes when determining if section 32(3) is breached – this is perhaps this is blessing in disguise because the court need only decide whether (in its sole opinion) the designated body took reasonable measures to identify the person to whom the service was provided

So what happens now? – According to the IBF, the Financial Regulator has confirmed the next steps as follows:

- End September 2005: FATF to issue its first draft report. The first draft will be furnished to the Financial Regulator, the Department of Finance, the Department of Justice and other government and quasi-government authorities. A 4 week period will be provided by FATF for comments to its first draft. The Financial Regulator anticipates that those who participated in meetings with FATF will be given sight of this draft of the report for input into this process.
- November/December 2005: FATF to issue a second draft report. By this stage it is envisaged that the substance of the report will have been settled, leaving Ireland perhaps little more opportunity than to address obvious factual inaccuracies. It is not clear as to the extent of the circulation of this draft.
- February 2006: The report in final form will be adopted by FATF and shall be published.

[Many thanks to the IBF for input on the above!]

3. CLRG Review of Directors' Compliance Statement

Wednesday, 3rd August 2005 (see <http://www.clr.org/about/pressarticle.asp?NID=41&T=N>)

The Review Group has completed its review of the directors' compliance statement - section 45 of the Companies (Auditing and Accounting) Act 2003 - and has reported its findings to the Minister for Trade and Commerce, Michael Ahern T.D. The Review Group's report is currently under consideration by the Minister. It is understood the report will be published in September 2005.

Commentary: The above press release issued by the Company Law Review Group (CLRG) is (as of today – 4 August 2005) as much information as you will find in the public domain until September 2005, at which time Minister Michael Ahern T.D apparently intends to publish the CLRG's findings and the submissions received. If you are a member of representative body, you should contact that body to see whether it responded on your industry's behalf (e.g. the Irish Bankers Federation released its response to its members). Despite telephone calls and an email to the CLRG, **Compliance Ireland** did not receive a response to its question on what date the Report will be published. Understandably this is a matter for the Minister (not the CLRG), however calls to the Minister's office were met by a negative response. In order to obtain the Report **Compliance Ireland** served a Freedom of Information (FOI) request upon the Department of Enterprise, Trade and Employment. If the FOI request is successful, we shall issue a further email containing more details on the Report. However given that a FOI request may take up to 4 weeks to be agreed or rejected, the Report may by that time be in the public domain. But then again, as this piece of law has been kicked around more often than a football during a F.A Premiership season, perhaps a date of early September might be adventurous?

Firms regulated by IFSRA – take note of the following;

For IFSRA (now known as the 'Financial Regulator') regulated firms, section 26 of the Central Bank and Financial Services Authority Act 2004, allows the Financial Regulator to serve a notice ('section 26 notice') on a regulated firm, compelling the firm to state that it has complied (or otherwise) with:

1. all the firm's financial legislative obligations contained in what is known as "designated enactments" and "designated statutory instruments" (e.g. Insurance Acts, Investment Intermediaries Act and Central Bank Acts to name but a few);
2. all Codes, Guidelines and Notices applicable to the firm (issued either by IFSRA or its predecessors) (e.g. Administrative Notices, Codes of Conduct and Client Money Rules to name but a few), and
3. all other enactments and statutory instruments with which the firm must comply.

The third lim (i.e. the 'all other enactments' provision) is far wider than the provisions contained in section 45 of Companies (Auditing and Accounting) Act 2003 and could include, depending upon the wording of the Financial Regulator's 'section 26 notice' a requirement to affirm compliance with anti-money laundering law, tax law, company law, employment law, health and safety law, pension law, data protection law and any

other law which a regulated firm must comply with, regardless of its relevance to financial/insurance/banking services. The Irish financial/insurance/banking industries are hopeful that the Financial Regulator will, as Dr Liam O'Reilly (CEO of the Financial Regulator) stated in March 2004, use the section 26 notice 'to focus on matters relevant to financial services regulation' and that 'it is their [regulated services providers] specific obligations that it should be used to supervise'. Dr O'Reilly went on to add that the 'we [the Financial Regulator] needs to consult with the industry before we settle in our minds how we will use these new powers. I can say to you here, we will be producing guidelines to assist directors and auditors in fulfilling their obligations under this legislation. I can also assure you that we will be consulting widely prior to issuing those guidelines.'

This approach was reiterated by Geraldine McWeeney, Financial Regulator, when attending the Industry Panel (on 9th June 2005) to inform of the Financial Regulator's approach to compliance statement requirements. Ms McWeeney confirmed that any incremental requirements of the Financial Regulator would not impose additional regulatory burdens on firms and that the Financial Regulator will issue a public consultation paper on Director's Compliance Statements later in the year.

In its *Regulatory Connection New Bulletin* June 2005, the Financial Regulator stated that it will delay publication of its consultation on its 'section 26 notice' powers pending the outcome of the Company Law Review Group's review on section 45 of the Companies (Auditing & Accounting) Act 2005. The Financial Regulator noted that this may also impact on the publication date of the Banking Corporate Governance consultation paper. The upshot of the above is that since the Minister will not be publishing the CLRG's report until September, which itself may lead to further debate, the Financial Regulator may not need to state its position on its powers until the end of 2005.

Effectively we have two very important corporate governance laws, both passed by the Oireachtas (Ireland's National Parliament) up to two years ago (following many years previous debate), which now languish in the fields of regulatory malaise. Mr Paul Appleby, the Director of Corporate Enforcement, must feel that he is the only regulator prepared to take steps against those accountable for corporate wrongs (i.e. directors and senior managers) as he seeks to have nine former senior managers of National Irish Bank Ltd disqualified by the High Court (under section 160 of the Companies Act 1990) who were criticised in the High Court Inspectors' Report on National Irish Bank Ltd. and National Irish Bank Financial Services Ltd (see <http://www.odce.ie/new/article.asp?NID=397&NCID=42>). Isn't about time our elected officials give our regulators the teeth to pursue the very things that they were created for?

4. 55% of survey respondents believe the Financial Regulator will be more active on the Supervision and Enforcement fronts than its predecessors.

In a recent survey carried out on www.complianceireland.com on the question of whether the Financial Regulator will be more active on the Supervision and Enforcement fronts than its predecessors, the following votes (percentage) were received:

- 55% responded 'Yes'
- 32% responded 'No'
- 12% responded 'Not Sure'.

Ah well – time will tell. Thanks to all those who voted!

Compliance Ireland is available to assist Irish and UK financial services firms (and other designated bodies) meet their anti-money laundering obligations and general compliance requirements. If you would like to discuss our consultancy and training services, please contact Peter Oakes on +353 (0) 87 273 1434 or email peter@complianceireland.com. **Go to the following link to read about our range of services** (<http://www.complianceireland.com>)

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