CITY OF LONDON LAW SOCIETY

RESPONSE TO CONSULTATION: ECONOMIC CRIME LEVY

October 2020

Introduction

The City of London Law Society ("CLLS") represents approximately 17,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees.

This response has been prepared by the CLLS Corporate Crime and Corruption Committee, which is comprised of lawyers with widespread experience of dealing with all aspects of white collar and corporate crime. A list of the members of the committee is on the CLLS website herewith:-

https://www.citysolicitors.org.uk/clls/committees/corporate-crime-corruption/corporate-crime-corruption-committee-members/

The City of London depends upon an independent, robust and effective legal system, including the system of criminal justice.

It is in the interests of law-firms practicing here, and of the City as a whole, for economic and financial crime to be dealt with as effectively as possible, congruent with the rule of law. Lawyers, like all citizens and taxpayers, benefit from the (relative) lack of corruption and graft in public life and the deterrence of organised crime. Strong systems preventing money-laundering are a public good to which members of the CLLS wish to contribute, alongside society as a whole.

All law-firms have professional obligations to uphold the rule of law and the proper administration of justice, including, of course, any and all anti-money-laundering ("AML") legislation. CLLS members have a particular role in doing this in light of their work advising and representing large corporate and banking clients. City firms are at the forefront of investigating large-scale frauds, bribery, false-accounting and other predicate offences, as well as advising corporate clients about AML and other forms of compliance. Of course, City firms are also regulated professionals, take their own legal obligations seriously and have robust anti-money-laundering procedures in place.

All these activities are part of more general obligations to deter and report crime which apply to all social and economic actors, the costs and benefits of which are shared by the country as a whole.

Executive Summary

The City of London Law Society shares the view that more can be done to improve the UK's response to economic crime and money-laundering in particular. However, the CLLS feels that the proposed levy model of financing such efforts is flawed.

It is wrong, and may well be counter-productive, to impose what is effectively a tax on groups of professionals who are already making a disproportionate contribution to AML efforts. The CLLS objects to the principle of singling out one section of society for an extra contribution to government functions which benefit all sectors of society. Doing so in this case risks harming the reputation of the UK as an attractive jurisdiction from which to provide or procure legal services, to the detriment of all.

This is not a case of "polluter pays". Legal professionals in particular are already making a very significant contribution to AML efforts – they are part of the protective architecture which tends to prevent and detect money laundering and ensure that the system is efficient.

We do not believe GPs or pharmacists should be subject to levies according to the fluctuating funding needs of the NHS. Nor should care-home operators or transport providers, police-forces or MPs be forced to contribute to selective funding regimes directed at problems facing their sectors which arise out of and affect society as a whole. We believe such regimes would ultimately do far more harm than good to the efficient provision of services.

In the particular case of the City of London, there is no doubt that the quality of the legal services available here are a major draw to domestic and international investors, business-people and other lawyers. The perception that if one provides legal services from the UK one will be subject to extra levies or taxes, especially those based on a general account of profits or revenues, could do significant damage to the UK's present reputation among global companies and investors. All of these have a range of choices as to where to locate their legal base and carry out their legal activity.

In the view of the CLLS, efforts to improve AML systems should be funded by the exchequer in the same way as other public services. The principle of a special levy on businesses operating within a sector in which certain public services are lacking is a troubling one.

If the levy is to go ahead in any case, a calculation model based on the number of Suspicious Activity Reports ('SARs') which a firm had submitted the previous year would be simpler, cheaper to operate and fairer than an income-based levy. It would also be more closely linked to risk.

We would be strongly against any levy being used for activities outside the fight against money-laundering. In particular, we would object to any use of the levy in the wider fight against fraud.

Levy principles

Question 1: Do you agree with the design principles as set out above? Should the government consider any further criteria?

The design principles themselves are common-sense propositions to which the CLLS does not object. It is not clear how much weight is to be applied to each principle or the parameters of any likely trade-offs between them. In our view, the principle of proportionality is especially important in designing any system where there will be a wide range of affected parties. Of course, any collection system should be as simple and cost-effective as possible.

What will the levy pay for?

Question 2: What do you believe the levy should fund? Are there any other activities the levy should fund in its first five years?

We are broadly supportive of initiatives to improve the number and quality of staff working within UKFIU and other agencies tasked with investigating potential money-laundering. In our view, improvements to the training and legal knowledge of staff-members would be beneficial.

We are also in favour of improvements to the resources of Companies House to check and verify information provided to it.

