



DON'T LOOK, WON'T FIND

**Weaknesses in the Supervision
of the UK's Anti-Money
Laundering Rules**

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Weaknesses in the supervision of the UK's anti-money laundering rules

Key statistics

Billions

of pounds of corrupt funds are pouring into the UK every year

22

different supervisors – mostly private sector institutions – have some degree of responsibility for supervising and enforcing UK anti-money laundering regulations across financial services, accountancy, legal services, luxury goods, property, and trust and company service providers

14

different supervisors take some responsibility for supervising the UK accountancy sector, leading to widespread variations and inconsistency in enforcement

6

out of 7 business sectors covered in this research are characterised by low or very low reporting rates for suspicions of money laundering

3

sectors – legal, accountancy and estate agency – have been identified by law enforcement authorities for large volumes of low quality or incomplete reports of suspicious activity

42%

of the most serious type of reports of suspicious activity in legal services were assessed to be poor quality or incomplete, raising concerns about 'gaming' of the reporting system

0.05%

of all suspicious activity reports in 2013/14 were from the estate agency sector, despite numerous studies indicating the attractiveness of UK property for the corrupt

20

of the 22 relevant supervisors fail to meet official standards of enforcement transparency

15

of the 22 supervisors have serious conflicts of interest between their private sector lobbying roles and their enforcement responsibilities

1/3

of banks dismissed serious allegations of money laundering regarding their customers without adequate review, according the last comprehensive survey

£1134

is the average fine issued by HMRC in 2014/15 for firms that break money laundering rules

21

of 22 supervisors have either a low or unreported level of enforcement against those who break money laundering rules

0

sector supervisors in the UK provide a proportionate and credible deterrent to those who engage in complicit or wilful money laundering

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Executive summary

The system that should prevent dirty money from entering the UK is failing. Billions of pounds of corrupt funds are pouring into the country every year. A radical overhaul of the UK's anti-money laundering system is needed to stem the flow of corrupt money and help prevent UK professionals from being unwitting facilitators of – or, indeed, corrupted by – vast sums of money stolen from around the world.

According to the Government's own risk assessment, only a very small proportion of the corrupt money entering the UK is being detected and investigated by the authorities.

This research evaluates the implementation and supervision of anti-money laundering rules across a range of sectors in the UK in order to understand why money laundering is such a persistent problem.

The frontline in the UK's defences against corrupt money should, in theory, be firms in the private sector identifying and reporting suspicions of money laundering. However, UK professionals can also be gatekeepers that let the dirty money into the UK and, then, help to hide it.

Our research indicates that the cornerstone of the problem is with the institutions that should be supervising the anti-money laundering rules in the UK. In this report, we analyse the vulnerabilities in the UK's framework for overseeing anti-money laundering risks across the following key sectors: financial services, accountancy, legal services, luxury goods, property and trust and company service providers.

The current regulatory system for these sectors relies on a patchwork of 22 different supervisors – mostly private sector institutions – to ensure that firms abide by the rules. It is this system that is structurally unsound.

The UK has experimented with a low-cost model of supervision that relies on outsourcing responsibility for regulatory oversight to a wide range of private sector bodies. This approach, unique to the UK, has led to an environment where standards of supervision vary widely. Ineffective supervision – where it occurs – leads to inadequate compliance with the rules by firms within the sector, low reporting of suspicions and poor quality reporting.

Overall findings

Our findings show that the vast majority of sectors are performing very badly in terms of identifying and reporting money laundering. Major concerns have been identified by law enforcement authorities over the quality, as well as the quantity, of reports coming out of the legal, accountancy and estate agency sectors.

Out of the 22 supervisors, only the Financial Conduct Authority has above a low or unreported level of enforcement of the rules. No sector supervisor in the UK is providing a proportionate and credible deterrent to those who engage in complicit or wilful money laundering.

Of the 22 supervisors, 20 fail to meet the standard of enforcement transparency demanded by the Macrory standards of effective regulation. In the public sector, HMRC appears to be particularly hampered by an institutional tendency towards secrecy. In general, the private sector supervisors are characterised by inconsistent and opaque enforcement.

Only 7 of the 22 supervisors control for institutional conflicts of interest affecting their supervisory responsibilities. Most of the private sector supervisors maintain serious conflicts of interest by being both lobbying and promotional bodies for their sector and also enforcement authorities.

The mish-mash regulatory structure undermines effective implementation of legislation and leaves the UK open to the threat of money laundering. It also presents an inconsistent, unclear and unhelpful environment for businesses that are intending to abide by the rules. A lack of transparency and inadequate evaluation of risk at the supervisor level can leave regulated businesses in the dark about what risk-based preventative action they should take to protect themselves from corrupt money in their sector.

There are also distinct vulnerabilities in each key sector, including:

- In financial services, around a third of banks dismissed serious allegations of money laundering regarding their customers without adequate review.
- In legal services, 42 per cent of the most serious reports of suspicious activity were assessed to be poor quality or incomplete.
- In the accountancy sector, at least 14 different supervisors take some responsibility for supervision, leading to widespread variations and inconsistency in enforcement.
- In property, the entire estate agency sector only submitted 179 reports of suspicious activity in 2013/14, which is only 0.05 per cent of all reports submitted.
- In the art and auction house sectors, only 15 reports of suspicious activity were submitted (0.004 per cent of the total), despite money laundering risks being well-recognised in this sector.

Recommendations

Our recommendations to mitigate the risks identified in this report fall into three major categories. We believe that the UK Government should:

- overhaul the way anti-money laundering standards are overseen to achieve consistency, integrity and accountability in the supervisory system
- ensure adequate levels of enforcement against money laundering
- provide better information about money laundering risks to the private sector

We make 20 specific recommendations to strengthen the UK's ability to stem the flow of corrupt money. Principal among them is that the UK Government should review the arrangements for supervision in the UK and evaluate options for consolidating the number of anti-money laundering supervisors. The review should examine the merits of replacing the existing patchwork and inconsistent structure of multiple supervisors with a single, well-resourced "super" supervisor.

The UK Government should also urgently seek to implement the Parliamentary Commission into Banking Standards recommendation that greater personal culpability should be placed on senior managers for misconduct within firms.

The UK Prime Minister has rightly said that dirty cash is not welcome in the UK. However, without tackling poor supervision and enforcement of anti-money laundering rules across the economy, a torrent of stolen money will continue to be allowed to find a safe haven in the UK. As the UK's national risk assessment acknowledges, as well as supporting criminality, this will likely fuel instability in key countries around the world and threaten the integrity, reputation and success of the City of London and the wider UK economy.

1. Money Laundering and the UK

What is money laundering?

Money laundering is the process of concealing the origin, ownership or destination of illegally or dishonestly-obtained money by hiding it within legitimate economic activities in order to make it appear legal.¹ All manner of financial transactions and investments are used to launder the proceeds of crime and corruption, including the sale of property and the purchase of luxury goods. Money laundering can mask corruptly acquired wealth – such as bribes, kick-backs, illicit political contributions, embezzled funds and loans – as well as the proceeds of other crimes. Money laundering helps the corrupt to escape justice and, after the funds have been successfully laundered, the corrupt can enjoy their ill-gotten gains or move the funds on for other purposes.

Law enforcement authorities and anti-money laundering (AML) professionals seek to identify instances of money laundering and to investigate whether assets or transactions involve the proceeds of crime.

Why does money laundering matter?

Corruption and the impunity achieved by the corrupt through money laundering are major contributors to global poverty. The theft of state funds for private gain depletes resources that would have otherwise gone towards public goods, such as social services, investment in infrastructure and economic development. This makes it harder for citizens to lift themselves out of poverty and move their country towards greater prosperity. Estimates suggest that at least US\$1 trillion leaves developing countries each year through a web of corrupt activity that involves the use of anonymous shell companies, money laundering and illegal tax evasion.² It has been suggested that as many as 3.6 million deaths could be prevented each year in developing countries if action was taken to tackle the corruption and criminality behind these illicit flows and the recovered revenues were invested in health systems.³

“Corruption has a deplorable effect on our societies – corroding justice, good governance and prosperity. The UK is a global financial centre, open for business with the world. It is one of our country’s great strengths, but it brings with it responsibilities: to ensure that we take the appropriate steps to prevent money laundering; and that we act to stop the proceeds of overseas corruption from being hidden here” – Home Secretary The Rt Hon Theresa May MP⁴

¹ http://www.transparency.org/glossary/term/money_laundering [accessed 17 Sep 2015]

² https://s3.amazonaws.com/one.org/pdfs/Trillion_Dollar_Scandal_report_EN.pdf [accessed 16 Feb 2015]

³ https://s3.amazonaws.com/one.org/pdfs/Trillion_Dollar_Scandal_report_EN.pdf [accessed 16 Feb 2015]

⁴ <https://www.gov.uk/government/speeches/home-secretary-speech-at-ukraine-forum-on-asset-recovery> [accessed 24 Jun 2015]

How does it affect the UK?

The UK Government's National Risk Assessment of Money Laundering and Terrorist Financing, published in October 2015, sought to establish the impact and scale of risk posed by money laundering to the UK.⁵ The assessment found that billions of pounds of suspected proceeds of corruption are laundered through the UK each year. It concluded that this money had the potential to fuel instability in key partner countries and threaten the integrity, reputation and success of the City of London and the wider UK economy.⁶

“The UK is an international financial centre, processing trillions of pounds of transactions every year. Together with the presence of a highly developed professional services industry, this increases the attractiveness and vulnerability of the UK's financial system to exploitation by those engaged in money laundering.” – **National Crime Agency**⁷

The national risk assessment describes how the UK's status as a global financial centre makes it vulnerable to money laundering threats from other countries. Recognising that the UK is the world's leading exporter of financial services, the national risk assessment states, “the same factors that make the UK an attractive place for legitimate financial activity – its political stability, advanced professional services sector, and widely understood language and legal system – also make it an attractive place through which to launder the proceeds of crime”⁸

There is a clear recognition now by both UK law enforcement agencies and the UK Government that significant amounts of money linked to cases of international corruption flow through the UK's major professional sectors. Both money laundering and corruption have been identified as high priority threats in the National Crime Agency (NCA) National Control Strategy, which prioritises the threats of serious and organised crime in the UK.⁹

Money laundering of the proceeds of corruption is not unique to the UK, and a number of other major global financial and real estate investment centres are both vulnerable and attractive to the corrupt.¹⁰ However, the UK is well-placed to lead international efforts to identify and recover the proceeds of corruption, using its position as a leading global financial and luxury goods centre, and making use of its significant law enforcement capability regarding the investigation of grand corruption.

⁵ Referred to from hereon as the 'national risk assessment'

⁶ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.5

⁷ <http://www.nationalcrimeagency.gov.uk/publications/560-national-strategic-assessment-of-serious-and-organised-crime-2015/file> p.21 [Accessed 10 July 2015]

⁸ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.4

⁹ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.24

¹⁰ The UN defines grand corruption as corruption that pervades the highest levels of a national government, leading to a broad erosion of confidence in good governance, the rule of law and economic stability. See :

http://www.unep.org/training/programmes/Instructor%20Version/Part_2/Activities/Interest_Groups/Decision-Making/Supplemental/UN_Anti_Corruption_Toolkit_pages_10to16.pdf [accessed 16 Sept 2015]

2. Secrecy, complicity and professional enablers

Once the corrupt have stolen money, they typically wish to make it as difficult as possible to trace their wealth to the original theft and to prevent due diligence professionals and law enforcement authorities from being able to discover such links. To achieve this, corrupt individuals often use complex and opaque corporate structures and legal arrangements spanning multiple jurisdictions. This typically involves at least one company registered in a so-called 'secrecy jurisdiction' or 'tax haven'.

The money trail can be concealed further by using third parties and nominee agents who act on behalf of corrupt individuals. These agents help hide the beneficial ownership of the assets in question and obscure any link back to the original acts of corruption. Some third parties and nominees may be business associates or family members.

For complex money laundering schemes, criminals usually purchase fiduciary or intermediary services from a range of financial and non-financial companies and professionals who, wittingly or unwittingly, facilitate the scheme. These professionals can include bankers, wealth management agents and other financial service providers, trust and company service providers (TCSPs), property lawyers and accountants. As well as laundering money through a complex chain of transactions, money can enter countries via formal investment schemes.

A recent review of foreign bribery cases published by the Organisation for Economic Co-operation and Development (OECD) showed that 71 per cent of incidents involved bribes paid by intermediaries, such as agents, front companies and lawyers.¹¹ This illustrates how professionals in the legal, finance and accountancy sectors are critical to supporting a series of financial transactions to give illegitimate wealth a legitimate face.

In this report, we examine the risks surrounding UK professional enablers of corruption and the vulnerabilities in the system that is designed to prevent money laundering taking place through the UK. We focus on the following key professions and sectors of the economy which fall under anti-money laundering regulations:

- financial services¹²
- accountancy
- legal services
- high-value dealers (including luxury, art and auctioned goods bought with cash)
- estate agents
- trust and company service providers

¹¹ http://www.keepeek.com/Digital-Asset-Management/oecd/governance/oecd-foreign-bribery-report_9789264226616-en#page30 [accessed 10 Jun 2015]

¹² We do not cover money service bureaux in this research, as there is limited evidence that they play a major role in money laundering linked to high net worth politicians and officials; the focus of this report.

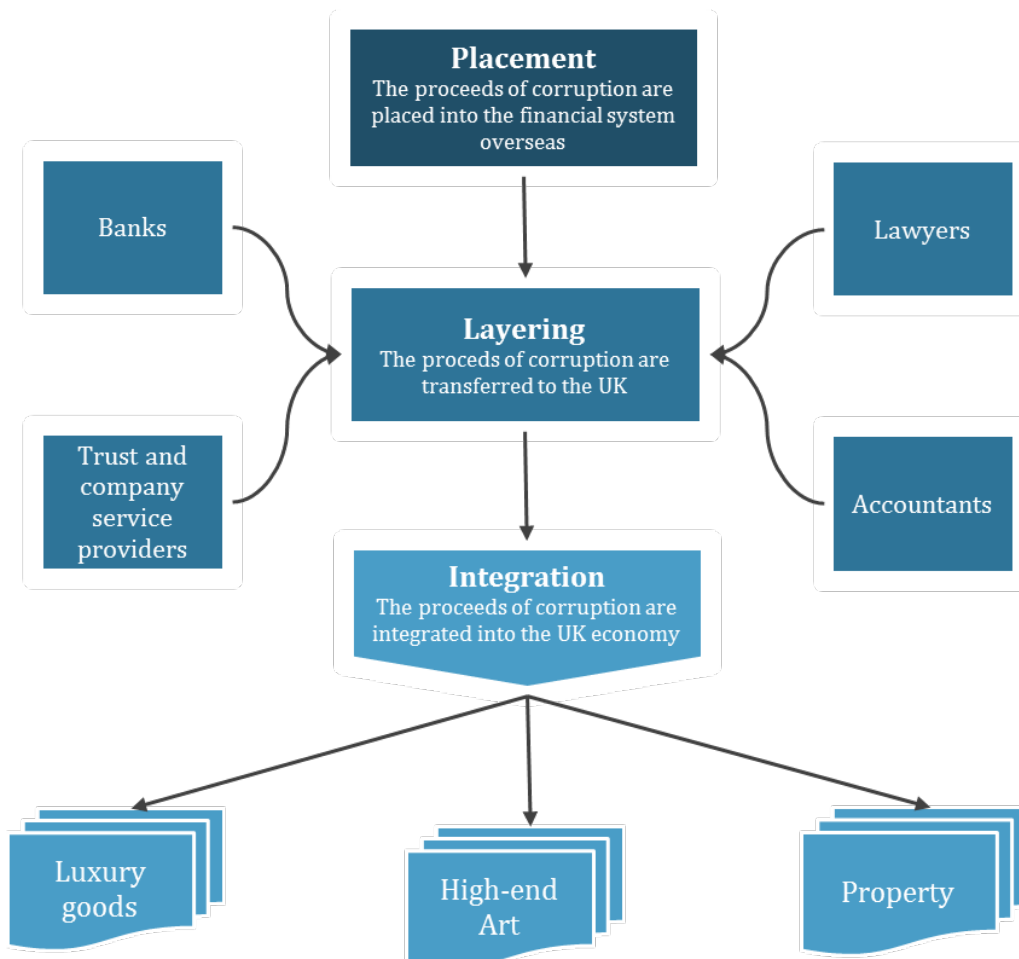
Terminology

In a basic money laundering scheme, stolen funds enter a financial system in some form (known as 'placement') and are re-injected into the legal market after having gone through a series of financial transfers (the 'layering' phase) that conceals their origin and beneficial owner. Once illicit funds have undergone the process of layering – which can include the use of corporate structures in secrecy jurisdictions – detecting the origin of the money is extremely difficult. Legitimate assets are then acquired at the last stage of the laundering scheme (known as 'integration'). Popular assets used to integrate laundered money into the legal market include property, luxury goods, high value art and antiques.

How UK professional enablers can help launder corrupt wealth

The following diagram shows how UK professional services facilitate the laundering of the proceeds of global corruption. It also identifies which sectors are susceptible to being used to integrate corrupt funds into the UK economy.

