

# Next steps for CCO compliance

Helping financial services institutions respond to the UK's new corporate criminal offence

The EY logo is positioned in the bottom right corner of the page. It consists of the letters 'EY' in a bold, white, sans-serif font. The background of the entire page is a photograph of a person walking on a bridge or walkway, silhouetted against a bright, hazy sky. Several power lines or cables run diagonally across the sky, creating a sense of depth and movement. The overall color palette is dominated by the yellow of the text box and the white of the logo, set against the natural tones of the background image.

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## Introduction

### **The hard work is just beginning**

While it is easy to assume that by completing the required risk assessment by 30 September, financial institutions have got the hardest part of complying with the Criminal Finances Act out of the way, this is far from being the case.

The next phase of work is likely to be both more challenging and critical in terms of establishing the right prevention procedures and a process to monitor this. As planning turns into execution, organizations that have already invested significant time and energy in addressing the new rules will need to maintain at least the same level of commitment throughout the implementation, and beyond that into business as usual (BAU).

## Extraterritorial scope expands the risks

In implementing their procedures, international groups with branches or representative offices in the UK should bear in mind the wide extraterritorial application of the offences. Crucially, having a UK place of business means the entire corporate is in scope for offences related to UK and non-UK taxes.

This extraterritorial scope brings significant risks that should be included in the risk assessment for the corporate criminal offence (CCO). For example, if a customer walks into an office in France and convinces the person behind the counter to help them evade French taxes, the fact that the organization has a UK place of business means a prosecution could be brought in the UK.

### Main points of the new legislation

Sections 45 and 46 of the 2017 Criminal Finances Act created a new corporate offence of failure to prevent the facilitation of tax evasion, which came into force on 30 September 2017. The new offence means a corporation can be held criminally liable if its employees, or anyone else providing services for or on its behalf, assist a taxpayer in evading their tax liabilities. Penalties include unlimited fines.

1. The legislation includes a defense of having reasonable procedures in place to prevent the facilitation of tax evasion. This is similar to the "adequate procedures" defense in the Bribery Act.
2. The aim of the legislation is to create an environment that fosters corporate monitoring and self-reporting of criminal activity.
3. In most organizations, complying with the new legislation will require coordination between tax, financial crime, compliance and legal departments. It will also create new governance and control burdens.
4. Breaching the legislation is a criminal offence punishable by potentially unlimited fines. There is also likely to be significant reputational damage.

# Key challenges for compliance

For all organizations, the new CCO presents challenges in four key areas:

1 Facilitation risks	2 Associated person risks	3 Ownership and accountability	4 Leveraging existing controls effectively
Unlike existing anti-money laundering (AML) controls, the CCO focuses on facilitation risks – thus exposing banks to the actions of dishonest employees or third parties. Financial institutions need to consider whether their existing or new controls could be circumvented by associated persons, making them liable to prosecution.	Like the Bribery Act, the CCO requires the organization to consider how the rules apply to third parties over which they may have little control. Clearly, identifying the risks related to these associated persons is key. Ensuring that controls are in place to cover all of them is a significant challenge.	Complying with the CCO requires a mix of tax and financial crime expertise, supported by resources to conduct risk assessments and ensure changes are implemented properly. Establishing ownership and accountability is vital, but it is made more complex by the fact that there is no obvious “home” for this team.	Achieving effective compliance with the CCO requires the organization to focus its efforts on the areas of highest risk and make use of existing controls. At the same time, the risk assessment and implementation planning must be robust and honest, in order to ensure that all relevant risks are addressed fully.

## Timing – if you have not yet started to address the CCO, do so now

Organizations do not face any penalty under the new law simply for failing to establish reasonable prevention procedures by 30 September 2017. However, they are running a large and unnecessary risk. If something were to go wrong, and a business has not conducted a risk assessment or documented its response, it is unlikely that it would be able to put forward a defense that it had reasonable prevention procedures in place. We would recommend that organizations in this position start to address the CCO rules as soon as possible.

## “Failure to prevent” offences: the wider context

While the CCO defines a new offence of failing to prevent the facilitation of tax evasion, the UK Government’s approach in the legislation mirrors the one it adopted in the Bribery Act, setting a pattern for the future. Going forward, the CCO is also expected to share a number of characteristics and consequences of another new offence that is due to be introduced in 2018. This offence focuses on the failure to prevent economic crime. We expect an announcement of this new offence in late 2017 or early 2018.

The common features of both offences are expected to include:

- ▶ Each puts greater responsibility on businesses to prevent criminal activities undertaken on their behalf, and makes businesses criminally liable if they fail to do so.