We would be in favour of a small percentage of the funds being used to improve training and compliance systems within smaller, more vulnerable firms. However we are not especially enthused by PR campaigns or "awareness-raising" at least beyond the types of professionals to whom AML is directly relevant.

We would be strongly against any levy being used for activities outside the fight against money-laundering. In particular, we would object to any use of the levy in the wider fight against fraud.

Transparency and review

Question 3: Do you agree with the government's approach to publish a report on an annual basis? What do you think this report should cover other than how the levy has been spent?

Yes.

The report should deal explicitly with the contributions of each sector including solicitors and others, as well as outlining specific effects of the levy for the regulated sectors in particular.

Question 4: What are your views on what the proposed levy review should consider and when it should take place?

We broadly agree with the contents of the report already suggested in the consultation. The review should be robust in challenging whether the levy itself should continue and seek to avoid continuation of the levy beyond its natural span in deference to the common "sunk costs fallacy". We consider that the review should also consider the externalities caused by the levy in particular any effects on the provision of / costs of / availability of legal services.

In our view the review should take place within three years of the introduction of the levy. Five years is too long given the fast-moving nature of the underlying subject-matter.

UK revenue

Question 5: Do you agree with our proposal that revenue from UK business should form the basis of the levy calculation? Please explain your reasoning.

No.

The use of revenue is far too crude an approach. A revenue-measure would de-couple the levy from any AML risk which it is intended to address and would be regressive in effect.

Subject to the CLLS' objection to the levy in principle, the CLLS would support a per-SAR-based approach to calculation of the levy.

If revenue is, however, to be used as the basis of calculation for the levy, it should be UK, AML-regulated revenue only. Care will also be needed to ensure that the firms' costs of calculating relevant income was not disproportionately high. (See below.)

Question 6: Are there any sectors that would be disproportionally impacted if revenue is used as a metric, or where revenue would be disproportionate to level of risk?

CLLS is not in a position to give a comprehensive answer to this question. However, in our view there would be a disproportionate impact on the legal-services sector if revenue was the key metric. Firms with high revenue but low risk as regards AML would be penalised out of proportion to their contribution to risk.

Question 7: Do you believe other levy bases would provide a better basis for the levy calculation? These could be the ones outlined in Table 4.A or those not considered in the consultation document

We suggest that the number of SARs submitted by a firm within the relevant accounting period would be preferable. This would link the level of the levy to the level of participation in the UKFIU / SAR system of each firm.

We would favour a system based on average number of SARs submitted within a defined period. We are not wedded to a particular accounting period but believe it would be more equitable to look at an average over several years rather than on merely the year immediately prior to the calculation.

An alternative, which might make the revenue stream more predictable, would be to develop bands of firms based on recent SARs, with a fixed amount payable according to band.

We feel strongly that a “per-SAR” system would reduce the risk of the levy being seen as merely a tax on successful solicitors’ firms, with all the negative effects on the legal services market which that would entail. It would also be simple to administer and for firms to calculate.

We do not agree that such a system would incentivise under-reporting or entrench poor practice. As to under-reporting, we do not accept the premise that a firm should be expected to risk committing a serious offence merely to avoid the relatively minor increase in the levy which each SAR would give rise to. The professional consequences of such an attitude would be disastrous. The number of solicitors prepared to take risks of this nature must be so tiny as to be negligible. This is particularly the case in circumstances where the smallest firms would be exempt in any event.

The same point goes for “poor reporting behaviour”. We would challenge the assumption that lower rates of reporting from any sector must be caused by errors or faults within that sector. For example, there are clear differences between the obligations of those providing legal advice and those providing financial services. Solicitors are obliged not to make a SAR about a client on the basis of information which is provided to them in privileged circumstances. Banks rarely if ever acquire information in such circumstances.

Of course, the financial services sector is involved in far more transactions than the legal sector is or ever could be. The legal sector will not need to carry out the type of bulk-reporting seen within the financial services sector.

Question 8: Should a fixed percentage or banded approach be taken to utilising revenue as a metric? Please explain your reasoning.

We are opposed to a revenue-based system in principle. We do not have developed view whether, notwithstanding this, a fixed percentage or banded approach is preferable.

Small business exemption and minimum payments

Question 9: What are your views on the principle of exempting small businesses from paying the levy, and on the level of a potential threshold?

The CLLS supports the principle of exempting smaller solicitors' firms.