Figure 1 – Money laundering and the role of professional enablers



The billions of pounds of suspected corrupt wealth that enters the UK each year is highly likely to be ‘serviced’ by one or more of UK professional enablers during, principally, the layering and integration phases. Those professionals are subject to UK anti-money laundering regulations.¹³ The national risk assessment identifies that banks, accountancy service providers and legal service providers are at ‘high risk’ of being used for money laundering, taking into account their exposure to risk and vulnerabilities associated to their current standards of AML supervision.¹⁴

If UK professional firms are servicing the proceeds of corruption, they may fall into a number of categories of involvement.

Table 1: Basic typology of professional firms involved in money laundering (and severity of misconduct)¹⁵

Typology	Description
Innocent involvement	There are no warning signs of the money laundering that the firm could reasonably detect.
Unwitting involvement	They undertake basic due diligence and there are some ‘red flag’ risks, but they are not recognised by the due diligence professionals (AML Failure).
Wilfully blind	After red flags have been identified, they authorise a specific transaction and fail to submit a report of suspicious activity to law enforcement authorities (AML Failure / Criminal).
Corrupted	After red flags have been identified, they repeatedly authorise similar transactions and fail to submit suspicious activity reports (Criminal).
Complicit	They understand the nature of the criminal activity they are involved in (Criminal).

AML regulation, supervision and enforcement should be proportionate to the risk of firms becoming involved in money laundering. The AML system should be strong enough to effectively identify and prevent illicit and corrupt wealth from entering the UK.

However, in this report, we identify a number of deficiencies in the UK’s AML regime, which indicate it is neither effective nor proportionate. This includes weaknesses that affect multiple sectors, and specific vulnerabilities within key UK sectors that are attractive to use by the corrupt.

¹³ See Annex 1 for details on the UK’s regulatory structure and requirements

¹⁴ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.11

¹⁵ Adapted from www.sra.org.uk/risk/resources/risk-money-laundering.page [accessed 11 Aug 2015]

3. Low quantity and quality of reports of money laundering suspicions

An effective AML system is reliant on firms making high-quality risk-based decisions about the origins of wealth they handle. This relies on them having access to information about money laundering risks and the true ownership of client's money and assets, and taking action in response to suspicions of money laundering. This can include refusing business to specific customers and reporting suspicions of money laundering to law enforcement agencies.

Outside of direct surveys of compliance in any given sector, the following indicators provide a useful proxy for how effective the UK's AML system is:

- the number of Suspicious Activity Reports (SARs) of money laundering that are submitted to law enforcement agencies, relative to the size of the sector and the money laundering threats facing the sector
- the quality and detail of reports of money laundering to law enforcement agencies
- the level of awareness in the relevant private sector institutions about money laundering responsibilities and the extent of Continuing Professional Development

Suspicious Activity Reports (SARs)

Regulated sectors are legally obliged to disclose any suspicious behaviour that they observe. SARs must be filed with the NCA every time that a staff member in the business suspects or has reasonable grounds for knowing or suspecting that a person is engaged in money laundering.

An officer responsible for submitting reports must be nominated. Failure to report suspicious activities is a regulatory offence, and is also potentially a criminal breach, unless the regulated professional is able to provide a "reasonable excuse for not making the required disclosure" or is a legal professional adviser, accountant, auditor or tax adviser to whom the information came under "privileged circumstances". Although these exceptions have been introduced with the purpose of addressing privacy concerns and expressly exclude information given with the intention of furthering a criminal purpose, they are still problematic. Their overly wide scope represents a considerable legal loophole, which ultimately shields key sectors from the duty to submit potentially useful SARs.

Taking into account the different size of the sectors under supervision, the number of SARs from the accountancy, legal services and high value dealer sectors appears to be 'low' relative to financial services reporting (5-10 per cent relative reporting rate). Estate agents, trust and company service providers and art and auction houses are classified as 'very low' compared to the financial services level of reporting, adjusted to the size of their sector (under 5 per cent relative reporting rate).

Table 2: Relative reporting rates of suspicious activity reports (SARs)

	SARs (Oct 2013 to Sept 2014)	Number of firms**	Relative to financial services reporting****	TI Assessment
Financial services*	320,851	73,000	N/A	High
Accountancy	4,930	23,000	5%	Low
Legal services	3,610	12,000	7%	Low
High-value dealers***	331	1294	6%	Low
Estate agents***	179	7927	1%	Very low
Trust and company service providers***	177	2674	2%	Very low
Art and auction houses	15	1500	0%	Very low

**Not including money service businesses*
***Data compiled from sources within sector analysis below and*
****From HMRC FOI release to Transparency International UK*
*****Adjusted for size of sector, based on reports per number of firms supervised*

Reporting of money laundering suspicions and awareness of reporting responsibilities appears to be inadequate in almost all sectors. Private sector reporting of SARs to law enforcement authorities should be the frontline of an effective AML regime. However, the reporting rates from October 2013 to September 2014 seems to indicate either a low level of awareness of reporting duties amongst firms or a low level of compliance with those duties.

Apart from financial services, the levels of suspicious activity reporting of money laundering across the sectors considered in this research are 'low' to 'very low'.¹⁶ This is particularly concerning for professional gatekeeper sectors, such as accountancy and legal services, because they have been rated by the Home Office and HM Treasury as 'high risk' in terms of vulnerability to money laundering.¹⁷

As well as there being low levels of SAR reporting, the quality of these reports tends to be poor. The NCA has repeatedly highlighted problems with the quality of SARs from across the private sector, particularly from legal services.¹⁸ The NCA's analysis of SARs from the legal sector found that 42 per cent of consent SARs required follow-up with firms because the initial report was incomplete.¹⁹

The national risk assessment raises concerns about the quality of reporting in a number of sectors. Analysis of SARs from the accountancy sector revealed that 21 per cent of reports did not clearly state the reason for suspicion. In addition, in 50 per cent of SARs from this sector, the reporter did not make it clear what services they were providing when the suspicion arose, which is an important part of the information required by law enforcement authorities.²⁰ Similarly, in the estate agency sector SARs typically did not clearly identify the reason for suspicion. This indicates a lack of general understanding of the requirement and purpose of reporting.²¹

The national risk assessment indicates that high-value dealers (luxury goods bought with cash, including art and auction houses), and estate agents generally have a low level of awareness of their AML responsibilities in the UK. No sector is believed by HM Treasury to have an adequate level of awareness about their responsibilities to prevent money laundering.²² This is a principal cause of the problem of low reporting rates and low quality reports.

¹⁶ <http://www.nationalcrimeagency.gov.uk/publications/464-2014-sars-annual-report/file> p.9 [accessed 24 Jun 2015]

¹⁷ <http://www.nationalcrimeagency.gov.uk/publications/560-national-strategic-assessment-of-serious-and-organised-crime-2015/file> p.3 [accessed 15 Oct 2015]

¹⁸ <http://www.ft.com/cms/s/0/8f0a2dee-7039-11e5-ad6d-f4ed76f0900a.html#axzz3oNt0hO9K> [accessed 13 Oct 2015]

¹⁹ <http://www.nationalcrimeagency.gov.uk/publications/560-national-strategic-assessment-of-serious-and-organised-crime-2015/file> p.45 [accessed 15 Oct 2015]

²⁰ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.41

²¹ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.55

²² See Table 2: Effectiveness indicators for AML reporting standards across key sectors for references

The table below summarises the level of suspicions reported, the quality of SARs submitted to law enforcement authorities and awareness levels of AML responsibilities within the private sectors. The number of SARs is based on data from the NCA's 2014 annuals SARs report, whilst the concerns about SAR quality and AML awareness have been taken from the UK Government's national risk assessment.

Table 3: Effectiveness indicators for AML reporting standards across key sectors

Sector	Reporting level	Quality concerns raised**	Awareness levels of reporting responsibility
Financial services*	High	N/A	Mixed ²³
Accountancy	Low	Yes ²⁴	Mixed ²⁵
Legal services	Low	Yes ²⁶	Mixed ²⁷
High-value dealers (Luxury goods bought with cash)	Low	N/A	Low ²⁸
Estate agents	Very low	Yes ²⁹	Low ³⁰
Trust and company service providers	Very low	N/A	Mixed ³¹
Art and auction houses	Very low	N/A	Low ³²

*Not including money service businesses
**Concerns raised over the quality of SARs by law enforcement authorities published in the UK national risk assessment

Even in the financial services sector – with its relatively high levels of SAR reporting – survey evidence indicates that there are persistent problems with compliance and awareness of how to make effective AML decisions.

The Financial Conduct Authority (FCA), and its predecessor the Financial Services Authority (FSA), have conducted in-depth surveys of risks associated with money laundering of the proceeds of corruption. The FSA's 2011 thematic review of banks' management of high money laundering risk situations revealed systemic failings in AML compliance by financial institutions with high-risk customers and Politically Exposed Persons (PEPs). Three quarters of the banks reviewed were not managing AML risk effectively. Over half the banks failed to apply meaningful 'enhanced due diligence' measures in higher risk situations and more than a third of banks failed to put in place effective measures to identify customers as PEPs. Around a third of banks dismissed serious allegations about their customers without adequate review.³³ The FCA's 2014 Anti-Money Laundering Report into small banks found that similar major failings remained in compliance systems.³⁴

²³ <https://www.fca.org.uk/static/documents/corporate/anti-money-laundering-annual-report-13-14.pdf> p.9 [accessed 12 Nov 2015]

²⁴ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.41

²⁵ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.39

²⁶ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.45

²⁷ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.43

²⁸ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.58

²⁹ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.55

³⁰ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.55

³¹ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.52

³² HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.58

³³ http://www.fsa.gov.uk/pubs/other/aml_final_report.pdf [accessed 24 Jun 2015]

³⁴ <https://www.fca.org.uk/news/tr14-16-how-small-banks-manage-money-laundering-and-sanctions-risk> [accessed 24 Jun 2015]

Abuse of the SARs regime

More than 14,000 of the 350,000 SARs filed to the NCA every year are “consent” requests, for transactions believed to be so risky they need to seek prior approval from the authorities.

There is a risk that the SAR system can be ‘gamed’. Corrupt or complicit UK professional enablers can provide some information in a SAR, but not enough for law enforcement agencies to object to or stop a suspicious transaction. The NCA only has 7 days to respond to a consent SAR. If the NCA does not object within 7 days, companies are protected from punishment if the transaction is later found to be criminal. Last year, the Agency refused just over 1,000 of the 14,155 consent SARs received.

The NCA believes that some banks, accountants, law firms and other professional services companies are abusing the system by ‘defensive reporting’ as consent SARs so they can offload due diligence requirements to the NCA and have raised ‘low quality’ SARs as a potential indication of gaming of the system.ⁱ

ⁱ <http://www.ft.com/cms/s/0/8f0a2dee-7039-11e5-ad6d-f4ed76f0900a.html#axzz3rHISjEPL>

4. Analysis of the performance of UK AML supervisors

It is important to evaluate why regulated firms across the relevant sectors are failing to meet an adequate standard.

There are 27 different supervisory bodies or supervisors charged with overseeing the UK's AML regime and ensuring high levels of awareness and compliance amongst firms. In this research, we do not analyse the money service business, insolvency or gambling sectors, and specifically we do not cover the following AML supervisors: the Gambling Commission; the Insolvency Practitioners Association; the Insolvency Service; the Faculty Office of the Archbishop of Canterbury; or the Department of Enterprise, Trade, and Investment Northern Ireland. Our research applies to the remaining 22 supervisors – that collectively cover financial services, legal services, accountancy, estate agents, luxury goods, and trust and company service providers.³⁵

We have found that there are reasons for concern about the effectiveness of the UK's system for supervising and overseeing AML regulations over the sectors covered in this research.

Supervisors are responsible for maintaining awareness of money laundering responsibilities within their sector and should provide clear and consistent signals to firms about the importance of AML measures. They should also support high quality Continuing Professional Development opportunities for firms in their sector.

Effective regulation requires adequately-resourced supervisors who can target their resources where they will have the biggest impact, encourage compliance through voluntary measures where it is possible, and provide a significant set of penalties as a deterrent against non-compliance.

The following key characteristics for effective supervision have been identified by three key independent reviews into effective supervision in the UK:

- The Hampton standard for risk-based regulation
- The Macrory standard for effective and transparent sanctions
- The Clementi principle for avoiding conflicts of interest

In addition, fit and proper tests on the owners of regulated businesses can help ensure those businesses act with honesty and integrity and are able to fulfil their AML obligations.

³⁵ See Annex 2 for a full list of UK AML supervisors

What do Hampton, Macrory and Clementi tell us about the characteristics of effective supervision?

In 2004 the then Chancellor of the Exchequer, Gordon Brown, asked Philip Hampton to lead a review into regulatory inspection and enforcement in the UK. The review's recommendations, known as the Hampton Report, published in March 2005, urged regulators to become more risk-based in their inspection and information requirements; focus greater effort on improving advice and guidance to help businesses that want to comply; and to deal more effectively with persistent offenders.³⁶

Following on from the Hampton Report, in September 2005, the then Chancellor of the Duchy of Lancaster, John Hutton, asked Richard Macrory, a barrister and professor of environmental law, to examine the UK's system of regulatory sanctions. Professor Macrory's report made a number of recommendations about how to deal effectively with non-compliance, including the characteristics of a successful sanctioning regime and how regulators should approach sanctioning.³⁷

In short, achieving effective implementation of regulations and a business environment that meets the standards set out by law requires proportionate and transparent enforcement, and a detailed analysis of risk.

Transparency and accountability are particularly important parts of any regulatory system. Like the police, supervisors should be exposed to public scrutiny about what impact enforcement activities are having, and whether these have improved compliance, or remedied the harm caused by regulatory non-compliance. Relevant regulators must publish the details of all sanctions they impose and the details of their enforcement policy, which is a legal document that explains how they intend to use these sanctions in practice.³⁸

The Clementi principle requires that the same organisation should not be both responsible for professional lobbying on behalf of their sector membership and provide supervision and enforcement actions over their sector. The 2004 Clementi Review led to the creation of the Solicitors Regulation Authority, an independent arm of the Law Society responsible for regulating solicitors in England and Wales.³⁹

Our analysis indicates that a large number of sectors in the UK are not supervised in a manner that is consistent with the standards of effective regulation.

³⁶ The full Hampton Report can be accessed at http://webarchive.nationalarchives.gov.uk/http://www.hm-treasury.gov.uk/budget/budget_05/other_documents/bud_bud05_hampton.cfm [accessed 12 Oct 2015]

³⁷ <http://webarchive.nationalarchives.gov.uk/http://www.bis.gov.uk/policies/better-regulation/reviewing-regulation/improving-compliance-among-businesses> [accessed 13 Oct 2015]

³⁸ <http://www.legislation.gov.uk/ukpga/2008/13/contents> [accessed 13 Oct 2015]

³⁹ <http://webarchive.nationalarchives.gov.uk/http://www.legal-services-review.org.uk/content/report/report-chap.pdf> [accessed 12 Oct 2015]

What does an effective sanctioning regime mean?

Professor Macrory's report, published in November 2006, established Six Penalties Principles, that sanctions should:

1. aim to change the behaviour of the offender
2. aim to eliminate any financial gain or benefit from non-compliance
3. be responsive and consider what is appropriate for the particular offender and regulatory issue, which can include punishment and the public stigma that should be associated with a criminal conviction
4. be proportionate to the nature of the offence and the harm caused
5. aim to restore the harm caused by regulatory non-compliance, where appropriate
6. aim to deter future non-compliance

To achieve this environment, Macrory set out seven characteristics that regulators should meet:

1. publish an enforcement policy
2. measure outcomes not just outputs
3. justify their choice of enforcement actions year on year to stakeholders, Ministers and Parliament
4. follow-up enforcement actions where appropriate
5. enforce in a transparent manner
6. be transparent in the way in which they apply and determine administrative penalties
7. avoid perverse incentives that might influence the choice of sanctioning response

The full Macrory Report can be accessed at:

<http://webarchive.nationalarchives.gov.uk/+/http://www.bis.gov.uk/policies/better-regulation/reviewing-regulation/improving-compliance-among-businesses>

The Hampton test - Multiple supervisors failing to assess risk in their sectors

HM Treasury requires that AML supervisors have a good understanding of what it means to have a risk-based approach. However, in the 2012 to 2013 supervision report by HM Treasury, over half of all supervisors reported that the money laundering and terrorist financing risks do not vary across the firms they supervise.⁴⁰ It is difficult to imagine those respondents had a good understanding of risk-based regulation if they thought all firms under their supervision were of an equal risk, regardless of size, location, commercial focus, historic money laundering performance, or previous compliance history. It is almost inevitable that the lack of appropriate risk assessments will result in the inappropriate supervision of some businesses.