- ▶ The line of defense for businesses rests on whether their preventative procedures are deemed sufficient in proportion to the risks.
- ▶ The reach of the legislation is international and wide-ranging, and will require a global approach for many organizations.

As EY’s latest *UK Bribery Digest*<sup>1</sup> describes, the Bribery Act’s Section 7 corporate offence of “failure to prevent” is being cited in a growing number of cases. In some instances, this has resulted in the Serious Fraud Office handing down significant fines to offenders.



1. “UK Bribery Digest Edition 11”, EY, September 2017, <http://www.ey.com/uk/en/services/assurance/fraud-investigation---dispute-services/ey-anti-bribery-and-corruption-uk-bribery-digest>.

# Establishing reasonable prevention procedures

An organization could establish a defense against the new CCO if it demonstrates that – at the time of the alleged offence – it had in place reasonable prevention procedures. This term refers to measures to prevent associated persons, such as employees and third parties providing services for or on behalf of the organization, from committing facilitation offences.

## A six-step process

Corporates looking to implement such measures should take six steps, as shown in the diagram below. These steps mirror the six principles set out in the HM Revenue and Customs (HMRC) guidance.

### Step one: Risk assessment

The first step is a risk assessment that considers the inherent risks across the corporate's business, and the capacity of the existing control environment to mitigate those risks. This assessment will help to clarify the residual risks to the organization, and identify higher-risk areas where further prevention procedures are needed.

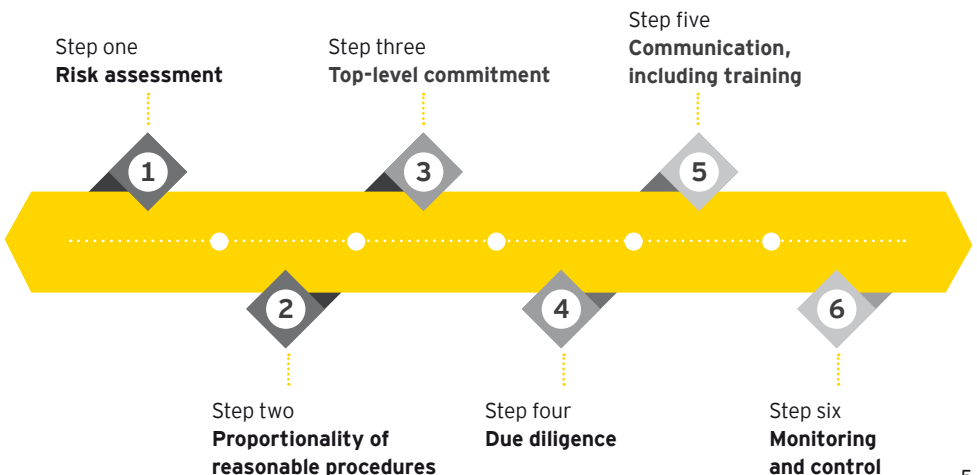
### Steps two to six: Other reasonable procedures

Once the risk assessment has been completed, HMRC suggests organizations take five further steps to address residual risks:

- ▶ Proportionality of reasonable prevention procedures
- ▶ Top-level commitment
- ▶ Due diligence
- ▶ Communications, including training
- ▶ Monitoring and control

We will now take a closer look at the six steps below. Critically, all six must be embedded into BAU processes to maintain compliance. This is likely to require periodic reassessments of risk, either as a stand-alone activity or as a part of wider financial crime risk assessments. It is also likely to mean that the ongoing monitoring of evolving industry practice, HMRC's expectations and the effectiveness of any procedures are put in place.

Figure 1: Six steps to establish reasonable prevention procedures



## Step one: risk assessment

### The initial risk assessment

As previously noted, the first step toward addressing the new CCO is a risk assessment that looks at the inherent risks across the corporate's business and the existing control environment. This assessment will help to clarify the residual risks, and identify higher-risk areas requiring further prevention procedures.

### Assessments in subsequent years

The financial services industry guidance says: **"Risk assessments will need to be refreshed or validated on a periodic basis. The frequency of review is likely to be linked to the inherent facilitation of tax evasion risk within the business."**

Organizations will need to perform a risk assessment on a group-wide basis, and record the outcomes in accurate and appropriate documentation that provides a clear articulation of tax evasion facilitation risks.

It's important to be aware that risk assessments are not a one-off exercise – and embedding the

risk assessment process into BAU will be essential for demonstrating reasonable procedures. Most organizations will already be undertaking financial crime, and anti-bribery and corruption risk assessments on either a continuous or periodic basis. Those reviews should be expanded to cover risks around facilitation of tax evasion.

