The Proceeds of Crime Act 2002

Consultation Document 2007: Obligations to report money laundering: The Consent Regime

Response from the City of London Law Society

Introduction

Set out below are the responses of the City of London Law Society ("**CLLS**") to the Home Office Consultation Document on the obligations to report money laundering (the "**Consultation Document**").

We welcome the recognition that the consent regime as currently operated has serious defects which hinder rather than assist the fight against serious crime. We are concerned that the focus on issues faced by the banking sector obscures the fact that there are other significant problems for non-banking sectors, particularly the professions. The criminal sanctions for non-compliance with the law are so serious that it is essential that all firms with reporting obligations have clarity and certainty as to their obligations. The fact that the money laundering regime attaches to offences which are not serious criminal offences makes the position for professionals even more complex, and as a result reports are required which are burdensome with no corresponding benefit. We consider that this aspect needs further thought if there is to be a truly effective regime.

We do not therefore think that any of the options proposed will adequately deal with the very real issues faced by the professions and we have suggestions as to how the proposals might be improved and would welcome the opportunity to discuss these with you.

Summary of major points

The key areas that concern the CLLS are:

- Whilst we note that the Consultation Document seeks to address some of the problems that have been encountered to date, mainly by the banking sector, there are a number of other issues that we have identified in relation to the consent regime which we believe need to be addressed in order to improve the regime. These can summarised as follows:

  (a) fungibility in relation to companies (para 1.3);

  (b) reporting regulatory breaches (para 1.5);

  (c) reporting information already in the public domain (para 1.6);

  (d) reporting where the regulator is (or should be) already aware of the breaches (para 1.10); and

  (e) reporting where remedial action has already been taken (para 1.11).

- Each of the proposals in Options 1 to 3 lacks clarity and certainty, and further work and consultation will be required in order to ensure that any new proposals are sufficiently clear, particularly in view of the criminal sanctions for non-compliance.

Each of these areas is discussed in detail below.

1 In the light of your experience and the discussion in this paper, do you believe the consent regime as it stands is workable?

General

1.1 Paragraph 1.2 of the Consultation Document states that "the underlying principle must be to ensure proportionate burdens on industry, and the individuals working in it, while preserving the efficacy of the money laundering regime as a tool against serious crime and terrorist financing." Furthermore paragraph 5.1 states that the consent regime should:

- "Avoid criminalising normal business activity or trivial or technical fouls by reporters, or creating disincentives to compliance with money laundering requirements, or related collaboration with the authorities.
- Be sufficiently flexible to address the very different needs and problems of different parts of the regulated sector, notably banks on one side and other reporting bodies on the other."

1.2 Paragraph 5.2 of the Consultation Document also suggests that the current regime is working well. However, our experience with the Proceeds of Crime Act 2002 ("**POCA**") and the consent regime has shown that there are a number of situations in which there are burdens on the regulated sector and industry which do not assist in the fight against serious crime and terrorist financing and the objectives set out above are not met. Our concerns are set out more fully below.

Fungibility and the proceeds of crime

1.3 We consider that the Home Office should develop the discussion of fungibility further as the analysis of fungibility contained in the Consultation Document is, in our view, insufficient as it only addresses bank accounts and ignores the interests of other types of reporters. For example, in paragraph 4.10 the Home Office refers to the freeze of an entire account – it must be remembered of course, that lawyers are also the joint major users of the consent regime and do not have 'accounts' as such. In practice, we find that where criminal property accrues to a company, any transaction the company undertakes could be suspected to fall within the principal offences. This issue has been raised in paragraph 4.13 of the consultation document; however it is not thoroughly explored.

1.4 We are concerned that the Home Office envisages a "common sense and practical approach to the POCA provisions" by relying on the defence in section 329 of POCA, where such an approach is untested at law. Given the criminal sanctions, we strongly favour certainty. This is borne out in the judgement in the Court of Appeal in R v Griffiths where Levenson J stated: "We do not leave the case without underlining to all professional people involved in the handling of money and with an involvement in financial transaction the absolute obligation to observe scrupulously the terms of this legislation and the inevitable penalty which will follow a failure to do so"'.