In the 2013-2014 HM Treasury report, no survey of risk awareness was published, and only a diplomatically phrased sentence is available to support public scrutiny of such poor risk awareness: “[the] majority of supervisors also had difficulty articulating how their assessment of risk translates into their monitoring approach, which is a vital step in demonstrating effectiveness.”⁴¹

The national risk assessment confirmed the inadequacies of the supervisors’ risk assessments, stating that “the majority of supervisors also have difficulty in explaining how their assessment of risk translates into the specific monitoring actions they undertake. This could lead to vulnerabilities in the sectors, as supervision may not be sufficiently focussed on those firms presenting the greatest risks”.⁴²

⁴⁰ <https://www.gov.uk/government/publications/anti-money-laundering-and-counter-terrorist-finance-supervision-reports/anti-money-laundering-and-counter-terrorist-finance-supervision-report-2012-13> [accessed 29 Jun 2015]

⁴¹ <https://www.gov.uk/government/publications/anti-money-laundering-and-counter-terrorist-finance-supervision-reports/anti-money-laundering-and-counter-terrorist-finance-supervision-report-2013-14> [accessed 29 Jun 2015]

⁴² HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.30

Falling short of the Macrory characteristics of effective and transparent enforcement

To meet the Macrory characteristics, a supervisor should establish a consistent, credible and transparent system of enforcement and penalties for regulatory non-compliance.

However, this research identifies the following issues across the range of sectors covered by AML supervisors.

1. fragmented AML supervision and inconsistent approaches to enforcement
2. inadequate enforcement overall and an absence of enforcement in many key sectors
3. lack of transparency on the part of AML supervisors

Fragmented AML supervision and inconsistent approaches to enforcement

The national risk assessment states that “the effectiveness of the supervisory regime in the UK is inconsistent. Some supervisors are highly effective in certain areas, but there is room for improvement across the board, including in understanding and applying a risk-based approach to supervision and in providing a credible deterrent.”⁴³

The UK has experimented with a low-cost model of supervision by outsourcing regulatory oversight responsibility to wide range of private sector bodies. This approach, unique to the UK, has led to an environment where standards of supervision vary widely and there is a poor overall understanding of risk. Ineffective supervision, in turn, leads to inadequate compliance with the rules by firms within the sector, low reporting of suspicions and poor quality reporting.

For accountancy alone, there are 14 bodies with regulatory responsibility for money laundering (HMRC and 13 private sector professional bodies).⁴⁴

The fragmented nature of the regime also leads to inconsistency in the resource dedicated to supervision and enforcement. In this research, we focus on the 22 supervisors that represent sectors believed to face the most exposure to the proceeds of corruption – financial services, legal services, accountancy, estate agents, high value dealers, and trust and company service providers.⁴⁵

In 2013, HM Treasury asked AML supervisors to provide more information regarding their enforcement activity, including how they measure that their actions are proportionate, effective, dissuasive and adequately applied. The survey results demonstrated differing approaches by regulators to sanctions. Of the 522 reported enforcement actions taken by private sector accountancy supervisors, 44 per cent were action plans or warning letters and four per cent were fines. In comparison, of the 1,381 reported enforcement actions taken by public sector supervisors (including the FCA and HMRC) 29 per cent were action plans or warning letters and 11 per cent were fines.⁴⁶

⁴³ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.5

⁴⁴ Association of Accounting Technicians (AAT); Association of Chartered Certified Accountants (ACCA); Association of International Accountants (AIA); Association of Taxation Technicians (ATT); Chartered Institute of Management Accountants (CIMA); Chartered Institute of Taxation (CIOT); Institute of Certified Bookkeepers (ICB); Institute of Chartered Accountants in England and Wales (ICAEW); Institute of Chartered Accountants in Ireland (ICAI); Institute of Chartered Accountants of Scotland (ICAS); Institute of Financial Accountants (IFA); International Association of Bookkeepers (IAB); Insolvency Practitioners Association (IPA); HMRC for firms and individuals not supervised by a professional body

⁴⁵ See Annex 2 for a full list of those supervisors

⁴⁶ <https://www.gov.uk/government/publications/anti-money-laundering-and-counter-terrorist-finance-supervision-reports/anti-money-laundering-and-counter-terrorist-finance-supervision-report-2012-13> [accessed 29 Jun 2015]

HM Treasury's 2014 report suggested that the accountancy sector has a relatively lenient enforcement regime. Only 12 per cent of enforcement action undertaken by private sector accountancy regulators resulted in expulsion or a fine compared to 88 per cent of action by public sector supervisors and 66 per cent of enforcement action in the legal sector.⁴⁷ 50 fines were issued in total by the 13 (non-HMRC) accountancy sector supervisors during 2013 to 2014.⁴⁸ However, there is no data on the value of fines that accountancy supervisors have issued or regarding which accountancy supervisors were responsible for the enforcement action. This lack of transparency on the part of those supervisors is, in itself, a direct breach of the Macrory principles for an effective sanctioning regime.

As an additional example of the varying level of seriousness that certain supervisors attach to their enforcement duties, five of them did not even submit a response to the HM Treasury annual review of AML supervisory performance for 2013 to 2014. These were the General Council of the Bar of Northern Ireland, The Faculty Office of the Archbishop of Canterbury, the Department of Enterprise, Trade, and Investment Northern Ireland, the Insolvency Practitioners Association and the Institute of Financial Accountants.⁴⁹

International comparison

The UK's approach of allocating AML supervision responsibility to 27 different entities, with the majority being private sector professional bodies, stands in stark contrast to the approach taken by comparable jurisdictions.

In New Zealand, there are three statutory supervisors responsible for the AML supervision of firms, The Reserve Bank of New Zealand, the Financial Markets Authority and the Department of Internal Affairs. All three supervisors are active in publishing guidance and sector risk assessments.ⁱ

Canada, Australia and Spain all have one central AML supervisor.

The Financial Action Task Force (FATF) – the global standard setter on AML rules – has identified the benefits of having a consolidated supervisory approach. For example, it has concluded that the system for supervising AML compliance in Spain is “strong” due to its unitary AML supervisor, which is able to take a “sophisticated approach to risk analysis”.ⁱⁱ

ⁱ <http://www.fatf-gafi.org/media/fatf/documents/reports/mer/FUR-New-Zealand-2013.pdf>

ⁱⁱ <http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/Mutual-Evaluation-Report-Spain-2014.pdf>

⁴⁷ <https://www.gov.uk/government/publications/anti-money-laundering-and-counter-terrorist-finance-supervision-reports/anti-money-laundering-and-counter-terrorist-finance-supervision-report-2013-14> [accessed 29 Jun 2015]

⁴⁸ <https://www.gov.uk/government/publications/anti-money-laundering-and-counter-terrorist-finance-supervision-reports/anti-money-laundering-and-counter-terrorist-finance-supervision-report-2013-14> [accessed 29 Jun 2015]

⁴⁹ <https://www.gov.uk/government/publications/anti-money-laundering-and-counter-terrorist-finance-supervision-reports/anti-money-laundering-and-counter-terrorist-finance-supervision-report-2013-14#analysis> [accessed 29 Jun 2015]

Inadequate enforcement overall, and an absence of enforcement in many key sectors

The level of enforcement and punitive fines by AML supervisors in the UK is generally low relative to the scale of money laundering passing through the UK, and is not likely to have a deterrent effect on money laundering through the UK.

In banking, the average annual level of AML punitive enforcement fines in response to serious breaches of money laundering standards has been approximately £8m.⁵⁰ However, according to law enforcement authorities “hundreds of billions” is laundered through the UK every year.⁵¹ Compared to the overall scale of expected money laundering in the UK and the profits made by financial services firms from this money, it remains questionable whether the level of fines levied currently has a sufficient deterrent effect.

In many sectors, it is difficult to assess the level of enforcement due to a lack of transparency. For example, HMRC has refused to disclose the level of penalties issued in the various sectors it regulates and has only released details on the total value of fines issued, across all the sectors it supervises. In 2014-15, this amounted to £768,000.⁵² This figure is spread over a total of 677 penalties, equating to just over £1100 per penalty. Considering HMRC is responsible for supervising seven different sectors, including estate agents where at least £180 million worth of property has been brought under criminal investigation as the suspected proceeds of corruption⁵³, it is unlikely this figure will have a deterrent effect.

Personal liability

One of the key issues why enforcement action is not ‘behaviour changing’ is that across all AML supervision there is a weak system of personal liability placed on regulated entities for money laundering failings. The UK’s Parliamentary Commission into Banking Standards concluded that a lack of personal consequences for individuals was a principal cause of repeated misconduct by financial institutions.⁵⁴ Until recently, it was expected that the FCA would adopt a new ‘Senior Managers Regime’ with a presumption of responsibility on relevant senior managers. Under these proposals, if money laundering had taken place, senior managers allocated with AML responsibilities would have been required to prove that they had taken reasonable steps to prevent it from happening.⁵⁵ However, reportedly due to heavy lobbying by the banking sector, the UK Government has removed the requirement for a presumption or responsibility from current draft legislation due to be put forward by HM Treasury.⁵⁶

The UK’s lack of credible enforcement deterrent allows businesses who fail to comply with the rules to gain an unfair advantage over businesses who have invested in systems and resources to address money laundering risks.

⁵⁰ TI-UK calculation from Financial Conduct Authority data and multiple FCA websites

⁵¹ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.32

⁵² <http://www.parliament.uk/business/publications/written-questions-answers-statements/written-question/Commons/2015-10-21/12787/> [accessed 12 Nov 2015]

⁵³ Transparency International UK “Corruption on Your Doorstep” (March 2015)

⁵⁴ <http://www.parliament.uk/business/committees/committees-a-z/joint-select/professional-standards-in-the-banking-industry/news/changing-banking-for-good-report/> [accessed 12 Nov 2015]

⁵⁵ <https://www.globalwitness.org/blog/uks-new-regime-hold-senior-bankers-accountable-helping-corrupt-could-be-game-changer/> [accessed 12 Nov 2015]

⁵⁶ <http://uk.reuters.com/article/2015/10/15/uk-britain-banks-idUKKCN0S82V320151015> [accessed 12 Nov 2015]

Lack of transparency on the part of AML supervisors

Since November 2011, HM Treasury has invested in cross-sector surveys of money laundering supervisors' performance. While the surveys represent a welcome improvement on understanding across the 27 money laundering supervisors in the UK, the information and statistics within the public report are grouped together in such a way that makes it impossible to assess the activities of individual supervisors.⁵⁷ For example, it is not possible to ascertain the level of fines or other types of enforcement action an individual supervisor has issued, or how many desk based reviews or compliance visits they have carried out. To be able to evaluate individual supervisors, it is essential that information about supervisory activity be in the public domain.

TI-UK submitted a Freedom of Information request to HM Treasury in June 2015 requesting individual AML supervisors' annual reports be released. After more than three months, we received a response but it provided no information on specific supervisory or enforcement activity. HM Treasury claimed that releasing the information would likely prejudice the 'commercial interests' of the supervisors and could assist money laundering.

In a UK Government review of national supervisors in 2015, HMRC, in its capacity as an AML supervisor, refused to release information on its budget for supervision, the number of staff responsible for regulatory activity, the number of entities regulated or details on regulatory activity.⁵⁸ HMRC has also refused to disclose information to Parliament on the level of penalties it has issued to the sectors it supervises.⁵⁹

However, numerous reports have concluded that transparency and accountability are fundamental components to an effective supervisory regime. The Macrory report explains the reasons why supervisors need to be transparent:

“Transparency is something that the regulator must provide to external stakeholders, including both industry and the public, so they have an opportunity to be informed of their rights and responsibilities and of enforcement activity. However, it is also important for the regulator itself, to help ensure they use their sanctioning powers in a proportionate and risk based way.”⁶⁰

The lack of transparency in the AML supervisory regime severely hampers its effectiveness, and the ability of the public and supervised businesses to scrutinise the regime and individual supervisors.

⁵⁷ <https://www.gov.uk/government/publications/anti-money-laundering-and-counter-terrorist-finance-supervision-reports> [accessed 29 Jun 2015]

⁵⁸ <http://discuss.bis.gov.uk/focusonenforcement/regulator-data-201213/> [accessed 12 Nov 2015]

⁵⁹ <http://www.parliament.uk/business/publications/written-questions-answers-statements/written-question/Commons/2015-10-21/12787/> [accessed 12 Nov 2015]

⁶⁰ <http://webarchive.nationalarchives.gov.uk/20121212135622/http://www.bis.gov.uk/files/file44593.pdf> [accessed 12 Nov 2015]

Table 4 - Evaluation of key sectors against Macrory key components of effective regulatory sanctions

		Macrory key components	
Sector	Supervisor	Enforcement levels	Level of supervisor transparency
Financial services	FCA	Moderate	High
Legal services	Multiple	Unknown	Moderate
Accountancy	Multiple	Unknown	Low
Property	HMRC	Low	Low
Luxury Goods	HMRC	Low	Low
Art and auction houses	HMRC	Low	Low
Trust and company service providers	HMRC	Low	Low

According to our analysis in this research, detailed in the sector-by-sector sections below, out of 22 supervisors assessed as relevant to the proceeds of corruption, only the FCA has above a 'low' or 'unreported' level of enforcement of AML regulations. 20 out of 22 supervisors fail to meet the standard of enforcement transparency demanded by the Macrory characteristics.

Failing the Clementi principle - A large number of private sector AML supervisors that are conflicted with lobbying interests

In 2004, the Clementi Review established the principle that organisations should not be both lobbyists and supervisors.⁶¹ The review led to the creation of the Solicitors Regulation Authority (SRA), an independent arm of the Law society responsible for regulating solicitors in England and Wales. However, the other Scottish and Northern Irish AML supervisors for the legal sector and all but one of the 13 private sector accountancy supervisors have not followed this principle. This can cause inconsistencies for businesses. For example, unlike in England and Wales, a solicitor in Scotland or Northern Ireland will not be subject to independent AML supervision from their promotional and educational professional body.

The national risk assessment identified that almost all of the private sector supervisors are also lobby groups for the sectors that they supervise and funded by the firms that they are obliged to investigate. This leads to problematic situations in practice where regulatory improvements that were developed by public sector supervisors, such as the FCA, can be subject to oppositional lobbying from private sector AML supervisors.⁶² There is no independent AML enforcement authority for the accountancy sector. Instead, the wide range of accountancy institutes claim responsibility over their own membership groups, whilst also being responsible for promoting, lobbying and championing their sector.

⁶¹ <http://webarchive.nationalarchives.gov.uk/+/http://www.legal-services-review.org.uk/content/report/report-chap.pdf> [accessed 12 Nov 2015]

⁶² <http://economia.icaew.com/news/october-2015/business-welcomes-changes-to-smr> [accessed 12 Nov 2015]

Table 5 - full list of supervisors and whether they meet or fail the Clementi principle of separating conflicts of interest

Supervisor	Sector Responsibility	Compliance with the Clementi principle
Association of Accounting Technicians (AAT)	Accountants	Failed
Association of Chartered Certified Accountants (ACCA)	Accountants	Failed
Association of International Accountants (AIA)	Accountants	Failed
Association of Taxation Technicians (ATT)	Tax advisers	Failed
Chartered Institute of Management Accountants (CIMA)	Accountants	Failed
Chartered Institute of Legal Executives (CILEX) regulating through an arms length body called 'CILEX Regulation'	Legal executives	Met
Chartered Institute of Taxation (CIOT)	Tax advisers	Failed
Council for Licensed Conveyancers (CLC)	Licensed Conveyancers	Met
Faculty of Advocates (Scottish bar association) (FoA)	Barristers in Scotland	Failed
Financial Conduct Authority (FCA)	Credit and financial institutions	Met
General Council of the Bar (England and Wales) (GCBEW) regulating through the Bar Standards Board	Barristers in England and Wales	Met
General Council of the Bar of Northern Ireland (GCBNI)	Barristers in Northern Ireland	Failed
HM Revenue & Customs (HMRC)	<ul style="list-style-type: none"> • Money Service Businesses • Bill Payment Service Providers • Telecommunication, digital and IT Payment Service Providers • Trust and Company Service Providers • Estate Agency Businesses • High Value Dealers • Accountancy Service Providers (for those not registered with a professional body) 	Met
Institute of Certified Bookkeepers (ICB)	Bookkeepers	Failed
Institute of Chartered Accountants in England and Wales (ICAEW)	Accountants in England and Wales	Failed
Institute of Chartered Accountants in Ireland (ICAI) regulating through the Chartered Accountants Regulatory Board in Ireland	Accountants in Northern Ireland	Met
Institute of Chartered Accountants of Scotland (ICAS)	Accountants in Scotland	Failed
Institute of Financial Accountants (IFA)	Accountants	Failed
International Association of Bookkeepers (IAB)	Bookkeepers	Failed
Law Society of England and Wales (LSEW) regulating through the Solicitors Regulation Authority (SRA)	Solicitors and Solicitor firms in England and Wales	Met
Law Society of Northern Ireland (LSNI)	Solicitors and Solicitor firms in Northern Ireland	Failed
Law Society of Scotland (LSS)	Solicitors and Solicitor firms in Scotland	Failed

The table above illustrates how AML supervisors compare against the Clementi principle of avoiding conflicts of interest between enforcement and promotional responsibilities. Only seven out of 22 AML supervisors comply with this principle. As a result, 73 per cent of the supervisors we have analysed hold institutional conflicts of interest.

Fit and proper tests

Several regulated sectors require individuals to be subject to a ‘fit and proper’ test prior to running a business, in order to ensure businesses act with honesty and integrity and are able to fulfil their AML obligations.

However, the use of fit and proper tests is inconsistent across the different regulated sectors.

