REVIEW OF THE MONEY LAUNDERING REGULATIONS 2007: A CALL FOR EVIDENCE

We acknowledge that some of the questions set out in HM Treasury's Call for Evidence relate to matters in the Third Money Laundering Directive and that statutory change may be difficult.

1. To what extent is the scope of the Regulations and their application to business activity appropriately risk-based?

One of the issues raised by the Call for Evidence is whether more activities should be proscribed. We do not believe that there are any further activities which should be proscribed at this stage. As a general rule, proscribing activities limits the ability to apply a risk based approach. However, we would acknowledge that proscription in relation to shell banks and anonymous accounts remains appropriate.

As regards the application of the Regulations to the legal profession, we note that the Risk Based Approach Guidance for Legal Professionals (***RBA Guidance***) issued by the Financial Action Task Force (***FATF***) states as follows:

"*It is possible that more than one legal professional will be preparing for or carrying out a transaction, in which case they will all need to observe the applicable CDD and record-keeping obligations. However, several legal professionals may be involved in a transaction for a specified activity but not all are preparing for or carrying out the overall transaction. In that situation, those legal professionals providing advice or services (e.g. a local law validity opinion) peripheral to the overall transaction who are not preparing for or carrying out the transaction may not be required to observe the applicable CDD and record-keeping obligations.*"

We believe this is a sensible and proportionate approach. However the scope of the UK legislation is wider – the definition of "independent legal professional" in the Regulations states that "*a person participates in a transaction by assisting in the planning or execution of the transaction or otherwise acting for or on behalf of a client in the transaction*".

The Law Society Practice Note seeks to clarify: "*The Treasury has confirmed that the following would not generally be viewed as participation in financial transactions:*

- ...
- *provision of legal advice*
- ...

If you are uncertain whether the Regulations apply to your work, seek legal advice on the individual circumstances of your practice or simply take the broadest of the possible approaches to compliance with the Regulations."

Despite the above guidance, where legal professionals provide advice or services which are peripheral to the overall transaction and who are not preparing for or carrying out the transaction, it remains unclear as to whether they would be required

to observe the applicable CDD and record-keeping obligations. In our view, due to the lack of clarity and the risk of potential criminal sanctions, there is a concern that many legal professionals may feel obliged to apply the Regulations in full in situations where the processes and procedures are disproportionately burdensome when compared to the potential money laundering risks.

2. To what extent are the Customer Due Diligence (CDD) requirements set out in the Regulations a proportionate response to the threat from money laundering?

General comment

We believe that it is self-evident that the gathering of CDD information assists in the fight against money laundering, but cannot, by itself, remove or even materially mitigate the risk of money laundering. It is important that the costs associated with putting in place systems and procedures to assist in the document gathering process do not become disproportionately high for firms when compared to the rate at which the authorities successfully prosecute actual money launderers.

Simplified due diligence

Simplified due diligence is intended to apply in lower risk situations. However, we consider that what should be a relatively simple process is more complicated than it needs to be in two particular scenarios:

1 By defining investment firms by reference to MiFID and excluding persons falling within Article 2 of MiFID, it appears that not all persons and/or firms regulated under the Financial Services and Market Act 2000 are covered. This causes issues in trying to assess whether an investment firm will qualify for simplified due diligence, and whether more time and effort is spent on what are essentially low risk cases. In our view, any client which is FSA regulated (or, in the case of an individual, FSA approved) should qualify for simplified due diligence. Furthermore it is not entirely clear whether simplified due diligence can be applied to subsidiaries of FSA regulated entities, although we would expect this to be the case.

2. In the case of companies whose securities are listed the question is whether the entity is subject to the disclosure requirements that are "consistent with" EU legislation (see the definition of "regulated market" in the Regulations). It is, however, unclear to us the extent to which the disclosure must be sufficiently consistent with Community legislation to enable them to fall within simplified due diligence. On one interpretation, a firm could require that all provisions in the relevant directives must be faithfully reflected in the relevant market's obligations. Other firms however may consider it enough to satisfy the major provisions in the relevant directives. Other firms may not feel able to make a judgment on the issue at all, with the result that clients who should qualify for simplified due diligence are denied the benefits of it. In order to have clarity on the issue, it might be helpful for there to be an official list of exchanges which meet the requirements. This would limit the expense involved in trying to establish whether simplified due diligence can be applied and result in a consistent approach across the regulated sector.