Example: Corruption in foreign subsidiary

Where a foreign subsidiary has committed criminal conduct (for example, paid a corrupt inducement or bribe) and derives a benefit from that conduct, for instance, the winning of a contract, the monies arising from that contract could be considered to be criminal property. Where this criminal property is returned as dividends to the parent company, any transaction, be it a deposit of the funds in treasury, transfer to another interest bearing account or investment in further assets, could constitute an arrangement under section 328

of POCA. This is not therefore a situation where an account is 'frozen' in the financial institution sense but there is clearly a " contamination" issue. This raises the question for the professional firm as to what it needs consent for, clearly it cannot be intended that it should have to seek consent to act for the companies on a daily basis and for each individual matter, but more clarity on the consent that is considered appropriate is very much needed.

Example: Town and country planning

It is a criminal offence for a company to erect roadside advertising hoardings without obtaining permission under Town & Country Planning regulations. Where, for example, an advertising company, which is aware that it needs to comply with the regulations, has obtained permission for approximately half of its advertising sites but has not attempted to do so for the other half, it will be in breach of the regulations. The annual turnover of the company is in the region of £25 million a year and it could be argued that at least half of that turnover has been generated as a result of the illegal advertising hoardings. As a result of fungibility, the "proceeds of crime" have contaminated all of the assets of the company (as it is impossible to segregate the "dirty money"). Thus any potential acquirer of that company would need to make separate SOCA reports in relation to any dealings with the company or its assets.

Reporting of regulatory breaches

1.5 In contrast to other European member states, the UK's POCA does not simply capture "serious crime" but adopts an "all crimes" test; in many cases, the tendency of UK lawmakers to create myriad criminal offences in "civil" areas means law firms must spend a disproportionate amount of time and money reporting regulatory breaches (e.g. the failure to apply for an environmental licence or breaches of copyright or health and safety legislation). This, coupled with the criminalisation for money laundering purposes of conduct which takes place overseas, makes the UK reporting regime far more onerous than that in other member states, with we suggest no corresponding benefit for the law enforcement agencies. The recent amendments to POCA in relation to overseas matters were too restrictive to make any difference at all. Resources within industry are therefore being expended on reporting these technical non-serious offences and there is the real danger that as a result there is insufficient resource available to focus on the more serious issues arising from money laundering. Accordingly we believe that the reporting of offences under POCA should be limited to those offences that are considered to be "serious" and in determining what is a "serious offences", these could broadly follow the offences in paragraphs 1 to 5 and 7 to 14 of Schedule 1 of the Serious Crime Act 2007.

Information already in the public domain

1.6 Under section 330 of POCA, a person is required to make a report to SOCA where he knows or suspects, or has reasonable grounds for knowing or suspecting, that a person is engaged in money laundering. "Suspicion" is not defined but has best been defined judicially in the case of Da Silva [2006] EWCA Crim 1654, where Longmore LJ stated: "It seems to us that the essential element in the word "suspect" and its affiliates, in this context, is that the defendant must think that there is a possibility, which is more than fanciful, that the relevant facts exist. A vague feeling of unease would not suffice."

1.7 As part of matter or client-opening checks, law firms often conduct searches of the internet and/or the databases of intelligence providers such as Worldcheck and Complinet. The purpose of performing this exercise is to assist firms in deciding whether or not to take on a matter or new client as well as determining the extent of customer due diligence measures for anti money laundering purposes.

1.8 Where the information suggests that the entity searched may be involved in "money laundering" (which would for POCA purposes include any regulatory breaches etc), a person may come to the conclusion that, based on the press reports (whether supplied by intelligence providers or generally available on the internet) that he has seen, "there is a possibility, which is more than fanciful, that the relevant facts exist" and therefore have a "suspicion" for the purposes of POCA. If he does reach this conclusion, then the question arises as to whether any information received in the course of conducting these checks "came to him in the course of a business in the regulated sector" for the purposes of section 330(3)(b). There is very little clarity on the scope of this phrase and that person must either (a) be comfortable that information obtained for the purposes of deciding whether or not to take on a new matter does not come to him in the course of a business in the regulated sector and therefore it is not reportable or (b) consider if he has a suspicion as a result (which may in part depend on the nature of the information and his instructions) and if he has make a report under POCA, regardless of whether he has any further evidence to substantiate the claim or (c) make a report regardless of whether he has any further evidence to substantiate the claim .