Table 6 – Fit and proper tests across the regulated sectors

Sector	Supervisor	Fit and proper test
Financial service providers	FCA	Yes ⁶³
Legal service providers	Multiple	SRA - Yes ⁶⁴
		Professional body requirements - Yes ⁶⁵
Accountancy service providers	Multiple	HMRC – No
		Professional body requirements - Yes ⁶⁶
Estate agents	HMRC	No ⁶⁷
High value dealers (covering luxury goods retailers and art and auction houses)	HMRC	No ⁶⁸
Trust and company service providers	HMRC	Yes ⁶⁹

According to the national risk assessment, HMRC does not operate a fit and proper tests for estate agents or high value dealers as the regulations do not provide them with the legal powers to do so.⁷⁰

Nevertheless, the assessment identifies the lack of a fit and proper test for estate agents as a key vulnerability⁷¹ and HMRC has argued the absence of a fit and proper test for high value dealers creates a low barrier to entry and therefore a potential vulnerability in the sector.⁷²

In respect of the professional body requirements required by private sector supervisors, the Government has admitted it is unclear as to the adequacy of those tests.⁷³

⁶³ <https://www.fca.org.uk/static/documents/factsheets/fs029-becoming-an-approved-person.pdf> [accessed 12 Nov 2015]

⁶⁴ <http://www.sra.org.uk/solicitors/handbook/suitabilitytest/part1/content.page> [accessed 12 Nov 2015]

⁶⁵ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.30

⁶⁶ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.40

⁶⁷ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.55

⁶⁸ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.59

⁶⁹ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.51

⁷⁰ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.30

⁷¹ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.54

⁷² HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.59

⁷³ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.30

5. Law enforcement barriers to responding to SARs

The national risk assessment states that “international corruption cases involving millions of pounds of assets in the UK are currently under investigation, with alleged predicate offending in Africa, the Middle East and Eastern Europe, and involving financial flows that span the globe”.⁷⁴ Whilst positive action is being taken, the amount under investigation is very small in comparison to the “billions of pounds” of corrupt money that the NCA assesses as coming into the UK each year. There are also clear geographic limitations to the current investigations.

Even when the private sector does successfully identify and report suspicions to law enforcement authorities, there are additional major barriers to effective action in response to the SARs.

The reasons for the lack of law enforcement investigations have several strands. They include:

A general reliance on cooperation from the jurisdiction of original corruption. The UK has typically not pursued cases where the origin state is hostile to the corruption allegation. The UK’s modus operandi for tackling the proceeds of corruption is largely one of being unable to act against the proceeds of corruption until there is a cooperative jurisdiction in the country of original corruption, or, in absence of that, waiting until there is a revolution. At the point of revolution – for example in the case of the Arab Spring and Ukraine – a large amount of UK law enforcement and government activity is put towards supporting corruption investigations in those countries.

Geographic limitations of policing investigations of international corruption. The UK International Corruption Unit within the National Crime Agency is predominantly funded by the UK Department for International Development (DFID), as was its predecessor law enforcement units in the Metropolitan Police Service and the City of London Police. Investigations, therefore, have been focused on DFID priority countries that are in receipt of UK development spending.

Lack of confidence in the integrity and accountability of systems in the origin country to receive recovered assets. There is also a risk that asset recovery from the UK may in some way be compromised by corruption once the assets are recovered and repatriated, which could undermine political support for the recovery of corrupt assets to high-risk jurisdictions more generally.

A very short timeframe for responding to reports of money laundering. The UK’s present system for reporting money laundering gives investigators seven days within which to refuse consent to a suspicious financial transaction. If law enforcement agencies refuse consent, they have a period of 31 days to obtain a court order to freeze the account by meeting a legal threshold of establishing that there is ‘a reasonable cause to suspect’ that the account contains the proceeds of crime. This timeframe provides insufficient time in which to investigate complex corruption cases, with international requests for information and potentially requiring law enforcement agencies to prove a corrupt criminal act in the origin country. Unless there is

⁷⁴ <http://www.nationalcrimeagency.gov.uk/publications/560-national-strategic-assessment-of-serious-and-organised-crime-2015/file> p.3 [accessed 15 Oct 2015]

compelling evidence for a case already contained within a report, or it relates directly to a case being brought to prosecution, then it is highly likely that no objection will be raised to the suspicious transaction.

Law enforcement authorities are affected by poor compliance rates and supervision standards for private sector AML in the UK, as they are reliant on the private sector reporting money laundering suspicions. However, in addition, the above policy and legislative issues reduce the effectiveness of the UK's policing of international corruption.

6. Sector by sector review of risks

In the following section, we look into detail in the key regulated sectors relevant to laundering the proceeds of corruption:

- financial services
- legal services
- accountancy
- trust and company service providers
- property
- luxury goods
- art and auction houses
- investor visas

We evaluate each sector to describe the:

- framework for AML supervision
- AML risks identified in the sector relevant to corrupt capital
- extent of known regulatory sanctions and enforcement
- detail behind the level of enforcement transparency
- public reporting of risks by the supervisors
- suspicious activity reporting from the sector

The financial sector

Summary table of supervision

AML supervisors	The Financial Conduct Authority ⁷⁵
Number of firms supervised	Approximately 73,000 firms
Fit and proper test of supervised population	Yes ⁷⁶
AML level of enforcement (annual)	Moderate. Annual average of £8.05m in punitive fines across 3 years (2012-2014)
AML level of public reporting and understanding of ML threat	High: <ul style="list-style-type: none"> • annual report detailing AML supervisory activity • major thematic reviews, surveying AML risk • regularly updated financial crime guide
SARs	High: The sector dominates SAR reporting compared to other sectors– 320,851 reports [October 2013 to September 2014] (90.59 per cent of total)
Major compliance issues in the sector	<ul style="list-style-type: none"> • poor identification, monitoring and management of high risk customers and those who are PEPs, particularly in relation to establishing the source of wealth and source of funds for PEPs • inadequate due diligence on correspondent banks • poor judgements or questionable decisions leading the firm to take on unacceptable money laundering risk

Overview

SAR reporting is strongest in the financial sector, particularly banking, and significant sanctions have been levied in response to money laundering failings. Transparency of sanctioning and supervision by the FCA is also the strongest out of all UK AML supervisors. However, there are still reasons for concerns that illicit flows from the proceeds of corruption, including from PEPs and high net worth individuals, may not be effectively identified through the sector.

“There are significant intelligence gaps in relation to the role of banks in ‘high-end’ money laundering.” – UK national risk assessment of money laundering and terrorist financing⁷⁷

The national risk assessment identified banks as the highest risk sector in the UK in terms of overall vulnerability to money laundering.⁷⁸ The UK financial system faces large risks associated to the laundering of the international proceeds of corruption. This is in part due to the sheer scale of foreign investment flowing through the UK and the amount of international financial transactions carried out through the country. London has been classed as the world’s leading

⁷⁵ Not including HMRC which oversees Money Service Businesses

⁷⁶ <https://www.fca.org.uk/static/documents/factsheets/fs029-becoming-an-approved-person.pdf> [accessed 12 Nov 2015]

⁷⁷ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.32

⁷⁸ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.32

financial centre and it is highly internationalised.⁷⁹ As of June 2014, there were over 250 foreign bank branches based in the UK and £2 trillion worth of assets managed in the UK for foreign clients.⁸⁰ This is larger than the entire UK GDP in 2014.⁸¹

AML risks identified in the sector

The FCA has conducted several recent thematic in-depth surveys of risks associated with money laundering of the proceeds of corruption. These have included a review by the precursor to the FCA, the FSA, into banks' management of high money laundering risk situations in 2011; a review of the anti-money laundering, anti-bribery and corruption systems and controls in asset management and platform firms by the FCA in 2013; and a review of how small banks manage money laundering and sanctions risks in 2014.

The FSA's 2011 thematic review of banks' management of high money laundering risk situations revealed systemic failings in AML compliance by financial institutions with PEP and other high-risk customers. The report found that three quarters of the banks reviewed, including a number of major banks, were not managing AML risk effectively. Over half banks failed to apply meaningful enhanced due diligence measures in higher risk situations and more than a third of banks failed to put in place effective measures to identify customers as PEPs. Around a third of banks dismissed serious allegations about their customers without adequate review.⁸²

In 2014, the FCA highlighted continuing AML weaknesses in a number of firms, including:

- inadequate governance and oversight of money laundering risk
- inadequate risk assessment processes to identify high risk customers
- poor management of high risk customers and those who are PEPs, particularly in relation to establishing the source of wealth for PEPs
- inadequate due diligence on correspondent banks
- inadequate or poorly calibrated AML and sanctions related IT systems
- weaknesses in handling of alerts relating to sanctions and/or transaction monitoring
- poor judgements or questionable decisions leading the firm to take on unacceptable money laundering risk⁸³

The main threats and vulnerabilities identified in the national risk assessment include:

- criminals using the banking sector to move and store the proceeds of crime
- proceeds of corruption being moved through the banking sector
- systemic failings in banks AML control frameworks, as identified by the FCA, mean products and services without adequate controls can facilitate money laundering and terrorist financing⁸⁴

⁷⁹ http://www.longfinance.net/images/GFCI18_23Sep2015.pdf [accessed 23 Sep 2015]

⁸⁰ CityUK, Key facts about the UK as an international financial centre (June 2014)

⁸¹ <http://data.worldbank.org/country/united-kingdom> [accessed 12 Nov 2015]

⁸² http://www.fsa.gov.uk/pubs/other/aml_final_report.pdf [accessed 24 Jun 2015]

⁸³ <https://www.fca.org.uk/static/documents/corporate/anti-money-laundering-annual-report-13-14.pdf> [accessed 24 Jun 2015]

⁸⁴ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.32

Regulatory sanctions

The FCA has investigation and sanctioning powers in relation to both criminal and civil breaches of the Money Laundering Regulations 2007. When dealing with AML failings, the FCA can:

- prosecute authorised firms and other designated financial institutions
- impose civil penalties on authorised firms and other designated financial institutions under regulation 42 of the money laundering regulations
- take regulatory action against authorised firms for failures which breach the FCA's rules and requirements.⁸⁵

The FCA follows a 'credible deterrence' strategy, committing to take tough and meaningful action against the firms and individuals who break the rules.⁸⁶ In 2014, almost £8m of fines were issued for AML failings. These fines were dominated by a £7.6m fine to Standard Bank PLC. Standard Bank is the UK subsidiary of Standard Bank Group, South Africa's largest banking group. Standard Bank Group is an international banking group with extensive operations in 18 African countries and 13 other countries outside of Africa. The FCA found that Standard Bank did not consistently carry out adequate due diligence measures before establishing business relationships with corporate customers that had connections with PEPs, or monitor those relationships for risk. This was the first AML case to use the FCA's new penalty regime, which applies to breaches committed from 6 March 2010, under which larger fines are expected for failings.⁸⁷ In 2013, the FCA issued £6.6m worth of fines for AML breaches, including a £4.2m fine for EFG Private Bank. The fine for EFG Private Bank, which claims to provide a "gateway to the UK financial system for ... high net worth international customers", was for failing to identify or monitor serious corruption and PEP risks over a three year period.⁸⁸

However, fines against banks for AML breaches in the UK pale in comparison to enforcement against banks in the US. For example, HSBC settled a money laundering and sanctions probe by American authorities for US\$1.9bn in December 2012.⁸⁹ In September 2014, Standard Chartered agreed to US\$300m in fines for violating AML rules.⁹⁰

Compared to the overall scale of expected money laundering in the UK and the profits made by financial services firms from this money, it remains highly doubtful whether the level of AML fines levied by the FCA currently has a sufficient deterrent effect on complicit and corrupted financial service providers.

A report by the British Bankers' Association has called for the FCA to be stripped of its enforcement powers.⁹¹ However, the BBA has only provided limited evidence supporting the recommendation. This recommendation sits at odds with the 2014 UK Government review of the FCA's enforcement powers, which concluded that any tensions between the roles of supervisors and enforcement staff are best resolved where those staff are situated in the same

⁸⁵ https://www.handbook.fca.org.uk/handbook/document/EG_Full_20141212.pdf p.111 [accessed 24 Jun 2015]

⁸⁶ <https://www.fca.org.uk/static/documents/corporate/business-plan-2015-16.pdf> p.65 [accessed 4 Aug 2015]

⁸⁷ <http://www.fca.org.uk/news/standard-bank-plc-fined-for-failures-in-its-antimoney-laundering-controls> [accessed 24 Jun 2015]

⁸⁸ <http://www.fca.org.uk/your-fca/documents/final-notice/2013/fsa-final-notice-2013-efg-private-bank-ltd> [accessed 24 Jun 2015]

⁸⁹ <http://www.economist.com/blogs/graphicdetail/2012/12/focus-1> [accessed 24 Jun 2015]

⁹⁰ <http://blogs.reuters.com/financial-regulatory-forum/2014/09/09/standard-chartered-aml-lapses-provide-crucial-lessons-on-internal-controls/> [accessed 24 Jun 2015]

⁹¹ https://www.bba.org.uk/news/press-releases/bba-warns-of-threat-to-uk-competitiveness/?utm_source=bbahomepage&utm_medium=banner&utm_campaign=Winningtheglobalrace#.VkoNQHbhC00 [accessed 15 Nov 2015]

organisation with a clear, unitary set of organisational objectives and priorities. The report stated, “there are clear advantages to locating the supervisory and enforcement functions within the same organisation, and sharing the same priorities. Supervisors will be the first to identify behavioural trends or recurring issues, in a particular sector, which lead to risks. Those risks can then inform strategic priorities; and, potentially, addressing those risks may call for enforcement action as a public deterrent to others in the industry. Therefore, co-ordination is key, if the regulator is to respond quickly and proactively to emerging risks.”⁹²

Enforcement transparency and public reporting of risks by the supervisor

The FCA provides the benchmark in the UK AML regime for transparency over its enforcement and sanctions regime and produces a large amount of analysis on the AML threat and compliance risks in the sector.

The FCA issues an annual report which includes information on AML and financial crime supervisory activity. The 2013/14 report did highlight some positive changes in the sector. The FCA believes that particularly large banks now recognise AML as an issue requiring senior management attention and a strong ‘tone from the top’. Private banks and wealth management firms are generally performing better on AML issues than retail and wholesale banks.

In 2012, the FCA launched a programme entitled the ‘Systematic AML Programme’, which provides for ‘deep dive’ AML assessments of 14 major retail and investment banks operating in the UK. The FCA also engages in early intervention in weak institutions with regard to AML performance. The approach often involves restricting a firm’s business until weaknesses in controls are corrected and does not prevent the FCA taking enforcement action later. In 2012/13 the FCA intervened with four banks in this way, one of which has also been referred for enforcement action.⁹³

The FCA also publishes a risk outlook, now within its business plan. In the most recent business plan it declared “during 2015/16 we will continue to focus on both anti-money laundering (including terrorist financing and sanctions) and anti-bribery and corruption measures, as these are the areas in which we consider we can deliver the most value”.⁹⁴

As part of its supervisory and enforcement regime, the FCA actively supports whistleblowers, stating in its business plan “after seeing an increase in the number of whistleblowers who contacted us in 2014/15, and in the quality of information they gave us, we will continue our work on whistleblowing and will embed better arrangements and support for whistleblowers in the coming year”.⁹⁵ In October 2015, the FCA published new rules on whistleblowing which further strengthen whistleblower protections for those working for FCA authorised firms.⁹⁶

Finally, the FCA has developed its ‘Senior Managers Regime’ which will place greater personal responsibility on individuals within a firm’s management.⁹⁷ In particular, firms will need to allocate a senior manager responsible for the firm’s policies and procedures for countering the risk that the firm might be used to further financial crime, including money laundering. However, the

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https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/389063/enforcement_review_response_final.pdf [accessed 15 Nov 2015]

⁹³ www.fca.org.uk/static/documents/anti-money-laundering-report.pdf [accessed 24 Jun 2015]

⁹⁴ <http://www.fca.org.uk/static/channel-page/business-plan/business-plan-2015-16.html> [accessed 24 Jun 2014]

⁹⁵ <http://www.fca.org.uk/static/channel-page/business-plan/business-plan-2015-16.html> [accessed 24 Jun 2014]

⁹⁶ <http://www.fca.org.uk/news/fca-introduces-new-rules-on-whistleblowing> [accessed 12 Nov 2015]

⁹⁷ <https://www.fca.org.uk/firms/being-regulated/improving-individual-accountability> [accessed 04 Aug 2015]

Government has recently watered down the proposals and has removed the 'presumption of responsibility' of senior managers. This would have meant that if a firm breached the FCA's rules, the relevant senior manager could have been fined unless they satisfied the FCA that they took reasonable steps to avoid the breach. If legislation, as currently drafted at the time of this report is enacted, it will be up to the FCA to prove that such steps were not followed. This is despite the fact the FCA confirmed the presumption of responsibility would have been an important tool to establish high levels of compliance with AML standards.⁹⁸

Suspicious activity reporting from the sector

It is unsurprising that the financial sector submits the highest proportion of SARs considering the FCA's enforcement and communication on the issues of AML compliance and the length of time banks have been subject to AML controls compared to other sectors. Financial institutions, regulated by the FCA, account for 90.59 per cent of all SARs submitted to law enforcement authorities, with the lion's share of reporting being carried out by banks.

