

CAMS-Audit White Paper

# The Line in the Sand: Senior Management Responsibility and Independence of the MLRO

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## Table of Contents

The Author .....	2
Executive Summary .....	3
The Focus of This Paper .....	4
Who Is the Senior Management Referred to in This Paper? .....	4
The Role of Senior Management.....	5
The Role of the MLRO .....	6
What Does It Mean for the MLRO to Act Independently? .....	7
Key Considerations for Auditors Regarding MLRO Independence .....	8
Practical Indicators of Independence .....	10
Conclusion .....	13
Additional Reading.....	14

## **The Author**

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## **Disclaimer**

The contents of this paper are the views of the author, and should not be interpreted as representing the views, opinions, or policies of the QFCRA or any past employer.

## **Executive Summary**

Senior management is responsible for ensuring that its firm<sup>1</sup> has effective AML/CFT<sup>2</sup> policies, procedures, systems, and controls (PPSC) to manage the Money Laundering (ML) and Terrorism Financing (TF) risks of its business.

One significant responsibility of senior management is to appoint a capable Money Laundering Reporting Officer (MLRO). In the Qatar Financial Centre, the UK, and other jurisdictions with similar regulatory frameworks, a key competency of the MLRO is the ability to act independently in the role. However, there is a dearth of information and guidance on what it means to act independently.

This paper will explore the respective roles of senior management and the MLRO, and what it means for the MLRO to act independently.<sup>3</sup>

There is a point of balance—a line in the sand—between the responsibility of senior management to ensure the effectiveness of the firm's PPSC, and the need for management to allow independence to the MLRO in performing the MLRO's function.

Given the diversity of each firm's operations, it is unlikely that there will ever be a one-size-fits-all solution. The line in the sand will change depending on particular circumstances. Each firm must devise a solution that suits its business. This paper will provide guidance on key areas of focus and practical considerations when deciding whether arrangements at a particular firm are appropriate.

The target audience for this paper is AML/CFT auditors.

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<sup>1</sup> The term "firm" is used to describe both financial institutions and designated non-financial businesses or professions (DNFBPs).

<sup>2</sup> Anti-Money Laundering and Combating the Financing of Terrorism

<sup>3</sup> In the main, the paper will deal with principles, rather than specific legislative provisions. Any legislative references will be to the Qatar Financial Centre Anti-Money Laundering and Combating Terrorist Financing Rules 2010 (AML/CFTR). However, the rules quoted in the paper reflect underlying principles, which are applicable to a number of jurisdictions, especially those modeled on the United Kingdom's regulatory framework.

## **The Focus of This Paper**

The focus of this paper is what it means for an MLRO to act independently and how that intersects with the responsibilities of senior management. Accordingly, the paper will consider two key areas of senior management's responsibility:

- Monitoring the effectiveness of the firm's PPSC
- Ensuring the independence of the MLRO

First, it is necessary to analyze the particular responsibilities of both senior management and the MLRO. This will bring clarity to where the division of responsibilities lies and identify the areas where the MLRO should act independently. This background will then inform the discussion about how an auditor should assess whether or not an MLRO has an appropriate level of independence.

## **Who Is the Senior Management Referred to in This Paper?**

This paper will focus on the role of the executive management of a firm, but will not cover in any detail the role of the Board. The senior manager<sup>4</sup> with primary responsibility for AML/CFT is usually the Chief Executive Officer (CEO). The particular organizational structure of a firm will determine the other senior managers with AML/CFT responsibilities.

The MLRO must be employed at the management level of a firm.<sup>5</sup> In some firms, MLROs will be part of the senior management team, but this is not necessarily the case. Nonetheless, MLRO is a controlled function,<sup>6</sup> and individuals performing that role are personally responsible for ensuring compliance with a number of regulatory requirements.

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<sup>4</sup> The glossary to the AMLCFTR defines a senior manager as "...an individual employed by the firm, or by a member of the firm's group, who has responsibility either alone or with others for management and supervision of 1 or more elements of the firm's business or activities...."