1.9 In these circumstances it is very difficult to interpret the meaning of the phrase "came to him in the course of a business in the regulated sector" and he may chose option (c). It is not clear what is gained from the submission of reports where they only contain information that is already in the public domain. It adds to the burden on industry in terms of costs and time whilst at the same time requiring SOCA to review the information in the report in circumstances where the report is of very limited intelligence value because, the information is already in the public domain and the reporter rarely has any further evidence to substantiate the claims set out in the press reports. We suggest that the correct view is that, unless additional information has come to the reporter which lends credence to the press reports, he is not under a reporting obligation, but clarity as to the expectations in this regard would be most welcome.

Regulator is (or should be) already aware of breaches

1.10 In a number of instances, particularly in the context of breaches of environmental legislation, law firms are submitting reports to, and requiring consent from, SOCA in circumstances where the relevant regulator or local authority, as the case may be, is already aware of the breaches and is working with the relevant parties to put remedial measures in place. Once again, law firms must spend time and resource preparing the report and SOCA must review the report and deal with the requirement to give consent. Given that remedial action is already being discussed with the relevant regulator, it is illogical that the reporters and SOCA should waste their valuable resources on reports of this kind.

Whether remedial action has "cancelled" any "benefit" gained

1.11 Section 340(4) of POCA provides that "property is criminal property if:

(a) it constitutes a person's benefit from criminal conduct or it represents such a benefit (in whole or part and whether directly or indirectly), and

(b) the alleged offender knows or suspects that it constitutes or represents such a benefit."

1.12 POCA section 340 (6) provides that "If a person obtains a pecuniary advantage as a result of or in connection with conduct, he is to be taken to obtain as a result of or in connection with the conduct a sum of money equal to the value of the pecuniary advantage." Under sections 6 and 7 of POCA, there is a direct correlation between the amount of the pecuniary advantage and the recoverable amount for the purposes of confiscation orders.

1.13 The question arises as to whether a recovery of a sum equal to the value of the pecuniary advantage "cancels" any benefit gained. There is an argument that, where a person benefits from criminal conduct, strictly speaking he cannot ever have that benefit taken away from him. As a result of a fine or confiscation proceedings, he might suffer a loss which, in financial terms at least, is equal to the benefit; however, it does not have the effect of extinguishing a benefit. We do not think this is the policy intention but would welcome clarification of the position that firms should take.

Example: pecuniary benefit

Where a person has evaded taxes for a year in the amount of £100,000 and is subsequently discovered, whilst that person will be required to pay the amount of the taxes plus any fine for example a total of £120,000, it may be argued that the person has benefited from not paying taxes for a period of a year such benefit may be the use of the criminal property to make other, higher capital or income bearing investments for that period of time. This situation could lead to reports being required for every instance of criminal conduct, even where a fine has been levied. We do not believe that this is correct but again would welcome more certainty on the point.

1.14 Even if, in principle, it is accepted that a benefit could be "cancelled", problems remain. Where fines can be levied in respect of criminal conduct, for example in cases where the competition rules are breached or in the context of other regulatory breaches, the amount of the fine may not always be the same as the pecuniary advantage gained. In competition cases, whilst the basic amount of a fine can be adjusted upwards to reflect aggravating circumstances, it can also be adjusted downwards to reflect mitigating circumstances, such as where the infringement was committed negligently rather than intentionally or in "whistle-blowing" cases. In addition, fines are subject to a legal maximum of 10% of a firm's total worldwide turnover in the preceding business year. Thus it is not always clear whether the amount of the fine has cancelled out the benefit gained or whether a report is required where a party has been granted immunity from prosecution.

1.15 Similarly, where an environmental or waste disposal breach or a breach of working time regulations has occurred, it is not possible to quantify the benefit obtained by not complying with the relevant legislation, which again may lead to a cautious approach towards reporting in these circumstances

Example: Cartels

By way of example, an airline is fined for price fixing after it held illegal talks with a rival. The rival tipped off the authorities and helped with the investigation and, in return, was given immunity from a fine.

In the case of the airline fined:

(a) it is not clear whether the fines represented the benefit gained through the price fixing arrangement and the cautious approach would therefore be to submit a report to SOCA;

(b) there is also an argument that whilst it was fined a significant sum of money (which might or might not have equalled the benefit received), dividends to the shareholders may represent, in part, a benefit from criminal conduct.