In particular, organizations should ensure that:

- ▶ Risk assessments are reviewed periodically and updated in line with changing circumstances.
- ▶ There are procedures in place to identify emerging risks and feed these into the organization's risk assessment process.
- ▶ There is scope for risk assessments to be challenged internally.

### Further investigations

While financial institutions and other organizations have probably completed their risk assessments for the CCO, they should carefully consider whether any further investigations may be needed. These usually come in two main types:

#### Deep-dive risk assessments



Particularly in cases where a lack of information or granularity has led to a conclusion that a business unit should be treated as a higher-risk one, a deep-dive assessment can enable better identification and quantification of the risk. Examples might include a global business unit with processes that vary in different locations.

#### Controls effectiveness testing



Many organizations have not conducted controls effectiveness testing specifically for the CCO, relying on their existing testing and management information. Instead, controls effectiveness should be approached as part of the longer-term implementation of CCO compliance, either comprising existing testing processes or on a stand-alone basis.



# Risk assessment and proportionality

## A CCO risk assessment checklist

*Here are some key points to consider in evaluating CCO risk assessments and readiness checks*

- Have you used a risk assessment process consistent with that set out in HMRC's guidance and the financial services industry guidance, or documented why the approach taken is reasonable?
- Have you covered all the risks identified by HMRC in its guidance? If not, have you documented why the scope is reasonable?
- Have you documented how you have ensured that the risk assessment is complete and has addressed all areas of the business in scope for CCO risks?
- Have you addressed any extraterritorial effects of the rules, including the risk that other group companies or JVs might act as associated persons for a company that is in scope?
- Have you considered risks in the back office, including accounts payable, supplier and vendor management, HR, and group tax?

### Step two: proportionality of the risk-based prevention procedures

The financial services industry guidance says: "Reasonable procedures should be proportionate to the risks the organization faces and to the nature, scale and complexity of the organization's activities. The procedures should also be clear, practicable, accessible, and effectively implemented and enforced."

This means any actions taken to address CCO risks should be appropriate in light of the nature, scale and complexity of the business, and the risk profile determined through the risk assessment. However, it is inevitable that many organizations will choose to be extra sure that they are

compliant by taking more prudent steps than those mandated by the risk assessment.

In deciding on the procedures to implement, financial institutions should take account of the fact that they already have a wide range of existing controls in place to manage risks across the business. Given this, they should take the time to identify and leverage existing controls and programs to address risks.

It is vital that organizations document the rationale for all decisions and steps they take to address the risks identified in the assessment. This audit trail will be critical to its defense if the organization does find itself under investigation for alleged CCO breaches in the future.

# Implementing the required changes

## Step three: top-level commitment

HMRC's guidance says: "The top-level management of a corporation is committed to preventing persons associated with the corporation from engaging in criminal facilitation of tax evasion. They foster a culture within the corporation in which activity to facilitate tax evasion is never acceptable."

To comply with this guidance, financial institutions will need to establish the right tone from the top, by ensuring that senior management sends a clear and consistent message to the whole business that there is zero tolerance of the facilitation of tax evasion. They must also set the tone from the middle management by ensuring that on a day-to-day basis management is aware of and follow the policies relating to the facilitation of tax evasion.

At the same time, a key aspect of establishing governance procedures is likely to be defining ownership and accountability within the senior management team. Unlike with financial crime, there is no specific requirement to make a specific individual within the organization accountable for risks around the facilitation of tax evasion. However, to ensure ongoing compliance, it is likely that most financial institutions will decide to appoint someone with dedicated responsibility.

As with other accountable persons, this individual will need to be supported with an appropriate level of resources to enable them to manage risks, policies and procedures, and to detect and address any risks embedded into business activities. The accountable person will probably be allocated responsibility for oversight of

CCO risks across the whole business, including support functions, management information, reporting mechanisms for suspicious activity, and regular reviews.

## Step four: due diligence

The financial services industry guidance says: "Financial institutions will need to ensure that they have controls in place that enable the identification, risk assessment and mitigation of risks posed by associated persons."

Financial institutions should be able to use their existing vendor management processes to comply with requirements relating to third parties. They can also make use of their existing infrastructure to establish a process for assessing the risks that third parties acting as associated persons could facilitate tax evasion, and for applying the necessary controls to all associated persons. These controls might include changes to contracts, restrictions on the types of activities that third parties can undertake and new approval processes.