<sup>5</sup> Rule 2.3.2(1)(a) AMLCFTR: "The MLRO and deputy MLRO for a firm must – (a) be employed at the management level by the firm..."

<sup>6</sup> A controlled function is one that involves the exercise of significant influence over the conduct of the firm's affairs and is subject to the approval of the regulator.

## **The Role of Senior Management**

Senior management must ensure that the firm's PPSC are effective in preventing money laundering and terrorist financing. This includes ensuring that the firm has effective AML/CFT PPSC in the following areas:<sup>7</sup>

- reporting to senior management;
- documenting risk management policies and methodology;
- taking ML and TF risks into account in the day-to-day operations, including development of new products, taking on new customers, and changes to the firm's business profile;
- approval of any action plans proposed by the MLRO;
- independent review and testing;
- promotion of a firm-wide AML/CFT culture;
- staff screening; and
- training.

In addition to the effectiveness of PPSC, another key responsibility of senior management is that the firm always has an appropriately qualified and resourced MLRO. This includes ensuring that the MLRO:

- has sufficient seniority, experience, and authority;
- knows and understands the MLRO's role and regulatory requirements;
- has sufficient resources, staff, and technology to carry out the role in an effective, objective, and independent way;
- has timely and unrestricted access to all of the firm's records and information (including customer documents); and
- has appropriate backup arrangements, including a Deputy Money Laundering Reporting Officer (DMLRO).

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<sup>7</sup> Part 2.2 AMLCFTR

## **The Role of the MLRO**

The MLRO is the key person in the firm charged with implementing AML/CFT strategies and supporting senior management's oversight. Specific responsibilities of the MLRO include:<sup>8</sup>

- promoting a firm-wide AML/CFT culture;
- being the key person in implementing the firm's AML/CFT strategies;
- ensuring that the firm's broader responsibility of preventing ML and TF is addressed centrally;
- supporting and coordinating senior management's focus on managing the firm's ML and TF in individual business areas;
- ensuring that the appropriate PPSC are in place, effective, and comply with relevant regulatory requirements;
- ensuring that the PPSC are implemented in the day-to-day operations of the firm;
- regularly reviewing the PPSC to ensure that they remain effective;
- recommending and championing improvements to the firm's PPSC;
- analysis and investigation of internal Suspicious Transaction Reports (STRs)<sup>9</sup>;
- providing STRs to the Financial Information Unit (FIU) and the regulator;
- acting as the central contact between the firm and the regulator and other state agencies;
- responding to information requests from the regulator and other state agencies;

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<sup>8</sup> Division 2.3B AMLCFTR

<sup>9</sup> In other jurisdictions, an STR is referred to as a Suspicious Activity Report (SAR).

## **The Line in the Sand: Senior Management Responsibility and Independence of the MLRO**

- acting on government, regulatory, and international findings about AML/CFT; and
- keeping the DMLRO up to date about significant AML/CFT issues in, and external to, the firm.

### **What Does It Mean for the MLRO to Act Independently?**

While many jurisdictions require that MLROs carry out their role in an independent way, “independence” has not been defined. Given that senior management is responsible for the effectiveness of the firm’s AML/CFT framework, it is clear that “independent” does not mean acting with complete autonomy. Senior management has a legitimate AML/CFT role, which will intersect with, and impact, the role of the MLRO.

Where, then, is the line to be drawn between appropriate oversight and undue interference?

There are only two areas where the AMLCFTR specifically requires that the MLRO act independently. Rule 2.3.6 states that:

*The MLRO for a firm must act honestly, reasonably and independently, particularly in—*

*(a) receiving, investigating and assessing internal suspicious transaction reports; and*

*(b) deciding whether to make, and making, suspicious transaction reports to the FIU.*

It is clear, therefore, that the handling of STRs is an area in which an MLRO has significant autonomy. An MLRO may consult with senior management, but decisions on the handling and disposition of both internal and external STRs are solely for the MLRO. Senior management must not direct the MLRO, even if it disagrees with the MLRO’s decision.