PEPs and source of funds

In summary, the source of funds is often difficult to ascertain. PEPs may be particularly wealthy in any event: in these circumstances, is it, for example, sufficient to rely on information in the public domain as regards a person's wealth? Or would we have to enquire further? Whilst guidance has sought to assist on these issues, there is no clear-cut procedure to be adopted – in the context of criminal legislation, this is an unacceptable position.

Furthermore, to require that enhanced due diligence be applied to all PEPs on a 'one-size-fits-all' approach is, we believe, contrary to a risk-based approach. The majority of PEPs are not high-risk but the legislation requires extra measures in all cases, regardless of the level of risk attached to the PEP.

PEPs are defined, broadly, as individuals who have been entrusted with a public function at a national level around the world or in international bodies, their immediate families and known close associates. When ascertaining whether a person is a known close associate, a relevant person must have regard to independent data and publicly known information. However, although information may be publicly available, it does not follow that it will be readily available to a regulated person conducting CDD checks. The requirement means that firms are forced to invest in expensive software applications even where the size of their businesses and their exposure to PEP-risk would not warrant this type of investment.

Domestic PEPs

We do not believe that the legislation should be extended to domestic PEPs. First, this would go beyond the requirements of the Third Money Laundering Directive. Second, PEPs are also individuals who must carry out day-to-day transactions – in the absence of an increased risk there seems to be no justifiable reason to subject them to enhanced due diligence. The rationale for looking more closely at foreign PEPs is that we should ask additional questions as to why the individual is doing business in another jurisdiction. Including a requirement to apply enhanced due diligence to all PEPs regardless of jurisdiction is not proportionate.

Beneficial ownership

We do not think it is clear as to why it should be necessary to establish whether there is a beneficial owner, and to identify the beneficial owner in all cases. In our experience, this often leads to firms chasing negative statements (i.e. that there is no beneficial owner), invariably from the client itself.

We refer to para. 114 (b) of the RBA Guidance issued by FATF which states that law firms should "Identify the beneficial owner, and take reasonable measures to verify the identity of the beneficial owner such that the legal professional is reasonably satisfied that it knows who the beneficial owner is. The general rule is that clients should be subject to the full range of CDD measures, including the requirement to identify the beneficial owner in accordance with this paragraph. The purpose of identifying beneficial ownership is to ascertain those natural persons who exercise effective control over a client, whether by means of ownership, voting rights or

otherwise. Legal professionals should have regard to this purpose when identifying the beneficial owner. ***They may use a risk-based approach when determining the extent to which they are required to identify the beneficial owner, depending on the type of client, business relationship and transaction and other appropriate factors...***" [Emphasis added]. We believe that this statement is consistent with the Third Money Laundering Directive and we are strongly of the view that this should be implemented in UK legislation and in practice.

3. To what extent are Customer Due Diligence (CDD) requirements effective in the fight against money laundering?

In our view, CDD requirements do not, by themselves remove, or materially mitigate, the risk of money laundering. They can help to underpin the more important ongoing monitoring process - but it is important that they do not become the 'tail that wags the dog'.

4. To what extent do the record keeping and policy and procedural requirements upon Regulated Firms support their anti-money laundering efforts?

Reliance

We do not feel that the reliance provisions work in practice for three key reasons:

(1) Liability remains with the relying party;

(2) Restrictions on providing information;

(3) The fear of civil claims.

Liability issues

The Third Money Laundering Directive envisages that "In order to avoid repeated customer identification procedures, leading to delays and inefficiency in business, it is appropriate, subject to suitable safeguards, to allow customers to be introduced whose identification has been carried out elsewhere." However the problem is that FATF Recommendation 9 and the Directive both provide that where an institution or person covered by this Directive relies on a third party, the ultimate responsibility for the customer due diligence procedure remains with the institution or person to whom the customer is introduced.

In our experience, firms are reluctant to rely on others particularly as the liability remains with the party seeking to rely and, conversely, firms are reluctant to be relied upon for fear of civil claims being brought against them. Thus the practice is often for firms to duplicate the verification process, thereby incurring additional and unnecessary costs. Therefore in order for reliance to be of any practical benefit, the liability issue would have to be addressed, allowing a firm to rely, without liability, on another firm in circumstances where it is objectively reasonable for it to do so - e.g. where the other firm is itself regulated under the Third Money Laundering Directive (or equivalent).