In the case of the rival, it presumably gained a similar benefit and, whilst it has been granted immunity from prosecution, this does not alter the fact that the conduct was criminal conduct and therefore there is a benefit from criminal conduct for the purposes of POCA. Accordingly on this bare analysis it would be necessary to make a report to SOCA, even though it is obvious that no action will be taken by law enforcement. In addition it is not clear how often consent would have to be sought, there would again be little point in every professional having to seek consent to act on every new matter.

Example: Waste management

It is a criminal offence to operating a landfill without a valid waste management licence. An example of where it might be difficult to quantify the benefit received by a company which is continuing to operate landfill in circumstances where the waste management licence has expired.

1.16 It is acknowledged that, in some circumstances where the criminal conduct of an individual has been punished by a prison sentence and/or the full amount of the pecuniary advantage gained has not been recovered through confiscation proceedings, it may be of interest to law enforcement to receive reports in relation to such individuals.

1.17 However, in the absence of a carve-out for breaches where the offence is only punishable by a fine/mitigation, and law enforcement will not be seeking to recover further assets, there is once again the problem that reporters and SOCA are required to expend resources on what is essentially a meaningless exercise.

2 Do you believe the additional measures proposed in Option 1 can strengthen confidence in the existing regime?

2.1 It is not clear exactly what is being proposed in Option 1 and therefore it is difficult to comment on whether it can strengthen confidence in the existing regime. We assume that the proposal is to continue to rely upon "course of conduct" so that a single consent can be given to a series of similar transactions. However, the proposal lacks clarity – for example:

2.1.1 Would the "course of conduct" route equally apply to co-mingling of assets held by corporates? How will it apply where, for example, a company saves costs by not making a filing to Companies House or where it wins contracts as a result of a bribe, the amount that represents the saved costs or the profits from the contractual arrangement will be held in the company's main bank account into which all other revenue generated by the company's business operations is paid? Or is the "course of conduct" route confined to the financial transactions through bank accounts?

2.1.2 Would law enforcement give a specific timeframe or clear guidance on what is covered by "course of conduct" in each case so that it is clear what can and cannot be done without a further consent?

2.2 Clearly, it is important to have certainty given that criminal sanctions apply where a report is not made. It is also important that there is wording in the statute to provide a specific exception to the requirement to report. It is not sufficient to assume that a court will consider that it would fall within the 'reasonable excuse' defence.

2.3 It is also not clear whether it is proposed that clarity is sought from the courts and a concern is raised in paragraph 5.8 of the Consultation Document that a definitive legal ruling may not support this approach. Presumably, however, lengthy and costly consideration of the underlying principles of fungibility can be avoided by introducing an amendment to POCA which provides an exception to the reporting requirement in certain circumstances.

2.4 In any event the pragmatic approach referred to in 5.2 cannot continue and is unacceptable. Under Human Rights legislation and common law, a citizen must be able to determine the extent of any prohibited criminal act with certainty. POCA should therefore be amended appropriately to avoid uncertainty, particularly in the context of criminal sanctions that, for the principal offences, can be up to 14 years imprisonment.

3 Do you believe Option 2 provides a viable alternative to the current consent regime?

3.1 In principle, the Pre Event Notification (PEN) system is to be welcomed. However, in the absence of detailed provisions, it will be difficult for reporters to understand in what circumstances they can use the procedure. It would be unacceptable to leave it to the reporters to decide whether or not the matter may be sufficiently important to require consent as this may lead to reporters taking either a cautious view towards the need for consent, thereby rendering the PEN regime obsolete, or taking an overly robust view which may cause concern for law enforcement as well as for themselves ultimately.

3.2 We have already suggested in 1.5 above that the provisions of POCA be limited to "serious offences". However, in the absence of such a change, there is a question as to whether the defence under the PEN route will be available regardless of the seriousness of the offence. The proposal set out in the Consultation Document does not appear to differentiate between types of offences so we would assume that it would apply in all cases although this should be made clear.