⁹⁸ <http://www.theguardian.com/business/2015/oct/15/financial-accountability-regime-will-not-be-fully-operational-until-2018> [accessed 12 Nov 2015]

The legal sector

Summary table of supervision

AML supervisors	Solicitors Regulation Authority (SRA) and 8 other legal services supervisors ⁹⁹
Number of firms/individuals supervised	12,000 firms and 150,000 individuals ¹⁰⁰
Fit and proper test of supervised population	SRA – Yes ¹⁰¹ Professional body supervisors – professional body tests ¹⁰²
AML level of enforcement	Unknown aggregate value of fines: The following sanctions in the legal sector were identified for AML breaches: ¹⁰³ <ul style="list-style-type: none"> • expulsion/withdrawal of membership: 65 • suspension: 26 • fine: 61 • undertaking/condition: 29 • reprimand: 8
AML level of public reporting and understanding of ML threat	Moderate: The SRA do not publish an annual money laundering report or details on any AML enforcement cases. However, they have published specific risk papers, an annual Risk Outlook report, alerts and thematic papers. In addition, various Law Societies in the UK publish guidance notes to AML practitioners. Gaps in information relate to the level of enforcement and specific details of enforcement. The level of enforcement transparency and public reporting of compliance weaknesses in the remaining six supervisors is low to negligible.
SARs	Low. October 2013 to September 2014 - 3,610 (1.02 per cent)
Major compliance issues in the sector	The SRA identifies the following key AML compliance risk in the legal sector: <ul style="list-style-type: none"> • failure to conduct appropriate identity checks • failure to conduct due diligence on source of funds and beneficial owner • infiltration of law firms by corrupt actors

Overview

Legal professionals are considered members of the ‘gatekeeper’ services that facilitate the spending of wealth in the UK economy. Legal representatives often act as advisers and enablers for the distribution of funds for high net worth individuals and PEPs. Existing regulations are intended to ensure that such gatekeepers conduct checks on the sources of this wealth and minimise or prevent the infiltration of money sourced from corruption or other illegal means into the UK.

⁹⁹ The General Council of the Bar (England and Wales) (GCBEW), the Faculty of Advocates (Scottish Bar association) (FoA), the General Council of the Bar of Northern Ireland (GCBNI), the Law Society of Northern Ireland (LSNI), the Law Society of Scotland (LSS), Council for Licensed Conveyancers (CLC), the Faculty Office of the Archbishop of Canterbury (FOAC) and the Chartered Institute of Legal Executives (CILEx)

¹⁰⁰ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) .p.42

¹⁰¹ <http://www.sra.org.uk/solicitors/handbook/suitabilitytest/part1/content.page> [accessed 12 Nov 2015]

¹⁰² HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.30

¹⁰³ <https://www.gov.uk/government/publications/anti-money-laundering-and-counter-terrorist-finance-supervision-reports/anti-money-laundering-and-counter-terrorist-finance-supervision-report-2013-14> [accessed 24 Jun 2015]

The national risk assessment identified legal service providers as a high-risk sector in terms of money laundering¹⁰⁴ and the NCA has identified the risk of legal professionals facilitating the laundering of the proceeds of crime, arguing that:

“Criminally complicit solicitors can effectively act as private banks to individual clients. Client accounts offer criminals relative anonymity, the ability to obscure the origins and beneficiaries of criminal proceeds, and the perceived protection of legal privilege”.¹⁰⁵

Devereux Chambers barrister Jonathan Fisher QC summed up the range of behaviour that can be found in the UK legal sector:

“Some [solicitors] turn a blind eye to AML... in particular the rainmakers who are out there getting business. Others are careless, a few are stupid and even fewer are dishonest.”¹⁰⁶

AML risks identified in the sector

The Financial Action Task Force (FATF) has highlighted the risk presented by gatekeepers whose “skills are important in creating legal structures that could be used to launder money and for their ability to manage and perform transactions efficiently and to avoid detection”.¹⁰⁷

FATF has identified several ways that law firms are used to launder money including the misuse of the client financial account, property purchases, the creation and management of companies and trusts, managing client affairs, making introductions and litigation.¹⁰⁸

The UK’s main supervisor in this sector, the SRA, has identified the following risks for AML compliance in the sector:

- the large sums of money handled confidentially by legal services firms
- the harm that money laundering causes to the public interest
- the potential for damage to public confidence in legal services
- ongoing cases showing serious failings in firms’ management of this risk
- the increasing number of reports the SRA receives relating to money laundering risk
- growing evidence that firms do not recognise the likelihood of this risk affecting them

With specific failings within firms including:

- failure to conduct appropriate identity checks
- failure to conduct due diligence on source of funds and the beneficial owner
- infiltration of law firms¹⁰⁹

¹⁰⁴ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.31

¹⁰⁵ <http://www.nationalcrimeagency.gov.uk/publications/560-national-strategic-assessment-of-serious-and-organised-crime-2015/file> p.22 [accessed 10 Jul 2015]

¹⁰⁶ <http://www.lawgazette.co.uk/news/solicitors-prickly-economic-crime-chief/5045241.fullarticle> [accessed 24 Jun 2015]

¹⁰⁷ <http://www.fatf-gafi.org/media/fatf/documents/reports/Laundering%20the%20Proceeds%20of%20Corruption.pdf> [accessed 24 Jun 2015]

¹⁰⁸ <http://www.fatf-gafi.org/media/fatf/documents/reports/ML%20and%20TF%20vulnerabilities%20legal%20professionals.pdf> [accessed 24 Jun 2015]

¹⁰⁹ <http://www.sra.org.uk/risk/resources/risk-money-laundering.page> [accessed 24 Jun 2015]

The national risk assessment identified the following sector-wide threats and vulnerabilities:

- complicit legal professionals facilitating money laundering
- levels of compliance with the regulations and criminal law are viewed as mixed
- criminals use of legal professionals to secure property with criminal proceeds
- abuse of client accounts facilitated by complicit or negligent professionals
- challenges in supervision, especially in relation to small firms and sole proprietors¹¹⁰

Recent media reporting has suggested several law firms are currently being investigated for severe money laundering offences, although the details are yet to be disclosed.¹¹¹ A number of money laundering reporting officers (MLROs) are reported by the SRA to be appointed by legal firms on an ad hoc basis, without appointees necessarily having regulatory or AML expertise. In one case cited, a MLRO was an 18-year-old son of a partner of the firm. In another case, the MLRO was a 'low grade' part-time employee.¹¹²

“We are seeing some very, very extreme cases... These cases will be genuinely shocking to the vast majority of the profession” – Sam Palmer, manager of regulatory management at the SRA.¹¹³

Regulatory structure and sanctions regime

The SRA was established in 2007 and replaced the Law Society Regulatory Board. It is charged with setting standards, regulating solicitors and protecting consumers of legal services in England and Wales. It is responsible for regulating the professional conduct of more than 130,000 solicitors and other authorised individuals at more than 10,000 firms, as well as those working in-house at private and public sector organisations.¹¹⁴

However, in addition, the General Council of the Bar (England and Wales) (GCBEW), the Faculty of Advocates (Scottish bar association) (FoA), the General Council of the Bar of Northern Ireland (GCBNI), the Law Society of Northern Ireland (LSNI), the Law Society of Scotland (LSS), the Council for Licensed Conveyancers (CLC), the Faculty Office of the Archbishop of Canterbury (FOAC) and the Chartered Institute of Legal Executives (CILEx) all have AML supervisory powers for the legal sector.

The multitude of legal sector supervisors causes inconsistencies for businesses. For example, unlike in England and Wales, a solicitor in Scotland or Northern Ireland will not be subject to independent AML supervision from their promotional and educational professional body.

The HM Treasury anti-money laundering and counter terrorist finance supervision report 2013-14, indicated that there had been 189 enforcement actions in the legal sector in one year, including 61 fines and 65 memberships being withdrawn. However, the SRA only has the authority to issue fines up to £2,000, which is highly unlikely to provide a significant deterrent to the 'wilfully blind', 'corrupted' or 'complicit' scenarios identified by the SRA.¹¹⁵ The SRA is also able to refer cases to the Solicitors Disciplinary Tribunal. The Tribunal's powers are wider than

¹¹⁰ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.42

¹¹¹ <http://www.legalfutures.co.uk/latest-news/sra-uncovers-genuinely-shocking-money-laundering-law-firms> [accessed 24 Jun 2015]

¹¹² <http://www.legalfutures.co.uk/latest-news/sra-uncovers-genuinely-shocking-money-laundering-law-firms> [accessed 24 Jun 2015]

¹¹³ <http://www.legalfutures.co.uk/latest-news/sra-uncovers-genuinely-shocking-money-laundering-law-firms> [accessed 24 Jun 2015]

¹¹⁴ https://www.sra.org.uk/sra/how-we-work/reports/data/population_solicitors.page [accessed 24 Sep 2015]

¹¹⁵ <http://www.sra.org.uk/consumers/solicitor-check/sanctions.page> [accessed 24 Jun 2015]

the SRA's and it can strike a solicitor from the roll of solicitors and issue fines exceeding £2,000.¹¹⁶

The Serious Crime Act 2015 created a new criminal offence of participation in a criminal enterprise, that was specifically targeted at corrupt lawyers and accountants who facilitate money laundering.¹¹⁷ It remains to be seen how effectively this new offence will be used in practice.

Enforcement transparency and public reporting of risks by the supervisor

The SRA provides a lower level of reporting on money laundering risks than the FCA, but is the second strongest supervisor overall in this regard. Though it must be added that this is set against a generally very low bar for the remaining supervisors.

The SRA publishes an annual Risk Outlook report for all potential regulatory issues in the sector. The 2013 report classified money laundering as an 'emerging risk'¹¹⁸, while the 2014 report states that managing this risk has increased in importance due to the increase in the number of cases of money laundering being reported.¹¹⁹ The 2015 report revealed that cases of money laundering have continued to rise – with the SRA receiving 184 reports in the previous year.¹²⁰ Specific risk papers are also published including "Cleaning up: Law firms and the risk of money laundering" in November 2014.

The SRA publishes alerts and has published some limited thematic papers. In 2013, the SRA published a thematic risk study on conveyancing – the legal support to property purchasing – with a section dedicated to property fraud and money laundering.¹²¹

However, as a result of the limits in information on specific enforcement outcomes, there is a lack of public understanding relating to the nature of AML enforcement and the specific details of enforcement cases. In contrast, this kind of information is provided by the FCA.

Suspicious activity reporting from the sector

Out of the total SARs submitted from October 2013-September 2014, amounting to over 350,000 reports of money laundering suspicion, only 3,610 or (1.02 per cent) were from the legal sector. This represents a drop of eight per cent from the previous year, despite the SRA highlighting money laundering as a risk of concern to the profession and inadequate AML oversight and reporting processes. The Government has found that the level of reporting from the legal sector is "low" compared to the size of the market and the nature of the activities undertaken.¹²²

¹¹⁶ <http://www.solicitortribunal.org.uk/constitution-and-procedures/powers/> [accessed 12 Sep 2015]

¹¹⁷ <http://www.bbc.co.uk/news/uk-27670756> [accessed 24 Jun 2015]

¹¹⁸ <http://www.sra.org.uk/risk/outlook/risk-outlook-2013-2014.page> [accessed 24 Jun 2015]

¹¹⁹ <http://www.sra.org.uk/risk/outlook/risk-outlook-2014-2015.page> [accessed 24 Jun 2015]

¹²⁰ <http://www.sra.org.uk/risk/outlook/risk-outlook-2015-2016.page#start> [accessed 13 Aug 2015]

¹²¹ <http://www.sra.org.uk/sra/news/press/conveyancing-survey.page> [accessed 24 Jun 2015]

¹²² HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.45

The SRA Risk Outlook 2014/2015 highlighted that SARs from the legal sector were of poor quality and did not contain enough information about the suspicious activity for the NCA to make a decision on whether the transaction should go through.¹²³ Donald Toon, NCA Director has also raised public concern over the quality, as distinct from the quantity, of SARs from the legal profession.¹²⁴

The national risk assessment revealed that 42 per cent of consent SARs submitted by the legal sector required follow up with firms because the initial report was incomplete and that the poor quality of SARs indicated a lack of understanding or compliance with the regulations by the submitter.¹²⁵

¹²³ <http://www.sra.org.uk/documents/solicitors/freedom-in-practice/risk-outlook-2014-2015.pdf> p.24 [accessed 24 Jun 2015]

¹²⁴ <http://www.lawgazette.co.uk/news/solicitors-prickly-economic-crime-chief/5045241.fullarticle> [accessed 24 Jun 2015]

¹²⁵ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.45

Accountancy

Summary table of supervision

AML supervisors	The most fragmented sector, with 14 different supervisors. ¹²⁶
Number of firms/individuals supervised	23,000 business carrying out accounting, bookkeeping, auditing and tax consultancy ¹²⁷
Fit and proper test of supervised population	HMRC - No ¹²⁸ Professional body supervisors – professional body tests ¹²⁹
AML level of enforcement	Unknown. 50 fines reported in 2013/14 but no aggregate data on the value of fines. The other sanctions in the accountancy sector identified for AML breaches were: ¹³⁰ <ul style="list-style-type: none"> • expulsion/withdrawal of membership: 31 • suspension: 3 • reprimand: 62 • undertaking/condition: 46
AML level of public reporting and understanding of ML threat	Low to negligible. Despite the multitude of supervisors, there are no sector specific annual reports on money laundering risks or detailed enforcement statistics and case information. There is no aggregate data on the value of fines that accountancy supervisors have issued.
SARs	Low: October 2013 to September 2014 - 4,930 (1.39 per cent)
Major compliance issues in the sector	Limited information published by supervisory bodies. FATF identifies key risks as: <ul style="list-style-type: none"> • financial and tax advice to corrupt HNWI and PEPs • creation of corporate vehicles or other complex legal arrangements such as trusts to disguise the links between the proceeds of a crime and the perpetrator • performing financial operations on behalf of a corrupt client

Overview

Similar to the risks posed by the legal sector gatekeepers, ‘wilfully blind’, ‘corrupted’ or ‘complicit’ accountants can provide vital support to the corrupt by managing the money laundering processes. Individuals with large quantities of wealth in various structures are likely to employ financial advisers and/or accountants, and the diversity of risks in the sector reflects the wide scope of services offered by accountants. In addition to wealth management, professional accountants may also provide trust and company formation services, which are highlighted in the following section as a separate significant risk category.

¹²⁶ Association of Accounting Technicians (AAT); Association of Chartered Certified Accountants (ACCA); Association of International Accountants (AIA); Association of Taxation Technicians (ATT); Chartered Institute of Management Accountants (CIMA); Chartered Institute of Taxation (CIOT); Institute of Certified Bookkeepers (ICB); Institute of Chartered Accountants in England and Wales (ICAEW); Institute of Chartered Accountants in Ireland (ICAI); Institute of Chartered Accountants of Scotland (ICAS); Institute of Financial Accountants (IFA); International Association of Book-keepers (IAB); Insolvency Practitioners Association (IPA); HMRC for firms and individuals not supervised by a professional body

¹²⁷ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.38

¹²⁸ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.40

¹²⁹ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.30

¹³⁰ <https://www.gov.uk/government/publications/anti-money-laundering-and-counter-terrorist-finance-supervision-reports/anti-money-laundering-and-counter-terrorist-finance-supervision-report-2013-14> [accessed 24 Jun 2015]

In theory, accountants should be in an ideal position to identify fraud and corruption risks however low reporting rates and industry surveys suggest that, at least, awareness of responsibilities is low. Comparative research by the University of Essex has demonstrated a relationship between the quality of accountancy, the quality of free reporting and levels of corruption in different countries. It also found that accountants can play a pivotal role in the detection of money laundering and corruption.¹³¹

The Government has assessed accountancy service providers to be amongst the most high risk sectors in terms of money laundering, being surpassed only by banks.¹³² According to the Government, accountancy service providers present a high money laundering risk due to:

- money launders using accountants, wittingly or un-wittingly, to provide legitimacy and to enable access to other regulated sectors without detection
- complicit accountants using their expertise to facilitate money laundering, possibly alongside facilitating the predicate offence¹³³

AML compliance and corruption risks identified in the sector

Several services provided by accountants have been identified by FATF as especially relevant to anti-corruption and AML issues:

- Financial and tax advice: criminals with a large amount of money to invest may pose as individuals hoping to minimise their tax liabilities or desiring to avoid future liabilities
- Creation of corporate vehicles or other complex legal arrangements such as trusts to disguise the links between the proceeds of a crime and the perpetrator
- Performing financial operations on behalf of the client, such as making cash deposits or withdrawals on accounts, retail foreign exchange operations, issuing and cashing cheques, purchasing and selling stock, and sending and receiving international funds transfers.
- Gaining introductions to financial institutions¹³⁴

Accountants came under UK AML regulations in 2000, when the regulations were expanded beyond banking following FATF guidance. A 2014 study by the UK Consultative Committee of Accountancy Bodies (CCAB) found that increased awareness was needed in the sector about accountants' ethical obligations to ensure that their services do not aid the laundering of money sourced illegally.¹³⁵

International sector surveys suggest that the recent economic downturn has resulted in a willingness for businesses to forgo checks and precautions against fraud and money laundering. EY's 12th Global Fraud Survey, for example, found in 2013 that 15 per cent of respondent companies' chief financial officers were willing to make cash payments to win business, up from nine per cent in the previous survey. The phenomenon was most pronounced in Indonesia, where 60 per cent believed the practice acceptable.¹³⁶ The survey also found that accountancy firms do not do enough to prevent bribery and corruption, with 42 per cent of respondents not having received anti-bribery or anti-corruption training.¹³⁷ EY's subsequent 13th Global Fraud

¹³¹ <http://repository.essex.ac.uk/1255/1/MoneyLaunderingFinal.pdf> [accessed 24 Jun 2015]

¹³² HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.31

¹³³ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.41

¹³⁴ <http://www.fatf-gafi.org/media/fatf/documents/reports/RBA%20for%20accountants.pdf> p.4 [accessed 24 Jun 2015]

¹³⁵ <http://economia.icaew.com/news/june-2014/improvements-to-be-made-to-uk-aml> [accessed 24 Jun 2015]

¹³⁶ <http://www.ey.com/GL/en/Services/Assurance/Fraud-Investigation---Dispute-Services/Global-Fraud-Survey---a-place-for-integrity> [accessed 24 Jun 2015]

¹³⁷ <http://www.ey.com/GL/en/Services/Assurance/Fraud-Investigation---Dispute-Services/Global-Fraud-Survey---a-place-for-integrity> p.6 [accessed 24 Jun 2015]

Survey found that over a third of executives chose at least one unethical action as an acceptable means of making their business survive, and that the number of employees who had received anti-bribery or anti-corruption training had decreased.¹³⁸

A survey conducted by the UK ACCA in 2013, found that 19 per cent of respondents believed businesses to be more willing to mis-state financial statements to cover up for corrupt behaviour and fraud since the onset of the global financial crisis in 2008, while only 40 per cent disagreed completely with the notion. Almost half the UK respondents considered that fraud and corruption risks to SMEs are likely to present themselves in relation to the negotiations of cross-border trade.¹³⁹

In a positive step, and potential good practice for other supervisors to follow, the UK national risk assessment highlighted that law enforcement agencies are currently working with the ICAEW, one of the accountancy supervisors, on a campaign to increase awareness of money laundering threats.