One of our key concerns is the fact that the institution or firm that is relying upon another person remains liable and could face potential criminal sanctions in the event that the CDD evidence is deemed to be insufficient. In the absence of actually obtaining the documentation from the other party, it is not possible to assess whether the standard of due diligence applied will meet the expectations of the institution or firm seeking to rely upon them. This is largely due to the differences in the application of the risk-based approach.

A number of law firms have indicated that when documents are in fact requested, as a result of the difference in applying the risk-based approach, the documentation is not adequate for their purposes (leaving them concerned about criminal penalties). One example of where there may be a difference in application of the risk-based approach stems from the difference in the way that the equivalence provisions are applied for the purposes of determining whether simplified due diligence applies. By way of explanation:

- In the case of financial institutions simplified due diligence can be applied to a non-EEA entity which is subject to requirements equivalent to those set out in the Third Money Laundering Directive. HM Treasury issued a list of jurisdictions for this purpose; however it included a statement that "*Firms should note that the list does not override the need for them to continue to operate risk-based procedures when dealing with customers based in an equivalent jurisdiction*". Accordingly the approach to simplified due diligence differs from firm to firm. Some firms may completely rely on the list whilst others may take precautionary measures in relation to certain jurisdictions on the list where corruption is perceived to be more prevalent. Thus the level of information on file will also differ.

- Similarly, as we outlined in our response to Question 2 above, in the case of companies whose securities are listed, there is an issue as to whether the entity is subject to the disclosure requirements that are "consistent with" EU legislation. However we consider that it is unclear as to the extent to which the disclosure must be sufficiently consistent with Community legislation to enable them to fall within simplified due diligence. On one interpretation, a firm could require that all provisions in the relevant directives must be faithfully reflected in the relevant market's obligations. Other firms however may consider it enough to satisfy the major provisions in the relevant directives. Again this means that different approaches will be taken towards simplified due diligence.

This problem is also exacerbated by the different rules introduced in different EU jurisdictions; for example, the relevant Dutch rules require the collection of name and date of birth details for the representative of an entity. This may not be required in other EU member states.

In summary, unless a firm knows that another entity has procedures that match its own standards and expectations, that firm is taking a risk in using the reliance provisions because liability remains with it. It should however be the case that a

person can assume that another party has put sufficient procedures in place and can also rely on their risk-based judgment.

We recommend that a presumption is put in place that, if the party being relied upon is regulated for AML purposes, it has appropriate standing/reputation/CDD processes.

Inability to supply documentation

Another issue that impacts upon the effectiveness of the reliance provisions is the fact that many regulated firms now use a number of service providers to supply electronic verification which often provides evidence of incorporation, registered address and director or shareholder details. All of the information obtained in this way is subject to licence and therefore cannot be passed on. There are also data protection issues to be considered in the context of personal documentation. This requires consent from the relevant individual before being released, which may not always be easy to obtain. Accordingly this sometimes leads to gaps in the CDD documentation that is provided to a third party.

This means that, if a firm signs up to the reliance provisions, not all of the relevant information can be provided upon demand, even if the information has been collected, leaving the party relying on them at risk of criminal sanctions. This may even stop firms from providing reliance certificates. The better position would be if firms could rely on a statement listing generic details of the evidence that has been collected.

Civil claims

Where firms have received requests to be relied upon, many are reluctant to do so in case it gives rise to a subsequent civil claim if the risk-based judgment turns out to be misjudged. Many firms therefore seek to provide the information upfront (subject to licensing and data protection laws).

However, there have been instances in the UK where the party being relied upon has been informed that the evidence is insufficient. This results from a different approach as to what is required in the circumstances; for example some firms in the UK still have procedures customarily requiring passport details of directors of companies whereas a number of companies only request such information in high risk situations. Furthermore some firms still expect to receive a utility bill dated within the last three months for individuals (even though the client may have been taken on some time before the reliance certificate is provided). In each case, had those firms with less stringent documentation requirements agreed to be relied upon, they would not necessarily be in a position to comply with the more stringent requirements of the relying party, thereby potentially exposing the party being relied upon to civil claims. Firms may therefore be more likely to simply provide what they can and leave the other party to complete their own CDD checks.

5. To what extent do the Regulations provide Supervisors with appropriate compliance monitoring and enforcement powers and penalties to deter non-compliance?

