Money Laundering Regulations 2007

Draft AML Practice Note: City of London Law Society response

1 Introduction

Set out below are the comments of the City of London Law Society ("CLLS") to the draft AML Practice Note relating to the Money Laundering Regulations 2007 (the "Regulations").

We attach a mark-up of the Practice Note which highlights the areas where we consider further clarification to be required.

2 General points

2.1 Indexes

Many of us will print off a hard copy of the Practice Note so it would be helpful if the index at the beginning of each chapter includes the relevant paragraph numbers for ease of reference. As a general comment, the document is very long and the index needs to be as comprehensive as possible. It might also be useful to include a summary of some kind to guide the reader as to how to navigate the text.

2.2 Definitions

It would be helpful to define the Regulations in this section and also check that all definitions are used consistently throughout the Practice Note.

In addition, we think that it would be helpful to have a definition of "beneficial owner" included given that the definition in Regulation 6 is very different from the traditional understanding of the term. We also think that there should be clarification of this point in the section on beneficial ownership.

3 Scope of the Regulations

3.1 Provision of legal advice – paragraph 1.4.5

We note that the guidance states that the provision of legal advice is not caught by the Regulations. We assume that this does not relate to legal advice given in connection with a financial or real property transaction concerning the activities listed at (a) to (e) of Regulation 3(9). We think that this should be clarified to avoid confusion given the consequences of not complying with the Regulations.

4 Risk assessment

There are a number of concerns that we have in connection with the risk analysis as follows:

4.1 The purpose of the risk analysis is to identify the factors that would put the firm at an increased risk of becoming involved in money laundering. However, given that the definition of money laundering under the Proceeds of Crime Act 2002 (POCA) is so wide, we also think that regard must be had to the seriousness of the offences that give rise to the money laundering offence. For example, if our client base includes a number of energy and utilities companies for whom we provide corporate M&A advice, there is a higher risk of "money laundering" within the definition of POCA by virtue of the higher propensity for such clients to have committed strict liability

environmental offences. It is clear that a risk-based approach does not apply to the reporting of such offences but acting for energy and utility companies should not of itself increase the risk to the firm. In view of the fact that Treasury approval of the guidance is being sought, we have included a paragraph to clarify this in paragraph 2.3.1.

4.2 Also it should be noted that the risks of money laundering and terrorist financing are constantly changing as criminals seek to find new ways of achieving their aims. Accordingly the firm's risk profile will be in constant flux and in order to be able to produce an outline of the current risk profile at any given date, as well as being in a position to provide training to staff, we will need to be in possession of relevant information from law enforcement. Will the Law Society be working with law enforcement to ensure that **all** firms have access to the information necessary in order to satisfy these obligations? This would inevitably involve distinguishing between firms in the city whose work types differ from many other firms.

4.3 As you are no doubt aware, many city firms have a number of offices in other jurisdictions. We have assumed that it is not a requirement to include in the risk assessment those jurisdictions which fall outside the ambit of the Third Directive (although many may chose to include them). Again we have included some draft wording to clarify this at the end of Chapter 2.

4.4 We also note the suggestion that we should consider conducting random file audits and the use of check-lists at the start and close of a matter (see paragraph 3.5). We would appreciate some guidance as to what matters ought to be covered in the audits/check-list. It is not clear to us why there should be any need for a check list at the close of a matter. It needs to be clear that there is a distinction between paragraph 3.5, which should be about checking that processes and procedures have been followed and paragraph 4.4, and in particular that the reference to random file audits in 3.5 is not a reference to checks of the kind referred to in 4.4.

5 Customer Due Diligence

5.1 When is CDD required?

We have included text in paragraph 4.3.1 to clarify when the third and fourth requirements apply.

5.2 Ongoing monitoring

We still have concerns about how we apply ongoing monitoring in practice and whether it goes beyond the current requirements to be alert and make any necessary reports to SOCA. Of particular concern is the ability to monitor compliance with the policies that we implement. As previously highlighted file audits require detailed knowledge of the subject of the transactions and would therefore require forensic experts to be employed at a huge cost. It is our view that the most appropriate ways to monitor compliance is to implement procedures and controls that capture the requirements at the beginning of a process and that ongoing training and regular updates to staff will assist in the ongoing monitoring process. Does the Law Society accept this as a tenable proposition?

In addition it is not clear to us what would constitute a "change in identity" – see comments on Paragraph 4.4.

5.3 Partnerships

We have included additional language in paragraph 4.6.2 to track part of the JMLSG guidance.

5.4 Companies

The guidance in paragraph 4.6.3 on regulated markets will need to be updated to reflect the final version of the Regulations. The question of what is a regulated market is key and we think it would be helpful, given the final phrasing of the Regulations, if the Law Society could give guidance that a firm can assume that all EEA regulated markets meet the objective criteria in the Regulations. We also think it would be extremely helpful if the Law Society, perhaps working jointly with the JMLSG, could produce a list of equivalent third country markets.