The CLLS recognises the very severe difficulties currently being faced by smaller solicitors' firms, due, at least in part, to the under-funding of legal aid. The CLLS recognises the importance of such legal practices to the wider economy and to the legal system in general and does not favour imposing any further financial burdens upon them. It is probably true that very small firms tend to be the most exposed to, and simultaneously least capable of dealing with, AML risks. To mitigate this risk, we suggest that further assistance and training is provided as regards the systems and controls in use at such firms.

In order to maintain a link between risk and payment, it might be that any small firm exemption would not apply to small firms who have made a number of SARs in the relevant accounting period which is clearly disproportionate to their size and/or turnover. Determining an appropriate threshold for such a rule would require further study.

Question 10: What are your views on having businesses below the threshold subject to a small flat fee?

We doubt that a flat fee would make much difference to the overall total or that the cost of collection would justify what would amount to a blanket tax on parts of the profession that are least able to pay, de-coupled from any independent markers of risk. However, this is something about which further research or analysis might usefully be done.

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Question 11: Do you believe the small business threshold should be determined by reference to revenue alone or to all three of the Companies Act 2006 criteria? Please explain your reasoning.

We do not have developed views on this topic.

Question 12: For businesses not exempted by a threshold, how should their revenue below the level the threshold is set at be treated – as an allowance, levied at the same level as the main levy rate, or levied through a fixed amount?

The tranche of each firm's revenue below the threshold should not be charged. We agree with the consultation that this would avoid a 'cliff-edge' effect.

Money laundering risk

Question 13: How do you think money laundering risk should be accounted for in the levy calculation?

We believe the most appropriate model is a per-SAR calculation, averaged over a reasonable time, as this is most likely to reflect the likely level of risk being faced by each firm.

Question 14: Do you believe using number of SARs reported as a metric through a banded approach would be an appropriate means of achieving this objective? Please explain your reasoning.

Yes, please see above.

Frequency of levy adjustment

Question 15: Do you believe there should be a periodic or annual process for setting the levy rate? If periodic, what would an appropriate period be?

It seems to us that an annual approach would be more sensitive to changes in the level of risk, however each year's review should be based on an average number of filings over a longer period, say three years.

Regulated versus unregulated activity

Question 16: Would you prefer to calculate the levy based on total revenue or revenue from AML-regulated activity only? Please explain?

We are opposed to a levy based on revenue.
However, if this were to be imposed against our advice, it would be best for it to be based exclusively on revenue derived from AML-regulated activity. To calculate the levy based on non-regulated activity would divorce the levy from its intended connection to AML-risk.

For law firms, regulated activity would include such typical work as tax advice, company formation and governance, conveyancing and management of trusts and estates. It would not include non-regulated activity such as advice on litigation, investigatory or regulatory matters.

Each firm will have different amounts of regulated and non-regulated work, and it would be preferable for firms to follow a common standard on how to allocate their revenue between them. Achieving this will require further analysis and we suggest that the Law Society is best placed to derive the standard for the legal sector.

Question 17: If applicable, what is your initial estimate of the proportion of your UK business which is AML-regulated (in revenue terms)? How many labour hours

would initially be required to enable your business to robustly calculate the proportion of regulated business on an ongoing basis?

We would expect CLLS member firms to make broad estimates of the regulated / unregulated split, and to contribute to the development of a common standard (see Question 17 above

Defining revenue

Question 18: Which is your preferred option for defining revenue?

Revenue generated from regulated activity carried out in the United Kingdom. Non-UK revenue should not be used as to do so would penalise the export of legal services in particular and provide an advantage to competitor firms with headquarters and tax bases outside the UK. Non-regulated revenue should not be used as to do so would weaken the link between AML risk and the levy.

Question 19: Do you agree the levy should be based on UK revenue only? How easy would it be split out your UK revenue from your total global revenue?

Yes. A split would probably not be logistically impossible, however, as explained above, it would be quite wrong to tax services provided to non-UK clients in order to pay for purely domestic initiatives.

Question 20: Do you agree it would be more appropriate to use total income or net operating income as a metric for calculating levy liability for deposit-taking institutions, and if so, which metric would be the most appropriate.

CLLS does not have a strong view on this topic which is mostly of relevance to banks.

Reference period

Question 21: Do you agree that the reference period for the levy calculation should be a business's accounting period? Please explain your reasoning.

Yes. This would simplify accounting for law-firms.

Newly regulated sectors and fluctuation with the AML-regulated sector

Question 22: Do you agree that the levy should apply to activity carried out from the date from which the activity is regulated? Please explain your reasoning.

