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July 2023 Edition

In this month's HORIZON:

- **Debanking** – are there larger ramifications around recording confidential information within Financial Institutions?

- **Shortening Settlement Cycles** – reduced timeframes between execution and settlement present increased operational risk, we explain how to prepare now.

- **Money laundering** – we revisit an ongoing topic in light of the recent UK Govt "Economic Crime Plan 2023 - 2026" which targets end 2024 for a new assessment of the money laundering through markets threat.

Debanking

July headlines reported on "debanking", a dispute which started with the closure of Nigel Farage's account at Coutts. Farage claims he was cut off on political grounds evidenced by a 40-page document he requested from the bank.

Despite resignations from the top brass at Coutts and NatWest, and discussions between Coutts and Farage to reinstate the accounts, we feel this theme is still gaining momentum, and has the potential to reach far wider than access to bank accounts. Indeed, at the time of writing, elements of the UK press are now linking limits on cash withdrawals to an overreach of banking power.

With the benefit of hindsight, it looks as though banks have been caught out, choosing to adopt a path of least resistance (so they thought) to enact changes designed to fit with regulatory demands to fight fraud. The path of least resistance has rapidly found to be strewn with brambles and boulders, as the press is awash with tales of high-profile individuals such as Farage and Gina Miller, seemingly able to draw connections with their banking challenges and those of their activist views. In addition, many businesses have run into similar issues - often these are businesses which transact internationally and are involved in aspects of procurement.

It is clear that KYC, onboarding and offboarding procedures are in the spotlight, and will continue to be under enhanced scrutiny for the near future. But we feel that a significant part of this story is in danger of being overlooked. This is a story not just about the access to banking and banking services, but is also a story about bank staff, their attitudes to customers, and how these views are aired, documented and retained within institutions.

Nicolas Corry, SKADI's Managing Director explains:

"There are a number of Forums that meet to discuss customers, business proposals and the raising of capital. Information from these meetings is rarely seen or shared outside of these forums, but it is often documented. Minutes are taken which can later be used in regulatory investigations or litigation and disputes. What the Farage scandal has demonstrated is that banks can be economical with the truth over the reason for a decision being made. In Farage's case the BBC initially reported he did not meet the wealth criteria to hold an account at Coutts, a point they subsequently withdrew, Reuters reported "commercial reasons" were cited. It was later revealed that his political views were discussed and appeared to be instrumental in the decision to withdraw his account.

One can foresee situations where customers may have been given false information in the past, which banks may have used to cover over the true reasons why transactions did not go ahead. For example, a company hoping to issue a convertible bond may have been told that market conditions, or investor feedback, led to an issue being abandoned, when in fact the minutes of the reputational risk committee or equity capital commitment committee may have concluded that the customer did not have a "good look" for the bank."

This continues the theme we raised last month in Horizon, that there is legal risk residing in the documents and records retained by financial institutions. There is the potential for great embarrassment (and worse) should these records be exposed. With the British public holding a significant stake in NatWest, Farage was able to use a subject access request to great effect. But thinking back to 2014, Sony suffered great embarrassment when hackers revealed emails, which discussed executives' views on some of its most bankable stars. We have no doubt that within Sony attitudes to what should and could be shared in emails has been changed. Similarly we encourage control staff to consider how they can bring about a sea change in documenting and sharing views from confidential decision making forums within their institutions, and ensure they are conveyed to customers in such a way to ensure accuracy, avoid tipping off (in the case of money laundering driven decisions) and to avoid potential future embarrassment.

This will need to be handled carefully. We can foresee a future path where client due diligence approaches expiry on a dormant account and requires refreshing. Could there be a danger that the Salesperson or Financial crime teams might err on the side of least resistance and allow KYC to lapse, thereby offboarding the client rather than deciding if they should remain onboarded?

Shortening Settlement Cycles

India's regulator SEBI announced plans for instant trade settlement (T+0) for cash equities. This would be the third in a series of moves to enhance capital efficiency and reduce transaction risk. This year India became the second market after China to move to a trade-plus-one-day (T+1) settlement cycle. This follows February's notice by the SEC to reduce settlement to T+1 for US cash equities and corporate bonds by May 2024. Other countries still take two or more days to settle up.

Nearly all markets pre-match instructions prior to settlement. A counterparty may be instructing with different economics or facing a firm's New York office rather than London. Such intervals between trade execution and settlement enable discrepancies to be resolved before settlement cut-offs preventing settlement failures.

Moving to T+0 necessitates quicker co-ordination of inventory management and funding. Sales may require intra-day reverse-repos to provide sufficient securities to make delivery. Purchases can require same-day funding to ensure enough cash is available to pay out. Further upstream, controls around trade capture will be ever more important to ensure transactions feed into the appropriate settlement systems prior to settlement deadlines. Furthermore, if counterparties cannot source the stock fast enough to deliver, increased stock borrow or reverse repo will be required – an additional cost for any trading book.

Money Laundering

We revisit a theme we have covered a few times in Horizon, as far back as our Jan 2022 edition, that of Money Laundering through Wholesale Markets. The trigger for this has been the recent announcement from Germany that they will set up a new body to combat money laundering…. plus the launch of our own training course that was successfully trialled at a Global Investment Bank.

We always draw our client's attention to the FCA release "Understanding the Money Laundering Risks in the Capital Markets", released in June 2019, for further details of the regulators insights on the matter. In addition, the UK Government's "Economic Crime Plan 2, 2023 - 2026" has a goal to: reduce money laundering and recovering more criminal assets, combatting kleptocracy and driving down sanctions evasion and cut fraud.

Money laundering through financial markets involves the strategic use of various securities and financial products to conceal the origins of illicit funds. Securities and stock markets are attractive targets for money laundering due to their size and liquidity.

Launderers are drawn to securities that offer transformative features, such as options, convertible bonds and exchangeable bonds (bonds with an embedded option to convert into stock). These transformations create breaks in the paper trail, making it difficult for authorities to trace the flow of funds.

Short holding periods are favoured by money launderers as they reduce the risk of discovery. Techniques like Mirror Trading allow for instantaneous bargains and facilitate the quick movement of funds in and out of the market. To further avoid scrutiny, launderers engage in tax avoidance through offshoring, converting local currency into offshore currency to evade foreign exchange trading scrutiny.

Anonymity is a key desire for money launderers, and they seek to avoid being listed in registers of holders. They may prefer convertible securities over regular stocks, which offer reduced transparency, and opt for private issuance to leave as little footprint as possible. Regulatory scrutiny over transaction reporting failures is a valid concern, and recent episodes have been attributed to operational oversight, enabling insiders to facilitate suppression.

The use of complex financial products allows launderers to create a mask of obfuscation. Convertible bond prospectuses, for example, can run to 300+ pages and are laden with risks and features.

Regulatory vigilance and enhanced scrutiny are crucial to combat such illicit financial activities and maintain the integrity of the financial markets.

SKADI provide bespoke (and free!) training on this topic that we are very happy to share within any interested financial institution. For any queries, please contact: martin.anthony@skadilimited.com

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The SKADI Podcast – The Greek Debt Crisis

Coming soon…!

We are all familiar with the Greek debt crisis that started in 2009. The fallout was far-reaching, impacting large international organisations and causing the European Union to step in.

How exactly did everything happen? What went so wrong and why was Greece known as one of the worst economic crises in history?
Join SKADI's team of experts as we take a deep dive into the intricate details and analyse the lessons learned.

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