Regulatory structure

Accountancy is the most fragmented sector from a regulatory point of view, with at least 14 different supervisors taking some responsibility for AML supervision.

Out of the 13 private sector accountancy supervisors, only the Institute of Chartered Accountants in Ireland (ICAI) has met the Clementi principle and separates out its lobbying and promotional function from its enforcement responsibilities, regulating through the Chartered Accountants Regulatory Board in Ireland.¹⁴⁰ Apart from these actions by ICAI, no independent regulatory enforcement authority has been created for the accountancy sector. The remaining 12 accountancy institutes claim responsibility over their own membership groups, whilst also being responsible for promoting and championing the sector in breach of the principle set out in the 2004 Clementi Review (the Clementi principle).¹⁴¹

“[The accountancy sector is a] regulatory mish-mash ... The great gaping hole in accounting is that you don't have to belong to any professional body to practise as an accountant, and the regulators aren't very interested ... the government should propose a single regulator for accountancy” – Nigel Coles, Managing Director, Exiger Ltd¹⁴²

The NCA has argued that the sector is “one of the most fractured in terms of membership of professional bodies, making compliance with the Money Laundering Regulations of 2007 more difficult to enforce.”¹⁴³

¹³⁸ <http://www.ey.com/GL/en/Services/Assurance/Fraud-Investigation---Dispute-Services/EY-global-fraud-survey-compliance-efforts-running-out-of-steam> [accessed 24 Jun 2015]

¹³⁹ <http://www.accaglobal.com/content/dam/acca/global/PDF-technical/other-PDFs/tech-tp-cbissuk.pdf> [accessed 24 Jun 2015]

¹⁴⁰ <http://www.carb.ie/> [accessed 12 Nov 2015]

¹⁴¹ <http://webarchive.nationalarchives.gov.uk/+http://www.legal-services-review.org.uk/content/report/report-chap.pdf> [accessed 12 Nov 2015]

¹⁴² TI-UK interview with Nigel Coles and Lisa Osofsky at Exiger Ltd

¹⁴³ <http://www.nationalcrimeagency.gov.uk/publications/560-national-strategic-assessment-of-serious-and-organised-crime-2015/file> p.22 [accessed 10 Jul 2015]

Firms and individuals who are not supervised by one of the 13 professional body supervisors must register with HMRC for supervision. However, concerns have been raised with HMRC's supervisory regime. In its June 2014 report on the AML regime, CCAB noted that "a few participants question HMRC's ability to monitor and supervise some areas of the regime such as unregulated accountants, money service businesses and anonymised ePayments due to resource constraints".¹⁴⁴

Such a disparate regulatory structure is likely to lead to inconsistency in monitoring, detection, enforcement, sanctions, training and development and priority messaging.

Enforcement and sanctions regime

AML enforcement in the accountancy sector, from the limited data available, appears to be particularly lenient, despite the sector being classed as high risk in the national risk assessment for money laundering.

In 2013, AML supervisors were asked by HM Treasury to provide more information regarding their enforcement activity, including how they measure that this action is proportionate, effective, dissuasive, and adequately applied. The survey results demonstrated differing approaches by regulators to sanctions. Of the 522 reported enforcement actions taken by the private sector accountancy supervisors, 44 per cent were action plans or warning letters and four per cent were fines. In comparison, of the 1,381 reported enforcement actions taken by public sector supervisors (including the FCA and HMRC) 29 per cent were action plans or warning letters and 11 per cent were fines.¹⁴⁵ In the 2014 report, enforcement again suggested a relatively lenient regime in the accountancy sector with only 12 per cent of enforcement actions resulting in expulsion or a fine, compared to 88 per cent of public sector enforcement action and 66 per cent of enforcement action in the legal sector.¹⁴⁶ 50 fines were issued in total by the 13 private sector accountancy supervisors during 2013-14.¹⁴⁷ However, there is no data on the value of fines that accountancy supervisors have issued or regarding which accountancy supervisors were responsible for the enforcement actions. Such lack of transparency is in itself, a direct breach of the Macrory principles for an effective sanctioning regime.

Public reporting

The level of public reporting and transparency from the myriad of different supervisors in the sector is very low. Despite the multitude of supervisors, there are no sector specific public AML annual reports on money laundering enforcement or supervision. While various accountancy institutes do produce high-level guidance for firms¹⁴⁸, none of the 13 private sector supervisors provide complete enforcement statistics or details of enforcement cases, as is standard in the financial sector. However, recognising the problem in part, in its June 2014 report, CCAB highlighted that "[better] publicity about successful cases is needed to demonstrate the effective use of intelligence gathering and enforcement."¹⁴⁹

¹⁴⁴ <http://www.ccab.org.uk/documents/AMLFinalReport.pdf> p.11 [accessed 12 Nov 2015]

¹⁴⁵ <https://www.gov.uk/government/publications/anti-money-laundering-and-counter-terrorist-finance-supervision-reports/anti-money-laundering-and-counter-terrorist-finance-supervision-report-2012-13> [accessed 29 Jun 2015]

¹⁴⁶ <https://www.gov.uk/government/publications/anti-money-laundering-and-counter-terrorist-finance-supervision-reports/anti-money-laundering-and-counter-terrorist-finance-supervision-report-2013-14> [accessed 29 Jun 2015]

¹⁴⁷ <https://www.gov.uk/government/publications/anti-money-laundering-and-counter-terrorist-finance-supervision-reports/anti-money-laundering-and-counter-terrorist-finance-supervision-report-2013-14> [accessed 29 Jun 2015]

¹⁴⁸ For example, <http://www.accaglobal.com/content/dam/acca/global/technical/members/factsheet/technical-factsheet-145.pdf> and <http://www.icaew.com/en/members/regulations-standards-and-guidance/practice-management/anti-money-laundering-guidance> [accessed 29 Jun 2015]

¹⁴⁹ <http://www.icaew.com/~media/corporate/files/technical/legal%20and%20regulatory/money%20laundering/amlfinalreport.ashx> [accessed 29 Jun 2015]

There are some ad hoc AML thematic reports produced by the sector including the “Anti-Money Laundering Requirements - Costs, Benefits and Perceptions”, produced by the City of London and funded by the Institute of Chartered Accountants in England and Wales (ICAEW) in 2005.¹⁵⁰ However, in evaluating costs and benefits, the report includes an emphasis on the reputational cost of money laundering, set against the costs of compliance and the need to ensure that the sector is not over-regulated in order to allow business to thrive. This tone, from two promotional bodies for their sectors, is in stark contrast to the tone in thematic reports from supervisors that are dedicated to addressing compliance gaps and who meet the Clementi principle of separation between enforcement and promotional responsibilities.

Reporting from the sector

Accountancy SARs represented 1.39 per cent of the total received from Oct 13 to Sept 14, which is a fall of almost 10 per cent from the previous year. Government analysis of SARs from the accountancy sector identified that, in 21 per cent of reports, the reason for suspicion was not clearly given and in 50 per cent of the cases, the reporter did not make it clear what services they were providing the client when the suspicion arose.¹⁵¹

¹⁵⁰ http://www.cityoflondon.gov.uk/business/economic-research-and-information/research-publications/Documents/2007-2000/Anti-Money%20Laundering%20Requirements_Costs%20Benefits%20and%20Perceptions.pdf [accessed 29 Jun 2015]

¹⁵¹ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.41

Trust and company service providers

Summary table of supervision

AML supervisors	HMRC ¹⁵²
Number of firms supervised	The number of TCSPs registered with a supervisor for AML/CFT and operating in the UK is currently unknown as professional body supervisors do not uniformly record whether firms supervised by them for other reasons are also TCSPs. There were 2,675 TCSPs registered with HMRC in 2013.
Fit and proper test of supervised population	Yes (for HMRC registered firms) ¹⁵³
AML level of enforcement	Low - 677 penalties totalling £768,000 across all HMRC regulated sectors (2014/15) ¹⁵⁴
AML level of public reporting and understanding of ML threat	Poor: No annual report or thematic studies into AML compliance in the sector
SARs	Very low: October 2013 to September 2014 – 177 (0.05 per cent of the total)
Major compliance issues in the sector	Compliance and money laundering risks include: <ul style="list-style-type: none"> • obtaining information from long-standing clients • identifying PEPs • client confidentiality and professional relationship conflicts • obtaining sufficient detail about the intended purpose and/or activities of a proposed legal person or legal arrangement • lack of statutory record-keeping and CDD requirements, and absence of legal backing to obtain required information • lack of awareness and full knowledge of legal obligations¹⁵⁵

Overview

Alongside the legal profession and the accountancy profession, dedicated trust and company service providers (TCSPs) can help clients establish companies and trusts to manage their wealth.

TCSPs can also provide a range of additional administration and management services – such as acting as nominee directors for companies or functioning as the trustee for a trust – in essence managing or representing the company or trust on behalf of the beneficial owner. As such, they are often privy to detailed information about their clients. Therefore, they could play an important role in applying customer due diligence measures and in providing information to relevant authorities on beneficial ownership.

¹⁵² Firms such as accountancy, legal and financial services providers may also provide TCSP services, in which case they will be supervised by their appropriate sector regulator (e.g. FCA for financial services providers).

¹⁵³ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.51

¹⁵⁴ <http://www.parliament.uk/business/publications/written-questions-answers-statements/written-question/Commons/2015-10-21/12787/> [accessed 12 Nov 2015]

¹⁵⁵ <http://www.fatf-gafi.org/media/fatf/documents/reports/Money%20Laundering%20Using%20Trust%20and%20Company%20Service%20Providers...pdf> pp.22 – 23 [accessed 29 Jun 2015]

The offshore link

UK TCSP professionals can also be used to create companies in offshore jurisdictions to enable secrecy and tax avoidance. Jurisdictions such as the British Virgin Islands (BVI) or the US state of Delaware operate a legal system that creates a deliberate veil of secrecy to obscure the identity of those arranging corporate structures and establishing companies, usually for the benefit and use of people or companies that are not resident there. The use of secret and anonymous companies disguises the identity and source of funds of the owners of those companies and constitutes a serious obstacle to investigating money laundering. Such jurisdictions have been termed 'secrecy jurisdictions'.¹⁵⁶

The appeal of the British Virgin Islands (BVI)

Since 1984, when legislation was first passed launching the BVI as an offshore centre, the BVI has sold more than a million offshore entities and in 2011 alone £3.8bn worth of UK property was bought by BVI-registered companies.ⁱ The BVI economy is heavily dependent on the offshore industry, in 2011 collecting US\$180m from company registration fees, more than 60 per cent of its total government revenue that year.ⁱⁱ In 2011 the BVI had 457,000 active companies, equating to more than 16 for every member of its 28,000 population.ⁱⁱⁱ

A World Bank investigation in 2011 found that, out of a total of 817 corporate structures linked to known grand corruption cases worldwide from 1980 to 2010, BVI registered structures had the second highest share (after the USA), with 91 structures.^{iv}

Secrecy is likely to be a key attraction for money launderers to register a company in the BVI. Local legislation grants offshore companies complete confidentiality with regard to the identity of beneficial owners, directors and shareholders. Such companies can be created in less than 48 hours from any location in the world for as little as US\$1,000, in some cases without proof of identity. An attraction of the BVI for money launderers is that the local judicial system is based on English Common Law, English is the official language and UK Government supervision guarantees political and defence stability.

The filing of corporate registers is optional; no commercial or financial record filing is required; nor is specification of a company's operational objects.^v A proposal to create a beneficial ownership register in the BVI was rejected by 81 per cent of the consultation respondents.^{vi}

ⁱ <http://www.icij.org/offshore/secret-london-real-estate-speculators> [accessed 29 June 2015]

ⁱⁱ <http://www.icij.org/british-virgin-islands-secrecy> [accessed 16 Feb 2015]

ⁱⁱⁱ <http://www.economist.com/node/21552197> [accessed 29 June 2015]

^{iv} <https://star.worldbank.org/star/sites/star/files/puppetmastersv1.pdf> p.121 [accessed 29 June 2015]

^v <https://www.offshorebvi.com/bvi-offshore-companies.php> [accessed 29 June 2015]

^{vi} <http://www.bvi.gov.vg/media-centre/premier-smith-beneficial-ownership> [accessed 29 June 2015]

¹⁵⁶ <http://www.financialsecrecyindex.com/faq/whatisasi> [accessed 29 Jun 2015]

A commercial litigator with significant experience of aiding governments in tracing and restraining corrupt assets commented:

“Shell companies and trusts [created by TCSPs] almost always occur in investigations of suspected corrupt individuals. They are used to conceal true ownership, in addition to the use of multiple jurisdictions – particularly secretive countries.” – James Maton, Partner at Cooley LLP ¹⁵⁷

According to FATF, the misuse of corporate structures “appears to be almost ubiquitous in money laundering cases”. ¹⁵⁸ According to evidence collected by the World Bank Stolen Asset Recovery Initiative (StAR) on over 213 cases of grand corruption ¹⁵⁹, more than 70 per cent of cases involved ownership of stolen funds disguised through the misuse of corporate entities, half of them anonymously owned shell companies. In these 150 cases, the total proceeds of corruption amounted to approximately US\$56.4bn. ¹⁶⁰ The true proportion may be even greater, because researchers were “unable to determine with certainty whether the involved corporate vehicles were shell companies” in about a quarter of investigated cases involving companies. ¹⁶¹ Our research has found that over 75 per cent of UK properties under investigation as the proceeds of international corruption were held by offshore companies. ¹⁶²

A higher cost to secrecy?