For associated persons who present a relatively higher level of risk, appropriate controls could extend to a requirement for statements of compliance, together with additional checks and approvals, including a contractual right to review policies or audit procedures. In general, financial institutions should use their current risk management processes in this area as a starting point for determining what constitutes a reasonable approach for higher-risk relationships.

While the need for due diligence also applies to employees, financial institutions will already have many of the necessary controls in place. Appropriate checks may include background screening as well as contractual changes, including disciplinary procedures. Providing appropriate training – which we discuss further in step five below – will also be key. Annual statements of compliance may be appropriate for very high-risk groups. These are already used for other higher-risk relationships, so it may be possible to introduce them as a simple addition to existing procedures.

### **Step five: communications, including training**

The financial services industry guidance says: “Internal communications should make clear the financial institution’s zero tolerance policy toward the provision of illegal services, including the facilitation of tax evasion” and “appropriate training is likely to be a key control that can be applied by a financial institution for its employees and contractors, and should be considered as part of the implementation of new or revised procedures under the act for future inductions and refresher training.”

All financial institutions are expected to provide their staff with communications and training on tax evasion facilitation risks. The training should be proportionate to the risks faced by individual employees, with more detailed training likely to be needed for higher-risk staff, and targeted training for people in control functions who may need to review these procedures.

To support these communication and training interventions, a financial institution might provide its employees with details of the organization’s approach to facilitation risk. In addition to implementing initiatives to reinforce the tone of zero-tolerance from the top and enable employees to understand and evaluate risks themselves. Further steps might include making updates to codes of conduct, employee handbooks, job descriptions and performance objectives.

As part of the training rollout, financial institutions will need to ensure that responsible senior management receives the level of training needed to oversee and manage risks effectively, and continue to communicate the right tone to employees and third parties. Organizations will also want to ensure there is appropriate communication with third parties – especially associated persons – about what the firm expects of them.



## Developing training for customer-facing staff

The purpose of training on tax evasion facilitation risks is not to make everyone in the organization an expert on tax in general or the Criminal Finances Act in particular. Instead, training should be provided in clear and simple language and not overly focused on technical tax details. This will typically mean focusing on the dishonesty elements of the offences.

The training should convey the key message that tax evasion and facilitation are broadly similar to fraud, and are characterized by dishonesty and concealment. At the same time, the focus on dishonesty needs to be carefully nuanced so it doesn't lead to "false positive" internal reporting because of a limited understanding of tax issues.

Other important elements may include interactive scenario-led training, providing staff with clear examples of what is and isn't evasion, and what they should do in different situations. Employees should also be given clear escalation routes as well as a final test to check their understanding and to help imprint the training in their memory.

**Figure 2: A typical training program for employees presenting various levels of risk**

Level	Training intervention	Potential audience	Description
0	Enhancements to existing training	At-risk staff in lower-risk areas	<ul style="list-style-type: none"> <li>▶ Enhance existing financial crime or AML training</li> </ul>
1	CCO awareness e-briefing	Awareness raising for medium-risk staff	<ul style="list-style-type: none"> <li>▶ Provide a short e-briefing video that gives an overview of the key requirements relating to the CCO to address short-term concerns</li> <li>▶ Visit <a href="https://bcove.me/jn5bov5y">bcove.me/jn5bov5y</a> for a short demonstration video that we produced for a FATCA e-learning module</li> </ul>
2	CCO operational and processes training	Higher-risk staff	<ul style="list-style-type: none"> <li>▶ Train staff on specific requirements covering operational, process and system needs</li> <li>▶ Training being typically 20-30 minutes long, including an assessment to reinforce learning</li> </ul>
3	Subject-matter expert training	Lines of defense and wider compliance teams	<ul style="list-style-type: none"> <li>▶ Designed to describe impacts per functional department</li> <li>▶ Focusing on functional areas impacted by the new CCO, such as financial crime, or lines of business, such as wealth management</li> </ul>
4	Senior management face-to-face briefings	Management and accountable executives	Brief senior management on an overview of the CCO, including its purpose and importance, and introduce key obligations and senior manager accountability

**Step six: Monitoring and control**

The financial services industry guidance says: “[Financial institutions should] ensure policies and procedures are and continue to be appropriate and effective as the environment and organization develops and that they are complied with.”

Maintaining reasonable prevention procedures for the longer term will be a challenge for all financial institutions, and it is vital to recognize the risk that solid compliance on day one might gradually become inadequate over time. To minimize this risk, organizations should combine all the elements explained above with actions to embed compliance within BAU.