In other aspects of the MLRO’s role, acting independently is more likely to mean that MLROs think for themselves and exercise independent judgment.

## **The Line in the Sand: Senior Management Responsibility and Independence of the MLRO**

The MLRO has a much greater operational role than senior management. In general, MLROs should be free to reach their own operational decisions, provided that they are consistent with the overall strategy set by senior management. Where senior management decides to not follow the advice of the MLRO on an operational matter, the reasons should be clear and cogent.<sup>10</sup>

Senior management has a responsibility to ensure the commercial success of the firm while complying with relevant statutory requirements. The MLRO should have no role in the commercial decisions of the firm and should focus solely on ensuring that the firm complies with AML/CFT requirements. The firm should have systems in place to prevent commercial pressures from inappropriately interfering with the day-to-day decision-making of the MLRO, and the MLRO's team.

### **Key Considerations for Auditors Regarding MLRO Independence**

The independence of the MLRO is not something incidental to the role; it is fundamental to the effectiveness of the MLRO. Following are some key questions for auditors when considering whether a firm has appropriate arrangements to ensure the independence of the MLRO.

Does the MLRO have sufficient knowledge, experience, and seniority to act independently?

The position of MLRO is an important role in the firm. It cannot be effectively carried out by a junior staff member. Only a person with the appropriate knowledge, experience, and seniority will have the gravitas to be effective in the role.

Senior management should actively participate in the recruitment of the MLRO. Ideally, the relevant senior manager—e.g., the CEO—should be directly involved in the recruitment process. If direct involvement is not

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<sup>10</sup> A written record should be made, explaining the reasons why senior management has declined to accept the advice of the MLRO.

## **The Line in the Sand: Senior Management Responsibility and Independence of the MLRO**

possible, then at the very least, the recruitment process should be monitored closely.

### Does the MLRO have sufficient resources?

Are staffing, budget, and access to technology appropriate, given the size of the firm's operations? Does the MLRO have timely access to all necessary records, including customer information? AML/CFT compliance is an essential part of the operations of the business. Inadequate resourcing will cause delays and is likely to impact the bottom line.

### Do the firm's PPSC support the independence of the MLRO?

There should be a specific policy statement supporting the independence of the MLRO, especially in relation to STRs.

### Is access to the MLRO restricted?

All staff should have direct access to the MLRO to discuss suspicious activity—it is not appropriate to instruct staff to raise issues with the MLRO only through the management chain.

### Is the remuneration of the MLRO structured to ensure that the role is not compromised by commercial pressures?

It is important that the firm set an appropriate remuneration package for the MLRO to ensure operational independence. As with any compliance position, remuneration should not be linked to the commercial success of the firm.

### Do the MLRO's reporting lines support the independence of the role?

The reporting line should reflect the importance of the MLRO position and allow direct access to senior management. A dual reporting line to the Board or a Board committee (e.g., the audit and compliance committee) may be appropriate.

## The Line in the Sand: Senior Management Responsibility and Independence of the MLRO

Is there a review mechanism within the firm to resolve conflict between senior management and the MLRO on AML/CFT issues?

There should be a mechanism to deal with disagreement between the MLRO and senior management on AML/CFT issues (e.g., referral to the Board).

Any directions given to the MLRO regarding AML/CFT issues should be in writing.

The firm should have in place a Board-approved whistle-blower mechanism to allow any staff member, including the MLRO, to make a protected report regarding misconduct or inappropriate conduct by senior management.

### **Practical Indicators of Independence**

It is important to move beyond “independence” as a concept and find specific audit evidence to determine whether an MLRO has appropriate independence. The table below sets out practical examples, which may indicate whether or not the independence of the MLRO is supported at a firm.<sup>11</sup>

<b>Independence Is Supported</b>	<b>Independence Is Not Supported</b>
The MLRO is authoritative and commands the respect of both management and staff.	The MLRO is frequently not consulted by management and staff on issues with AML/CFT implications.
	Senior management deals directly with the regulator on AML/CFT issues without participation by or consultation with the MLRO.
	There is high turnover in the MLRO position or other compliance staff.