In the recent Privy Council case of *Credit Agricole v Papdimitriou*, it was concluded that unnecessarily complex layers of offshore company structures are indicative of money laundering in and of themselves. In such suspicious circumstances, a bank must satisfy itself that there is a legitimate reason for the complex financial arrangements.ⁱ This is a key judgement which may incentivise corporate transactions to be carried out with much higher levels of transparency and disincentivises transactions through multiple secrecy jurisdictions – often referred to as ‘Financial Privacy Jurisdictions’.ⁱⁱ

ⁱ <http://www.transparency.org.uk/news-room/12-blog/1279-when-could-an-innocent-bank-be-liable-to-the-victims-of-fraud>

ⁱⁱ [http://www.europarl.europa.eu/RegData/etudes/etudes/JOIN_ET\(2013\)490673_IPOL-JOIN_ET\(2013\)490673_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/etudes/JOIN_ET(2013)490673_IPOL-JOIN_ET(2013)490673_EN.pdf)

¹⁵⁷ TI-UK interview with James Maton, Partner at Cooley LLP

¹⁵⁸ <http://www.fatf-gafi.org/media/fatf/documents/reports/ML%20and%20TF%20through%20the%20Real%20Estate%20Sector.pdf> p.12 [accessed 29 Jun 2015]

¹⁵⁹ defined by the UN as ‘corruption that pervades the highest levels of a national Government, leading to a broad erosion of confidence in good governance, the rule of law and economic stability’

http://www.unep.org/training/programmes/Instructor%20Version/Part_2/Activities/Interest_Groups/Decision-Making/Supplemental/UN_Anti_Corruption_Toolkit_pages_10to16.pdf p.1 [accessed 29 Jun 2015]

¹⁶⁰ The data was calculated from a sample of 213 instances of grand corruption recorded in the last 30 years: <https://star.worldbank.org/star/sites/star/files/puppetmastersv1.pdf> [accessed 29 Jun 2015]

¹⁶¹ Appendix B <https://star.worldbank.org/star/sites/star/files/puppetmastersv1.pdf> p.34 [accessed 29 Jun 2015]

¹⁶² Transparency International UK “Corruption on Your Doorstep” (March 2015)

AML risks identified in the sector

Complex company structures create significant barriers to investigators and private sector due to diligence checks to identify beneficial owners. The NCA has identified complex company structures using tax havens as one of the main methodologies used for laundering the proceeds of corruption.¹⁶³ The national risk assessment found the following risks present within the sector:

- creation of front companies and complex corporate structures for money laundering
- inadequate control environments in place to prevent the misuse of this service by criminals.¹⁶⁴

The OECD cite several features of corporate vehicles that “make them ideal for separating the origin of funds from the real beneficial owner”:

- They can be easily created and dissolved in most jurisdictions.
- They can be created as part of a multi-layered chain of inter-jurisdictional structures, whereby a corporation in one jurisdiction may control or be controlled by other companies or trusts in another, making it difficult to identify the ultimate beneficial owner.
- Specialised intermediaries, professionals, or nominees can be used to conceal true ownership.
- Regulations vary amongst jurisdictions, but very few collect beneficiary information at the time of company formation, which increases the challenges of international co-operation.¹⁶⁵

According to the Crown Prosecution Service, corrupt individuals attempt to resist having their assets investigated and restrained by “distancing themselves from the assets by using corporate structures and trusts to hold assets. They will often make use of overseas companies and trusts ... This is a substantial issue for prosecutors ... [trusts and corporate structures] make it more difficult to show beneficial ownership and may slow down investigations.”¹⁶⁶ The national risk assessment also concluded that TCSPs can be used to conceal the identities of those involved in illicit activities, frustrating law enforcement investigations.¹⁶⁷

Trusts may be used in similar way to shell companies for illicit purposes. However, it is likely to be harder to trace the beneficiaries in a trust than the owners of a company because trusts are not subject to the same disclosure requirements. Unlike companies, trusts do not constitute legal entities in their own right. They do not have to be centrally registered in the same manner and are not subject to the same reporting requirements. For example, whereas UK companies are required to maintain a register of shareholders, and their annual returns (including details of shareholders) are publicly available at Companies House, there is no such requirement for trusts.

¹⁶³ <http://www.nationalcrimeagency.gov.uk/publications/560-national-strategic-assessment-of-serious-and-organised-crime-2015/file> p.21 [accessed 10 Jul 2015]

¹⁶⁴ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.53

¹⁶⁵ http://www.oecd.org/corruption/Illicit_Financial_Flows_from_Developing_Countries.pdf p.38 [accessed 29 Jun 2015]

¹⁶⁶ TI Interview with Crown Prosecution Service Asset Restraint Team

¹⁶⁷ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.53

Instances of shell corporate vehicles created by TCSPs being used to launder money are plentiful and include the following reported cases:

- An NCA investigation identified 19 UK shell companies created by UK TCSPs with sources of wealth potentially ranging from people trafficking to corruption and large-scale tax avoidance, totalling around £13bn.¹⁶⁸
- Two Latvian TCSPs are reported to have served as directors and shareholders for hundreds of companies in the BVI, Panama, Cyprus, New Zealand, the USA, the UK and Ireland. They were involved in illicit activity including defrauding governments and investors and arms dealing in Eastern Europe including Ukraine.¹⁶⁹
- Shell companies created by TCSPs were used by James Ibori, former Nigerian Delta State Governor, in laundering the proceeds of his grand corruption.¹⁷⁰
- Former Russian central bank governor, Sergei Ignatiev, stated in 2013, shortly before the end of his tenure, that US\$49bn a year “is routinely laundered from Russia via banks and sham companies”. He described one case study that used 1,173 shell companies to channel US\$24bn to foreign banks.¹⁷¹

The huge potential for TCSPs to deliberately or otherwise aid corrupt money launderers prompted researchers at Griffiths University in Australia to undertake a major study involving 3,700 providers from 182 countries. The study found that 48 per cent of providers in the survey did not request proper identification, and 22 per cent did not ask for identity documents when forming a shell company.¹⁷² They found that offering to pay a premium to avoid international rules reduced identification checks from TCSPs. In the UK, the Government has found that several law enforcement investigations involving money laundering have involved TCSPs acting as nominee directors of a large number of limited companies.¹⁷³

Regulatory structure and sanctions regime

In the UK TCSPs are supervised for money laundering purposes by HMRC and must appoint a Money Laundering Reporting Officer (MLRO) and report money laundering suspicions to the NCA. Firms such as accountancy, legal and financial services providers may also provide TCSP services, in which case they will be supervised by their appropriate sector regulator (e.g. FCA for financial services providers). The Government has stated that the potential for multiple supervisors creates challenges to ensure consistency.¹⁷⁴ An additional weakness of the supervisory regime is that the Government is not able to assess the size of the TCSP sector as the professional body supervisors do not uniformly record whether firms supervised by them for other reasons are also TCSPs.¹⁷⁵

¹⁶⁸ <http://www.independent.co.uk/news/business/news/britains-fbi-probes-corrupt-use-of-uk-shell-companies-in-13bn-laundering-scam-9885672.html> [accessed 29 Jun 2015]

¹⁶⁹ <http://eurodad.org/files/integration/2013/01/Secret-structures-hidden-crimes-web.pdf> p. 12 [accessed 29 Jun 2015]

¹⁷⁰ <http://www.reuters.com/article/2013/09/18/britain-nigeria-ibori-idUSL5N0HE2PA20130918> and

<http://star.worldbank.org/corruption-cases/node/18618> [accessed 29 Jun 2015]

¹⁷¹ <http://www.bne.eu/content/story/russian-money-infests-london> [accessed 29 Jun 2015]

¹⁷² https://www.griffith.edu.au/_data/assets/pdf_file/0008/454625/Oct2012-Global-Shell-Games-Media-Summary_10Oct12.pdf p.1 [accessed 29 Jun 2015]

¹⁷³ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.52

¹⁷⁴ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.52

¹⁷⁵ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.52

HMRC registers TCSPs on the basis of a 'fit and proper test'. However, this demands no more of an applicant than compliance with a list of negative criteria involving the non-conviction of the applicant for certain offences. There are no requirements in respect of qualifications, experience or competence. It is therefore extremely doubtful that this system can be effective in catching those TCSPs who are complicit in facilitating money laundering.

A major loophole exists in the AML regime for TCSPs, in that they only have to carry out due diligence checks (including identifying beneficial owners) when establishing an 'on-going business relationship'. Many TCSPs have taken the position that company formation services are one-off transactions and that they are therefore not required to carry out due diligence checks. For example, the company '1st Choice Formations' specifically states on its website that "The one-off formation of a company does not trigger a due diligence check".¹⁷⁶

There is no requirement for UK companies to open a UK bank account when formed. Therefore, it is possible that a UK company can be formed with an overseas bank account without having any due diligence checks in the UK. This presents a major risk, given the potential role of complex company structures in money laundering.

Enforcement transparency and public reporting of risks by the supervisor

HMRC has not published any annual AML report as a supervisor. Whilst HMRC has produced AML guidance for TCSPs,¹⁷⁷ there have been no public thematic studies into AML compliance levels for TCSPs in the UK.

Despite the recognition of the role of TCSPs in facilitating money laundering, there is no public record of any AML regulatory enforcement action against TCSPs and the Government has confirmed that the scale of the misuse of services provided by UK TCSPs is an intelligence gap.¹⁷⁸

Reporting from the sector

UK TCSPs' lax approach to AML regulation is reflected in their low proportion of SARs submitted: 177 reports (0.05 per cent of the total).¹⁷⁹ This figure was down 19.18 per cent from the previous year.

Overall, our research indicates that shell companies and trusts are very common in cases of corruption and money laundering. TCSPs are essential to establishing shell companies and trusts. As a result, the low level of suspicious activity reporting and the low level of information on the sector in general is a serious cause for concern.

¹⁷⁶ <https://www.1stchoice-formations.co.uk/money-laundering/> [accessed 11 Aug 2015]

¹⁷⁷ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/372271/mlr8_tcsp.pdf [accessed 12 Oct 2015]

¹⁷⁸ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.52

¹⁷⁹ <http://www.nationalcrimeagency.gov.uk/publications/464-2014-sars-annual-report/file> [accessed 29 Jun 2015]

Property

Summary table of supervision

AML supervisors	<ul style="list-style-type: none"> • HMRC for estate agents • SRA for conveyance solicitors • FCA for UK banks involved in property transactions
Number of firms supervised	HMRC - 7,927 registered estate agency businesses (2013), though an unknown number of estate agents in operation are not registered with HMRC for AML purposes
Fit and proper test of supervised population	No (for HMRC registered firms) ¹⁸⁰
AML level of enforcement	Low - 677 penalties totalling £768,000 across all HMRC regulated sectors (2014/15) ¹⁸¹
AML level of public reporting and understanding of ML threat	Poor: <ul style="list-style-type: none"> • HMRC does not publish an annual AML enforcement report. • There are no thematic papers produced by HMRC or detailed reviews of compliance. • The SRA has published a thematic paper on conveyance solicitors, but with only a small sub section dedicated to AML risks.
SARs	Very low: October 2013 to September 2014 Estate agents SARs – 179 (0.05 per cent of the total)
Major compliance issues in the sector	<ul style="list-style-type: none"> • Anti-money laundering regulation for estate agents only require due diligence on the seller, not the purchaser. • The regime relies on lawyers to cover any estate agency risks, which ignores the risk of complicit lawyers. • There are low levels of awareness of AML responsibilities within the sector.

Overview

The UK's high-end property (real estate) sector is particularly vulnerable to being used to launder the proceeds of corruption. Buying such properties allows the corrupt to launder very large sums of stolen money with a single purchase. Money can be 'parked' in high-end property and then reinvested elsewhere with little risk of capital loss.

The national risk assessment set out the key threats and vulnerabilities within the estate agency sector:

- complicit professionals negotiating and arranging the purchase of property
- negligent professionals enabling money laundering and terrorist financing through non-compliance with Proceeds of Crime Act 2002 (POCA) and regulations
- need to increase standards of compliance with the regulations among the registered population
- challenges to ensure those covered by the regulations are registered

¹⁸⁰ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.55

¹⁸¹ <http://www.parliament.uk/business/publications/written-questions-answers-statements/written-question/Commons/2015-10-21/12787/> [accessed 12 Nov 2015]

- low levels of SARs submitted
- the international exposure of the UK property market; rising prices also increase the attractiveness to criminals of investing in UK property
- HMRC does not operate a 'fit and proper' test for estate agents as the regulations do not provide them with the legal powers to do so
- misuse of third party reliance by estate agents, or use of reliance when the bodies being relied upon may be complicit.¹⁸²

We focus on London prime property in this chapter because the UK's capital has been a focus for investments in property for grand corruption case studies¹⁸³ and it is the favoured location for high value foreign investment. London also dominates the UK in terms of offshore holdings of property, a key pre-requisite for corrupt money laundering through property.¹⁸⁴

Our recent research found that over £180m worth of property in the UK has been brought under criminal investigation as the suspected proceeds of international corruption since 2004, which was described by law enforcement authorities as "only the tip of the iceberg".¹⁸⁵

The NCA has identified the vulnerability of the property market being used for money laundering, stating that:

"Purchasing property as a method of money laundering provides the criminal with the opportunity to clean large amounts of illicit funds in a single transaction. It is likely that a significant proportion of criminals purchase property through estate agents to launder the proceeds of crime"¹⁸⁶

Compliance issues

Luxury new build property in central London is, in particular, associated with very high exposure to investors from high corruption risks jurisdictions. It is estimated that £2.2bn of international capital was invested in 2012, with purchasers from high-risk countries, China, Russia, Nigeria, Saudi Arabia and the United Arab Emirates - all within the top 10 countries for investment.¹⁸⁷ Overall, industry figures indicate that China is the largest source of investment in prime London property for both new build and resale (16 per cent), followed by investors from the Middle East and North Africa region (12 per cent); and Russia and neighbouring countries (11 per cent).¹⁸⁸

The UK regulatory regime for property is characterised by a number of weaknesses. Chief among these is that AML regulation for estate agents only requires due diligence checks on the seller, not the purchaser. The regime relies on lawyers to cover any estate agency risks, which ignores the risk of complicit lawyers. Weaknesses also include the lack of recorded sale price by the Land Registry; the historic lack of regulatory sanctions for AML breaches; and low levels of awareness of AML responsibilities within the sector. The TI-UK research paper: "Corruption on Your Doorstep" (2015) provides an in-depth review into compliance weaknesses in the property sector.¹⁸⁹

¹⁸² HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.54

¹⁸³ Transparency International UK "Corruption on Your Doorstep" (March 2015) p.12

¹⁸⁴ Transparency International UK "Corruption on Your Doorstep" (March 2015) p.15

¹⁸⁵ Transparency International UK "Corruption on Your Doorstep" (March 2015) p.13

¹⁸⁶ <http://www.nationalcrimeagency.gov.uk/publications/560-national-strategic-assessment-of-serious-and-organised-crime-2015/file> p.22 [accessed 10 Jul 2015]

¹⁸⁷ <http://content.knightfrank.com/research/503/documents/en/2013-1217.pdf> [accessed 12 Nov 2015]

¹⁸⁸ Extrapolated from <http://pdf.euro.savills.co.uk/residential---other/spot-worldlondon-lr.pdf> [Accessed 10 Aug 2015]

¹⁸⁹ Transparency International UK "Corruption on Your Doorstep" (March 2015)

The risks of offshore property ownership by companies should be minimised with the Government's recent proposals on increasing transparency for foreign companies owning UK property. However, at the time of this research, the detail remains to be seen as to what is included in the Government's proposals. The delay in publishing the proposals prompted the National Association of Estate Agents to call on the UK Government to follow through on this commitment and ensure that foreign companies holding property are held to the same standard of beneficial ownership transparency as UK companies.¹⁹⁰

“The recent documentary From Russia with Cash demonstrated that there is still not absolute clarity in relation to anti-money laundering among those in the property sector, despite the very clear legislation in place and regular training and updates from within the industry. It is now time to step up the level of scrutiny that the sector comes under to ensure that a small minority of agents do not support criminal activity and those that do are appropriately sanctioned.”
– **Mark Hayward, National Association of Estate Agents**¹⁹¹

From the conveyance side, the SRA found that firms dealing in conveyancing had particular compliance shortcomings with clients failing to provide valid identity documents and attempts in conveyancing transactions to avoid or cheat identity checks. Purchasing property is considered by FATF to be one of the main ways that criminals launder money through law firms.¹⁹²

The SRA's thematic paper in 2013 found that a quarter of firms reported that at some point they have experienced a client attempting to use a conveyancing transaction as an opportunity to commit property-related fraud or money laundering.¹⁹³ In addition, the study found that levels of awareness of compliance processes and how to report suspicions were low - a third of firms did not know how they would decide whether to report a suspicion of money laundering.¹⁹⁴

¹⁹⁰ <http://www.propertyindustryeye.com/naea-calls-on-ministers-to-act-over-money-laundering/> [accessed 12 Nov 2015]

¹⁹¹ <http://www.transparency.org.uk/press-releases/18-press-releases/1358-uk-government-urged-to-deliver-on-promise-of-property-transparency> [accessed 12 Nov 2015]

¹⁹² Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals, Financial Action Task Force, 2013 <http://www.fatf-gafi.org/media/fatf/documents/reports/ML%20and%20TF%20vulnerabilities%20legal%20professionals.pdf> [accessed 29 Jun 2015]

¹⁹³ <http://www.sra.org.uk/documents/SRA/research/supervision-thematic-study-conveyancing-2013-full-report.pdf> p.36 [accessed 29 June 2015]

¹⁹⁴ <http://www.sra.org.uk/documents/SRA/research/supervision-thematic-study-conveyancing-2013-full-report.pdf> p.35 [accessed 29 June 2015]

From Russia with Cash

A recent Channel 4 undercover documentary has highlighted estate agents' lack of compliance with AML regulations.ⁱ

An imposter Russian minister, Boris, claims to be buying a high-end London property for his girlfriend and confides that he has stolen money from his country's healthcare budget. In response, he is told that the estate agents are comfortable and familiar with dealing in such matters and that they know lawyers who can help make sure that the purchase is made in secret, through anonymous companies based in offshore financial centres.

The casual familiarity displayed by the estate agents adds to the suspicion that corrupt officials buying property is not an unusual phenomenon in the London luxury market. One estate agent shown specifically explains that they work for the seller and are therefore not required to report any money laundering suspicions with prospective purchasers.

ⁱ <http://www.theguardian.com/uk-news/2015/jul/07/london-estate-agents-caught-on-camera-russian-buyer> [accessed 12 August 2015]

The link between offshore company secrecy and property

Secret company and trust ownership of property in the UK remains a critical barrier to any private sector due diligence for AML, or law enforcement criminal investigations.