3.3 If, however, the defence will not be available in cases where there is a "serious" offence, we would suggest that the definition of "serious" could broadly follow the offences listed in paragraphs 1 to 5 and 7 to 14 of Schedule 1 of the Serious Crime Act 2007. . An advantage of differentiating between offences is that it may alleviate the burdens on law enforcement. Paragraph 5.15 states that "It will take extra capacity and functionality for the UKFIU to be able to process PENs, as well as SARs. This would have to be built into the SARs Transformation Project, meaning that delivery of this option will not happen immediately." Presumably, however, if the circumstances in which PENs are permitted are clearly defined by reference to circumstances which are not related to serious criminal conduct, it follows that, in many circumstances no further action will be required on the part of SOCA.

3.4 The second issue relates to the timing of the PEN. We note that paragraph 5.17 focuses on the defence being available if a report is made in a "timely manner". The meaning of "timely manner" is uncertain. The wording itself suggests that that the defence would be available if the reporting institution submits the PEN as soon as possible after first discovering the criminal activity (but it must be clear that this is only after the suspicion/knowledge has been established after relevant investigation by the reporter as happens now). However, paragraph 5.17 provides that "There is an additional risk that firms would choose to use the PEN route rather than submitting requests for consent, but might submit the PEN with insufficient time for the transaction to be analysed and for an appropriate response to be determined. It would be important to stress that the defence against money laundering relies on PENs having been made in a timely manner." This suggests that the defence is only available where law enforcement has the time to respond appropriately. Thus it is not clear whether the defence would apply in circumstances where the PEN is submitted immediately after discovery of the criminal activity, even though the proposed transaction is due to complete very soon thereafter. If the focus of the defence is the ability of law enforcement to respond to the PEN, then firm rules on the timeframes which will apply to PENs must be specified.

4 Is it your view that it is worth continuing with the current consent regime as an option if the Pre Event Notification system and the new restraint power are introduced?

See comments above.

5 Do you have specific views on the new powers suggested in option 2.

See comments above.

6 Do you believe Option 3 provides a viable refinement to Options 1 and 2 as regards resolving difficulties around the operation of the consent regime?

6.1 Option 3 provides for a new POCA defence to be introduced which provides that an institution would have a defence when it had made sufficient disclosures to give SOCA "a reasonable picture of the criminal activity". The key issue, which is identified in the Consultation Document, is the issue of the interpretation of what is a "reasonable picture of the criminal activity". How, for example, would this phrase be applied in the examples set out in section 1 above?

6.2 As we have highlighted above reporters must have sufficient clarity as to the circumstances in which a report must be made. However, despite the explanation in the Consultation Document, it is still not clear how the proposed defence would operate. Under POCA, each and every dealing in criminal property is technically a separate criminal offence and therefore a separate criminal activity. Thus, the wording "reasonable picture of the criminal activity" would not necessarily provide sufficient clarity. Is it the intention to make law enforcement aware of sufficient information regarding the *original offence* which has given rise to the issue and that either (a) only new facts which might help to further any investigation need be reported or (b) the relevant conduct has the consequence that all of the criminal property is transferred outside of the UK and beyond the reach of law

enforcement? Is it proposed that SOCA will give a direction upon receiving the first report that no further reports are necessary or will the conditions be embedded in statute?

7 Do you have any alternative approaches which you think might contribute to resolving any problems?

See comments under Question 1 above. We would recommend that POCA is amended to provide carve outs for the following:

7.1.1 Where the information provided is already in the public domain and the reporter cannot provide any further information to substantiate the claim (see 1.6 to 1.9 above).

7.1.2 Regulatory offences should be excluded from the regime (for the reasons set out in 1.5) or failing that, we should exclude them where the regulator is already aware of the breaches (see 1.10 above).

7.1.3 Where the offence has already been prosecuted or settled or any breach has been remedied or immunity from criminal sanction is granted (see 1.11 to 1.17 above)

8. General

Our final general comment relates to the handling of reports. If a law firm makes a report then it, like other reporters, would expect the fact that it has made a report to be kept utterly confidential. We would be grateful if you could confirm that it is not practice for the name of firms who have made a report to be given to others who report the same matter, as happened to one of our members. We also think that when contact is made with someone to discuss a particular matter, that that person should as a matter of course identify themselves. Again our members have had experience of being refused a contact name.

City of London Law Society

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