<sup>11</sup> These examples are not exhaustive, and auditors need to consider the particular circumstances of the firm.

**The Line in the Sand: Senior Management Responsibility and Independence of the MLRO**

<b>Independence Is Supported</b>	<b>Independence Is Not Supported</b>
Staff members are free to discuss suspicious activity directly with the MLRO. This is supported by procedures manuals and emphasized in staff training.	The firm restricts communications with the MLRO (i.e., staff does not have direct access to the MLRO).
The MLRO regularly attends management meetings and board meetings. AML/CFT is a standing item at both management and board meetings.	The MLRO does not participate in management and board meetings that have implications for AML/CFT.
There is a direct reporting line from the MLRO to senior management.	There is no direct reporting line from the MLRO to senior management.
MLRO reporting to senior management is not censored (i.e., the MLRO reports directly, and reports are not redrafted by other levels of management before submission to senior management).	MLRO reporting is subject to review and approval before submission to senior management.
The MLRO participates in key decisions, which have implications for AML/CFT.	The MLRO does not participate in the development, review, or implementation of AML/CFT PPSC.
	The MLRO has no role in setting parameters for customer screening systems.
	The MLRO does not participate in the purchase of new customer management or similar IT systems.
	The MLRO has no role in designing, delivering, or choosing external

**The Line in the Sand: Senior Management Responsibility and Independence of the MLRO**

Independence Is Supported	Independence Is Not Supported
	<p>providers regarding AML/CFT training.</p> <p>The MLRO has no role in deciding whether to accept a high-risk customer or deal with high-risk jurisdictions.</p>
<p>The MLRO is consulted before the implementation of new products or services.</p>	<p>The MLRO is not consulted regarding changes in business strategy, new products, etc.</p>
<p>The MLRO has full access to the firm's records, including customer records.</p>	<p>The MLRO does not have access, or has inappropriately restricted access to key IT systems, such as customer databases.</p>
<p>Senior management has not given directions regarding the filing of an STR.</p>	<p>Senior management has directed the MLRO not to file an STR with the FIU.</p>
<p>It is rare for senior management to act against the advice of the MLRO.</p>	<p>The MLRO's recommendations are frequently rejected.</p>
<p>Clear and cogent reasons have been recorded by senior management if a decision is taken to act against the advice of the MLRO (e.g., in deciding to onboard a high-risk customer or not to implement enhanced due diligence measures recommended by the MLRO).</p>	<p>No reasons are recorded when a decision is taken to act against the advice of the MLRO. Alternatively, brief reasons are recorded that do not address the substance of the MLRO's concerns.</p>
<p>Appropriate consideration is given to MLRO reports, including</p>	<p>MLRO reports are not circulated to the Board.</p>

## The Line in the Sand: Senior Management Responsibility and Independence of the MLRO

Independence Is Supported	Independence Is Not Supported
consideration at Board level. There is documentary evidence of this consideration.	
MLRO remuneration is not linked to the commercial success of the firm. Metrics for assessing MLRO bonuses are based on specific areas of AML/CFT responsibility.	The MLRO's bonus is dependent upon profitability targets.

### **Conclusion**

AML/CFT compliance is a very important aspect of the business of every firm. Errors, such as failing to report suspicious activity or conducting business with a sanctioned entity, can have profound impacts on the reputation and financial performance of a firm.

A competent MLRO, with the authority to act independently, is essential for a firm to fulfil its AML/CFT responsibilities. Accordingly, the independence of the MLRO should be a key consideration when conducting an AML/CFT audit.

## **Additional Reading**

Although the author's research did not locate any sources directly relevant to the topic of this paper, the following references touched on the paper's themes, including senior management responsibility and the meaning of independence.

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