The guidance in paragraph 4.6.3 includes a statement that we need to ensure that the person instructing us has the authority to do so. This should not be a CDD requirement, it is a matter of judgement for the firm as to who has authority - this is not a necessary element of identifying a client. In addition, unlike banks, where there are authorised signatories for the purposes of funds transfers etc, law firms often receive instructions from an in-house lawyer or from someone in the deal team and there is a presumption that they have the authority to give the instructions as an employee of the relevant client. In addition:

5.4.1 Public companies in the UK - What listed companies in the UK would not qualify for simplified due diligence?

5.4.2 Private and unlisted companies in the UK - There needs to be an explanation with examples to explain that, because of the wide range of the UK's authorisation requirements, just because a company is FSA authorised, this does not mean that it is subject to the requirements of the Money Laundering Directive and therefore eligible for simplified due diligence. Many firms would simply not appreciate that point, which could lead to confusion in relation to the reference at the end of paragraph 4.6.3 and the section on simplified due diligence. The words in brackets which suggest that a copy of the entry showing the relevant director is FSA approved should be deleted - for some firms, e.g. insurance intermediaries, there is no requirement for all directors to be FSA registered.

5.5 CDD on funds

We have also prepared a new section (paragraph 4.6.7) on CDD on funds as we feel that cross referring to the JMLSG guidance could cause some confusion. The paragraphs are consistent with the JMLSG guidance but seek to provide clarity on how to conduct CDD in these circumstances.

5.6 Beneficial owner

5.6.1 See comments above on the definition of "beneficial owner".

5.6.2 The opening sentence in paragraph 4.7.1 states as follows: "*When you are acting for a client who is instructing you on behalf of another person, entity or arrangement, you will need to identify the beneficial owner as well*". This is misleading as the definition of beneficial owner also includes references to individuals who "own or control" the customer. We have amended this.

5.6.3 Paragraph 4.7.1 refers to certificates from our client "verifying" the identity of beneficial owners. It is not clear to us what such a certificate contain over and above that which we have set out in the attached mark-up?

5.6.4 In addition reference is made in paragraph 4.7.1 to obtaining copies of partnership agreements – these often contain confidential provisions and it should be noted that in many cases there will be reluctance on the part of a client to provide this document. We strongly suggest that this is unnecessary - how many law firms would want to hand over their partnership deeds? There might, in the case of some newly established unknown partnership, be a need to be satisfied that the partnership existed, and the deed might be proof of that, but this should be an exception rather than the rule.

5.6.5 In paragraph 4.7.3 reference is made to receivers and administrators acting on behalf of another. This section does not make sense however as it is contained within the beneficial ownership section. Administrators and receivers are appointed over companies whereas a beneficial owner is an "individual" so is this suggesting that we look to the shareholders of the company in receivership/administration? This is surely not intended given that in the case of insolvent companies the shareholders do not have any interest. It should also be pointed out that where a trustee in bankruptcy is appointed in respect of an individual, it is difficult to see how a bankrupt would fall within the definition of "beneficial owner" in Regulation 6 given that control of the assets is passed to the trustee. We would recommend that a separate section on insolvents is included in the CDD section (see draft paragraph 4.6.6) rather than in the section on beneficial ownership.

5.6.6 Paragraph 4.7.3 includes a statement that "*Where the holder of the requisite level of shareholding of a company is another company, apply the risk-based approach when deciding whether further enquiries should be undertaken.*" This paragraph is unclear. It seems to suggest that there could be circumstances where one does not have to investigate whether there are individuals who are beneficial owners.

5.7 Existing clients

We have added in clarification in paragraph 4.10 in relation to subsidiaries of existing clients. This is particularly relevant in the context of large corporates which often set up special purpose vehicles for the purpose of acquiring companies etc.

6 Privilege

Paragraphs 5.7 and 6.5 do not deal with the situation where privileged information is disclosed to the nominated officer. We note the reference in paragraph 6.6.2 that information may be shared within law firms without losing the protection of LPP. However, it would be helpful to include:

6.1 a paragraph in 6.5 which specifically deals with the disclosure of privileged information to the nominated officer both under the common law and under section 330(9A) of POCA, including guidance on the application of section 330(9A)(c), in circumstances where:

6.1.1 both LPP and section 330(6) apply; and

6.1.2 LPP does not apply but section 330(6) does;

6.2 a paragraph in 5.7 which deals with the above points in the context of defences.

7 Civil liability

7.1 Professional indemnity

Paragraph 10.6 states that we consider notifying our insurers when we make a disclosure to SOCA, depending on the precise facts of the given instance. We feel very strongly that guidance on anti-money laundering practices is not the place for a reference to what firms should do in relation to their insurance. We doubt that at present firms make disclosures to insurers when making SOCA disclosures and we do not think that in the ordinary course a firm would need to do so. We fear that, although the Law Society may be trying to be helpful with this reference, it might be unhelpful as it may suggest that firms should be making disclosures to insurers when in fact they should not be. We suggest that this area is so potentially complex that it should be the subject of further work and not included in the guidance at this time. We would be happy to assist with such further analysis.

8 Money Laundering Warning Signs

8.1 Private equity and collective investment schemes

We have provided a revised section on this. However we have a concern that these sections are not sufficiently visible to the reader as they are contained in Chapter 11 which is entitled "Money Laundering Warning Signs". Given that private equity is stated to be "low risk", is this chapter the appropriate place for these sections? It may be more appropriate to place these sections in Chapter 4. Alternatively you should ensure that these sections are adequately referenced in Chapter 4.

8.2 Should I make a disclosure?

Again, is Chapter 11 (Money Laundering Warning Signs) the appropriate place for the information relating to share and asset sales etc. Should this not appear in Chapter 5?

City of London Law Society

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