The criminal offences of engaging in money laundering and non-reporting of suspicious transactions, including where the regulated person was not himself suspicious, but on objective facts should have been, are, in our view, adequate. However, it is likely that supervisory authorities will be better placed to encourage relevant persons and firms to have systems in place which are responsive to developing risk areas without resorting to criminal sanctions, except in the most egregious cases.

6. To what extent do the Regulations provide for a suitable system of registration and 'fit and proper' testing to be established and carried out on a risk basis?

No specific comments.

7. Are the requirements of the money laundering Regulations compatible with and complementary to the requirements of a) other aspects of the UK's broader anti-money laundering regime /legislation and b) international standards/practices?

We believe that there is an overlap between ongoing monitoring and the provisions of the Proceeds of Crime Act 2002, giving rise to dual criminality. This was not envisaged by the Third Money Laundering Directive and we believe that a more proportionate response would be to introduce a system of civil fines.

8. How well does HMT engage with you in developing the Regulations and are the requirements of the Regulations clearly communicated?

We would welcome a more detailed discussion of the issues raised in this submission that affect law firms.

Questions about Guidance

9. To what extent does Guidance promote both an effective and proportionate approach to anti-money laundering?

We believe that government-approved guidance is an essential element of a proportionate and pragmatic AML regime.

10. How clear and consistent is Guidance including whether Guidance is consistent for those sectors where more than one supervisor exists and generally across sectors?

No specific comments.

11. In what ways does Guidance assist with a risk-based implementation of Customer Due Diligence (CDD) measures within your sector?

Please see our comments above on simplified due diligence.

12. In what ways does Guidance assist and support Regulated Firms' anti-money laundering policies and procedures?

Please see our comments in response to Question 9.

13. How is the Guidance made accessible and are there opportunities to engage in its formulation?

Given its importance, we believe that the JMLSG Guidance should be made available in a fully-navigable web-based format for all firms (i.e. like the FSA Handbook on the FSA website). At the moment this is only available for firms which subscribe. Those who do not subscribe have to rely on PDF documents which are amended by subsequent PDF documents from time to time (but without consolidated, updated versions).

Questions about Supervision

14. To what extent does the supervisory framework support an effective, risk-based anti-money laundering regime and compliance with the Regulations?

No specific comments.

15. In what ways do Supervisors communicate and engage with the firms they regulate to ensure a sound understanding of legal duties and responsibilities under the Regulations?

No specific comments.

16. How do Supervisors ensure a consistent approach to compliance monitoring and enforcement is taken across the anti-money laundering regime?

No specific comments.

17. To what extent is Supervisors' monitoring of compliance targeted, proportionate and risk based?

No specific comments.

18. How effective and proportionate is the enforcement regime?

As highlighted above, we believe that the inclusion and pursuit of criminal penalties (whilst an option under the Third Money Laundering Directive) is not necessarily a proportionate approach.

19. In what ways could the registration process for Regulated Firms be improved?

No specific comments.

Questions about Industry Practice

20. Are there barriers to implementing risk-based policies in practice? If so, what are they?

No specific comments.

21. During the process of customer due diligence (CDD), how are risks (in terms of likelihood and impact) taken into account to decide the type of due diligence that will be undertaken?

Such an analysis is not necessarily permitted e.g. the requirements in relation to PEPs are fixed regardless of the risks in terms of likelihood or impact.

22. To what extent do the Regulations support or complement Regulated Firms' 'business as usual'?

No specific comments.

23. Are "fit and proper" tests being conducted in an effective and proportionate manner?

No specific comments.

24. How easy or difficult is it to comply with reporting and record keeping obligations?

No specific comments.

25. What forms of communication and engagement take place with stakeholders, from government agencies through to customers?

See comments above.

Questions about the Customer Experience

26. How proportionate do you believe the Regulations appear once they reach the customer?

No specific comments.

27. Are you able to provide customers with access to information and resources to check what information is needed from them and why?

No specific comments.

Questions about the Regime

28. To what extent do the Regulations, the accompanying Guidance, the supervisory framework and industry practice (the Regime) provide an effective tool in the fight against money laundering?

See comments above.

29. To what extent are the Regulations, the accompanying Guidance, the supervisory framework and industry practice (the Regime) a proportionate response to the risk of money laundering in the UK?

See comments above.

30. Would you say that all relevant stakeholders are able to participate in the development of the Regime?

No. See comments above.