To lay the foundations, organizations should start by documenting the risks and related controls required across the organization. It is likely that the testing of controls will be covered by existing processes, but financial institutions will need to undertake ongoing monitoring of changes in the business – such as new client segments, jurisdictions or business areas – that may trigger the need for a rereview of the risks.

At the same time, organizations should establish monitoring and review processes for both facilitation risks and the effectiveness of the related controls, in order to check whether the controls are still proportionate to risks that have been identified or need to be enhanced. This should include monitoring for changes in market best practice as it evolves.

# Next steps

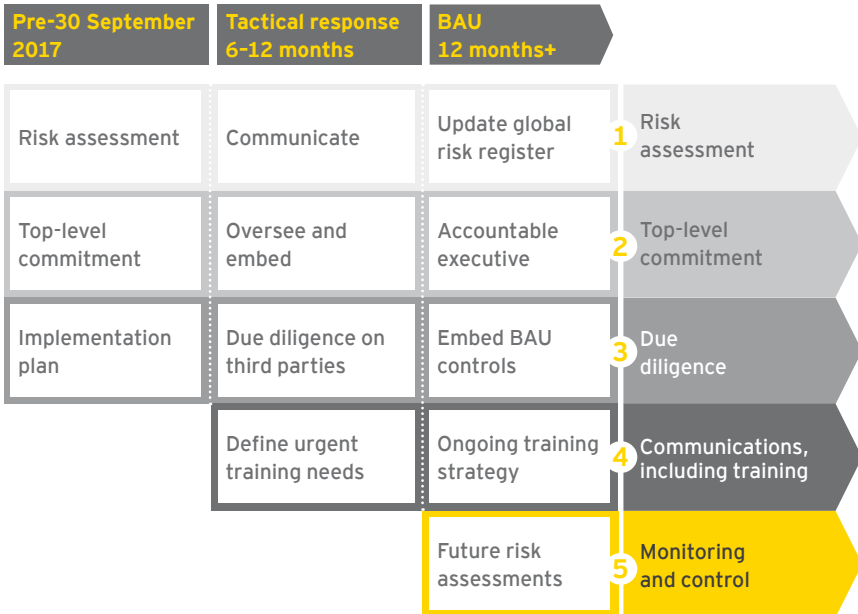
When planning and implementing prevention procedures that will stand up as reasonable under legal scrutiny, it is vital for firms to consider:

- ▶ Each of HMRC’s six principles in turn, and the related steps
- ▶ The existing controls they have in place to address these risks
- ▶ The need to enhance or improve these existing controls

Wherever possible, existing controls should be reused to address the risks raised by the new CCO. New controls should only be implemented when existing controls cannot be enhanced to address them.

With the new offences now in force, organizations must act swiftly to implement any additional controls needed across their organization, and embed those controls into BAU. The chart below shows a typical implementation plan on a page.

**Figure 3: A sample implementation plan for reasonable prevention procedures**



The need for a tactical response is driven by the risk assessment and the time taken to incorporate the CCO into BAU operations.

# How EY can help

EY can help you achieve and maintain compliance with the new legislation in four main ways:

## **1. Help implement an effective compliance model**

We can help you tailor the change program precisely to your needs, and decide how to leverage your existing controls and expertise to greatest effect.

## **2. Readiness assessment and compliance checks**

We can support you in maintaining compliance from day one, by providing an independent view and benchmarking you against your peers.

## **3. E-learning and e-assessment**

We can provide you with our off-the-shelf and tailored e-learning and e-assessment modules that can be incorporated into your own training or provided as part of our tool.

## **4. Complete support from our multi-disciplinary teams**

We can provide end-to-end support for every aspect of your compliance by leveraging our tax, legal, financial crime, technology, training and implementation professionals.

## **Why EY**

For financial institutions facing the need to implement reasonable prevention procedures for the new CCO, the good news is that your existing controls already provide you with a solid foundation to build on. Reusing these lets you leverage prior investments and minimize costs and disruption, while managing your risks effectively and appropriately.

This is why we look to build on your existing control sets and only invest in new ones where necessary. Combined with our integrated multi-skilled teams, this approach has helped us successfully deliver risk assessments, implementation support and training for a large number of financial institutions, ranging from global banks and insurers to private equity houses and hedge funds.

# Contact us

The message is clear. The CCO is now a fact of life for your financial institution and completing your risk assessment under the new legislation is just the start. It's time to make the journey to embed compliance into BAU. EY can support you every step of the way.

For more information on how we can help you tackle the challenges of the new CCO, please speak to a member of our CCO team or your usual EY contact.



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