Yes, subject to any reasonable period of adjustment.

Group calculations

Question 23: Do you believe levy liability should be calculated and invoiced at entity or group level? Please explain your reasoning.

This question has less direct relevance for law-firms. In general, we would support calculation and invoicing per entity.

Partnerships

Question 24: Do you agree limited partnerships should pay the levy at partnership level? Do you have any other views on how partnerships should be treated for the purpose of the economic crime levy?

We are not aware of any viable alternatives to payment at the entity level – i.e. by an LLP or partnership.

Registration, notice to file, and reporting in a single agency model

Question 25: Do you think the agency should issue a notice to file or that business should be required to submit a return proactively? Please explain your reasoning.

CLLS does not have a strong view on this.

Question 26: Do you think all businesses should report their levy liability to the agency? If not, do you think small businesses should report a nil declaration or nothing at all?

Qualifying businesses should report their levy liability to the agency.

Rate calculation, invoicing, and payment

Question 27: Do you agree with the proposed approach for calculating the levy rate, invoicing, and payment of the levy? If not, please explain why.

No. We prefer a SARs based model. If, despite this recommendation, the levy is based on revenue, it would be a sensible for firms to submit their relevant revenue and for the collecting agency to calculate the levy liability and then produce an invoice.

Non-compliance in a single agency model

Question 28: What are your views on the proposed compliance framework in a single agency model?

We do not object to the suggested framework.

Payment in a supervisor model

Question 29: Do you agree that the supervisors should be able to determine the frequency of reporting and payment, provided they transfer levy payment to the government a maximum of a year after the end of a business' accounting period?

The CLLS is not a supervisor per se. However, we do not favour this model. There is a risk of an unnecessary administrative burden.

Non-compliance in a supervisor model

Question 30: What are your views on the supervisor carrying out compliance activity as set out above.

As above.

Single agency or supervisor model

Question 31: Which model do you prefer? Please explain why. Do you have suggestions on any other models that may be used?

Again, CLLS is not a supervisor. However, our broad view is that any levy should be collected, and compliance handled by a government agency. Locating this task with a supervisory body would involve higher costs for the supervisor which would inevitably be passed on to the firms themselves. It may also be the case that such tasks would require amendments to primary legislation in order to empower the supervisors in question. Such further complexity is to be avoided.

Question 32: If you are a supervisor, what do you estimate your costs would be each model?

This is not a relevant question for the CLLS.

Funding for fraud

Question 33: How much did your organisation spend on countering fraud in 2019? What are these funds spent on, in high level terms?

This is not a relevant question for the CLLS.

Question 34: What additional financial contribution should the private sector contribute towards improving fraud outcomes?

This is a question about public policy and resourcing priorities which the CLLS has not studied in depth. It is our, anecdotal, view that fraud is uniquely difficult to combat given basic structural features of the global economy and the fungibility of money.

Fraud is both complex and international in a way that justice systems and police forces are not designed to deal with. Only a "joined up" and internationally effective approach to policy can be expected to combat it with any effectiveness. Such initiatives can, realistically, only be actioned at the state level, with the result that the majority of financial contribution should come from governments and/or international institutions.

The private sector's contribution will, as always, come in the form of:
i) normal taxation,
ii) the upholding and further development of appropriate regulatory regimes
iii) in the case of the legal sector, the upholding and further development of professional, regulatory and ethical standards of conduct as regards clients, counterparties and the courts.

CLLS member- firms and other solicitors make a very significant contribution to each of i) to iii).

Other than through general taxation, it is not appropriate for the private sector to be asked to make a financial contribution (in the form of levy or tax) to fund the fight against fraud. It is often the victim of fraud.

Question 35: Which sectors do your think should be involved in countering the system-wide fraud risk? Please explain your rationale – for example whether you believe that those included should be included based on benefit, or risk?

It is clear that most large-scale fraudsters and corrupt actors seek to acquire assets in the form of real property, cash and securities. The financial services sector has traditionally been in the forefront of efforts to combat fraud. The property sector should also be in a leading role. Of course, other sectors, including the legal sector also have a role to play in at-risk transactions and should continue to be vigilant.

Question 36: What mechanism would you recommend in order to collect additional funding?

See discussion above. The most appropriate mechanism in our view is general taxation rather than sector-specific levies.

If you would find it helpful to discuss any of these comments then we would be happy to do so. Please contact Eoin O'Shea by email at eoin.oshea@cms-cmno.com in the first instance.

Yours sincerely

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