The UK's official record of corporate landholdings, maintained by the Land Registry, shows that there are over 36,000 properties in London held by companies registered to offshore secrecy jurisdictions, both residential and commercial, representing an estimated 2.25 square miles of London property.¹⁹⁵

Out of all foreign-company-registered properties in London, the overwhelming majority (89.5 per cent) are located in secrecy jurisdictions, chiefly in British Overseas Territories and Crown Dependencies. More than a third are registered in the BVI (13,831 properties), followed by Jersey (5,960), the Isle of Man (3,472) and Guernsey (3,280). More than 1,000 London properties are owned by overseas companies registered in unknown locations. The City of Westminster, Kensington & Chelsea and the City of London have the highest ratio of properties registered to offshore secrecy jurisdictions. In general, the higher the average property price in a borough, the more likely it is to have a relatively large number of properties registered offshore.¹⁹⁶

Analysis by the *Financial Times* (*FT*) indicates that at least £122bn worth of property in England and Wales was held via companies registered in secrecy jurisdictions in 2014.¹⁹⁷ The *FT* considers this likely to be a substantial underestimate, because in more than a third of cases, Land Registry titles held by offshore entities do not record property value.¹⁹⁸

¹⁹⁵ Jones Lang LaSalle's 2011 estimate of the average property size (from a sample of properties sold) of 1,722 square feet (which does not account for the likely large size of high-value 'enveloped' property or the higher size of commercial property titles, thus making our estimate a conservative one), provides a total estimate of 70,128,450 square feet, or 2.5 square miles, of London property registered to an overseas company <http://www.propertyweek.com/Journals/44/Files/2011/5/25/JLL%20London%20Heat%20Maps.pdf> [accessed 16 Feb 2015]

¹⁹⁶ Transparency International UK "Corruption on Your Doorstep" (March 2015)

¹⁹⁷ <http://www.ft.com/cms/s/0/6cb11114-18aa-11e4-a51a-00144feabdc0.html> [accessed 16 Feb 2015]

¹⁹⁸ <http://www.ft.com/cms/s/0/a421beac-3ce7-11e5-8613-07d16aad2152.html#axzz3mY6gillf> [accessed 23 Sep 2015]

Regulatory structure and sanctions regime

HMRC is the AML supervisor for estate agents, while the SRA is the supervisor for conveyance (property) solicitors. A large number of SARs relating to property originate from banks, again showing the importance of the FCA and for a coordinated approach by regulators.

In addition, the supervisors responsible for TCSPs (HMRC, the SRA, and the 13 other accountancy supervisors beyond HMRC) also bear a responsibility in AML supervision in the property sector.

Unlike other sectors supervised by HMRC, such as the TSCP sector, HMRC does not operate a 'fit and proper' test for the estate agency business. The Government has identified this as a key vulnerability in the regime.¹⁹⁹

In terms of AML enforcement, the only substantial sanctions to be published for estate agency AML breaches were carried out in March 2014 by the Office of Fair Trading (OFT). In a swansong episode of enforcement before regulatory responsibility was passed to HMRC in April 2014, the OFT fined three estate agents almost £250,000 for "significant and widespread" anti-money laundering lapses. These were Hastings International of London (fined £48,000), Jackson Grundy of Northampton (£170,000), and Jeffrey Ross of Cardiff (£29,000).²⁰⁰

Enforcement transparency and public reporting of risks by the supervisor

The AML level of public reporting and understanding of money laundering threats by the responsible supervisors is poor. There has been no annual AML report for the sector, although HMRC only took over responsibility from the OFT in April 2014. Whilst HMRC has produced guidance for estate agents,²⁰¹ there are no thematic papers or compliance risk reviews on money laundering.

The lack of public reporting may explain why the national risk assessment found that "firms often lack understanding of what is required of them under the regulations and the Proceeds of Crime Act (POCA), including applying customer due diligence and submission of SARs".²⁰²

Suspicious activity reporting from the sector

Estate agents are the one of the lowest SARs reporters for the period for October 2013 to September 2014 (with 0.05 per cent of all SARs). This represents a fall of 16.74 per cent from the previous year.

The national risk assessment confirmed there were issues with both the quantity and quality of SARs from estate agents. The Government's analysis of SARs submitted by the sector revealed that in a number of cases, activity was only reported once law enforcement authorities identified an interest to the reporter.²⁰³

¹⁹⁹ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.54

²⁰⁰ <https://www.estateagenttoday.co.uk/665-of-fines-three-estate-for-breaching-money-laundering-regulations> [accessed 29 Jun 2015]

²⁰¹ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/321830/MLR2007.pdf [accessed 12 Sep 2015]

²⁰² HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.55

²⁰³ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.56

The luxury goods sector

Summary table of supervision

AML supervisors	HMRC
Number of firms supervised	HMRC - 1,294 registered high value dealers (2013)
Fit and proper test of supervised population	No ²⁰⁴
AML level of enforcement	Low - 677 penalties totalling £768,000 across all HMRC regulated sectors (2014/15) ²⁰⁵
AML level of public reporting and understanding of ML threat	Poor: No annual report or thematic studies into AML compliance in the sector
SARs	Low: October 2013 to September 2014 – 331 SARs (0.09 per cent of the total)
Major compliance issues in the sector	<ul style="list-style-type: none"> Limited knowledge of compliance issues due to lack of information from supervisor However, the limited available evidence indicates a general lack of awareness of AML obligations in the sector

Overview of risk

Spending on luxury goods is a typical way in which the corrupt enjoy their wealth, but luxury goods also have a practical use in money laundering and commonly arise as a feature in money laundering cases. Expensive cars, boats, private jets and other high-priced goods represent 'badges of wealth' that many corrupt individuals appear keen to display, seeing expenditure on luxury goods as an end-game for themselves and their families.²⁰⁶

The NCA has identified investment in high-value luxury goods as one of the methodologies frequently used in laundering the proceeds of corruption and fraud.²⁰⁷

Luxury goods retailers are covered by the UK's AML regulations under the category High Value Dealers (HVDs), if they accept cash payments of €15,000 or more (or equivalent in any currency) in exchange for goods.

Certain types of business are particularly likely to be HVDs, such as:

- motor dealers
- jewellers
- boat dealers
- builders, bathroom and kitchen suppliers

²⁰⁴ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.59

²⁰⁵ <http://www.parliament.uk/business/publications/written-questions-answers-statements/written-question/Commons/2015-10-21/12787/> [accessed 12 Nov 2015]

²⁰⁶ <http://www.oecd.org/ctp/exchange-of-tax-information/43841099.pdf> p.14; <http://www.transparency.org.uk/our-work/corrupt-money-in-the-uk/luxury-goods-and-services>; <http://watchdog-watcher.com/2012/05/21/globalizing-stolen-assets-greed-fear-a-taste-for-the-luxury-goods-of-the-west/> [accessed 10 Jul 2015]

²⁰⁷ <http://www.nationalcrimeagency.gov.uk/publications/560-national-strategic-assessment-of-serious-and-organised-crime-2015/file> p.21 [accessed 10 Jul 2015]

Businesses such as auctioneers and yacht brokers may not own the goods they sell, but if they receive high value cash payments, they fall under the regulations.

Despite the requirement for HVDs to register with HMRC for AML supervision, the Government believes that the low number of registrations (1,294) suggests that there may be a level of under registration.²⁰⁸ This represents a key risk, as those who have failed to register are more likely to be involved in facilitating money laundering.

AML risks identified in the sector

The national risk assessment highlighted the following vulnerabilities within the sector:

- criminal use of the sector to purchase luxury and high value goods with criminal proceeds
- HVDs enabling money laundering through complicity, including the use of HVD businesses to transfer large sums of criminal cash into the regulated sector
- businesses selling goods with a turnover in cash of over €15,000 are not HVDs unless they accept high value payments
- negligent HVD operators enabling criminals to launder criminal proceeds or enabling the financing of terrorism due to failures to fully comply with the regulations and POCA
- the challenges inherent in supervising this particularly diverse sector²⁰⁹

A 2014 risk report on the luxury goods sector found that 56 per cent of respondents in the industry cited bribery, corruption, fraud and money laundering as factors which caused them the most concern and acknowledged that the globalised nature of the sector had increased the risks.²¹⁰ The European luxury goods market is expected to reach £96bn by 2018, and research suggests the UK is set to overtake France and Italy to become the leading luxury shopping market in Europe by 2018.²¹¹

“High Value Dealers are designated as risky because it is possible to move large sums of cash without stringent identity checks.” – Nigel Coles, Managing Director, Exiger Ltd²¹²

The UK topped the ‘Big Spenders Index’ in 2015’ with the high-end estate agent, Knight Frank, commenting “It would be fair to say that the UK secured poll position off the back of the many visitors who flock to London’s luxury stores”.²¹³

While many luxury goods items are expensive enough to require some form of customer due diligence checks on the purchaser, there is little evidence of awareness or compliance in the industry of AML obligations, making the sector a significant loophole in the UK economy for illicit funds.²¹⁴ The national risk assessment found that “as a result of weak levels of compliance the sector can be vulnerable to being used for money laundering/terrorist financing”.²¹⁵

²⁰⁸ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.59

²⁰⁹ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.57

²¹⁰ http://www.acegroup.com/eu-en/assets/2014-06-13_luxury_goods_report.pdf p.15 [accessed 29 Jun 2015]

²¹¹ <http://conlumino.com/?p=1583> [accessed 29 Jun 2015]

²¹² TI-UK interview with Nigel Coles and Lisa Osofsky at Exiger Ltd

²¹³ <http://www.knightfrank.com/wealthreport> p.59 [accessed 16 Jul 2015]

²¹⁴ http://www.transparency.org/whatwedo/publication/policy_brief_04_2014_regulating_luxury_investments [accessed 29 Jun 2015]

²¹⁵ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.58

A loophole in the regime is that HVDs are only caught by the AML regulations if they sell in cash and there are no requirements on the sellers when items are purchased through other methods. This includes using a debit, credit or prepaid card which may be issued outside the UK, in a jurisdiction with a weak AML regime. The regime also excludes the provision of services.

Regulatory structure and sanctions regime

HMRC is the supervisor for HVDs. As with estate agents, there is no fit and proper test for HVDs. HMRC believes the absence of a fit and proper test creates a low barrier to entry and therefore a potential vulnerability in this sector.²¹⁶

Enforcement transparency and public reporting of risks by the supervisor

There is no dedicated annual AML report for the luxury goods sector. There are no thematic reports on AML compliance within the sector. There is no public record of enforcement against individual luxury goods retailers.

Due to the lack of any published surveys, thematic reports or compliance risk assessments for the sector, there is limited understanding about the state of compliance in this sector. The little that we do know, as a result of the national risk assessment, suggests that a lot more needs to be done to improve compliance levels.

Reporting from the sector

From October 2013 to September 2014, HVDs made just 331 suspicious activity reports, or (0.09 per cent) of the total. This figure is down 9.81 per cent on the previous year. The Government has confirmed that the levels of reporting for this sector appear low which further emphasises the vulnerability created by the low level of registration.²¹⁷

²¹⁶ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.59

²¹⁷ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.59

Auction houses, arts and antiques

Summary table of supervision

AML supervisors	HMRC
Number of firms supervised	HMRC - 1,294 high value dealers (2013)
Fit and proper test of supervised population	No ²¹⁸
AML level of enforcement	Low - 677 penalties totalling £768,000 across all HMRC regulated sectors ²¹⁹ (2014/15)
AML level of public reporting and understanding of ML threat	Poor: No annual report or thematic studies into AML compliance in the sector
SARs	Very low: September 2013to September 2014 – 15 (0.004 per cent of total)
Major compliance issues in the sector	<ul style="list-style-type: none"> • Limited knowledge of compliance issues due to lack of information from supervisor • General lack of awareness of AML obligations in the sector • HVDs only required to carry out checks when items paid for in cash

Overview of risk

The arts and heritage sectors are at similar risk to the luxury goods sector of attracting and enabling corrupt individuals to launder money. They offer similar lifestyle and image attractions, especially to corrupt PEPs, and present relatively easy opportunities to launder large sums of cash, since few art dealers and auctioneers seem equipped to deal with the risk of their businesses being used to launder the proceeds of corruption.

"The core of any successful money-laundering enterprise is secrecy -- the lack of a defined 'paper trail,' ... That makes the secretive nature of the art market in general, and China's market specifically, ideal for covering illicit activities." – Lynda Albertson, CEO of the Association for Research into Crimes against Art²²⁰

²¹⁸ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.59

²¹⁹ <http://www.parliament.uk/business/publications/written-questions-answers-statements/written-question/Commons/2015-10-21/12787/> [accessed 12 Nov 2015]

²²⁰ <http://money.cnn.com/2014/02/20/news/economy/china-art-laundering/index.html?iid=EL> [accessed 29 Jun 2015]

AML risks identified in the sector

Case studies indicate that high value art is often bought through a series of transactions via offshore companies.²²¹ Art is appealing for money laundering for many reasons. Typically the price is difficult to determine and verify. It is portable and easily shipped across borders. Transactions may be brokered by advisers, who are not regulated. In art sales it is not unusual for the identities of both seller and buyer to be kept secret and cash is a commonly accepted form of payment, making it difficult to track transactions.

Many of those investing in high value art choose to store their collections in air-conditioned security storage vaults housed in tax-free zones known as freeports. The facilities are traditionally clustered in Switzerland, but Luxembourg opened a 20,000 square metre operation in 2014 and another is planned for Beijing this year. There is no requirement to declare beneficial ownership at these freeports, or more generally in private ownership and customs authorities have no way of determining ownership of the asset. As works of art have come to resemble other types of assets — they are used as collateral for loans or as a way to diversify a portfolio — there are calls for it to be regulated like other financial products.

“As Swiss banks are forced to divulge long-held secrets, some investors are keen to flee the banking system in favour of a more discreet solution. I respond to a demand,” Mr Bouvier, owner of art freeport storage facilities told the *Financial Times*.²²²

High value art ownership is therefore one of a very small number of ways to own something of high value completely anonymously. The rise of freeports for use as tax free storage resemble the function of offshore financial centres that provide anonymity and tax benefits, which have been exploited for money laundering purposes.

“You can buy something for half a million, not show a passport and ship it. Plenty of people are using it for laundering” – Nouriel Roubini, Economist²²³

The Basel Institute in Switzerland warned in 2012 of high volumes of potentially illicit money spent on purchases of artwork²²⁴, alleged examples of which include a case involving a Saudi prince, a South American cocaine cartel and European banks.²²⁵

Regulatory structure and sanctions regime

Auction houses, arts and antiques are covered by the UK’s AML regulations under the category ‘High Value Dealers’, defined businesses that accept cash payments of €15,000 or more (or equivalent in any currency) in exchange for goods. As with luxury retail goods, HMRC is the relevant AML supervisor.

²²¹ The FT conducted a detailed review of the case of the family trust of Russian billionaire Dmitry Rybolovlev who filed a complaint in a Monaco court over Yves Bouvier and secured a worldwide freezing order against Mr Bouvier in a Singapore court over an art deal turned sour: <http://www.ft.com/cms/s/2/a91a1608-d887-11e4-8a23-00144feab7de.html?segid=0100320#axzz3WnWs5czy> [accessed 29 Jun 2015]

²²² <http://www.ft.com/cms/s/2/a91a1608-d887-11e4-8a23-00144feab7de.html?segid=0100320#axzz3WnWs5czy> [accessed 29 Jun 2015]

²²³ <http://www.ft.com/cms/s/2/a91a1608-d887-11e4-8a23-00144feab7de.html?segid=0100320#axzz3WnWs5czy> [accessed 29 Jun 2015]

²²⁴ <http://www.nytimes.com/2013/05/13/arts/design/art-proves-attractive-refuge-for-money-launderers.html?pagewanted=all> [accessed 29 Jun 2015]

²²⁵ http://www.forbes.com/2003/04/08/cx_0408hot.html [accessed 29 Jun 2015]

Enforcement transparency and public reporting of risks by the supervisor

Whilst guidance for the sector has been published by the British Art Market Federation²²⁶ and HMRC²²⁷, there is no dedicated annual AML report, no thematic reports on AML compliance within the sector and there are no known cases of enforcement action against auction houses or high-end art dealers.

Suspicious activity reporting from the sector

Auction houses have filed only 15 suspicious activity reports out of a total of 354,186 in the year to September 2014 (0.004 per cent of the total).²²⁸

²²⁶ http://www.lapada.org/public/BAMF_Anti_Money_Laundering_Guidelines.pdf [accessed 24 Sep 2015]

²²⁷ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/372267/mlr8_hvd.pdf [accessed 12 Oct 2015]

²²⁸ <http://www.ft.com/cms/s/2/a91a1608-d887-11e4-8a23-00144feab7de.html?segid=0100320#axzz3WnWs5czy> [accessed 29 Jun 2015]

Investor visas

Summary table of supervision

AML supervisors	No bespoke AML supervision
AML level of enforcement	No public record of enforcement action
AML level of public reporting and understanding of ML threat	Poor
SARs	N/A

Overview of risk

While not an individual ‘sector’ of the economy and not an area of specific AML supervision, the issuing of UK residency visas in exchange for investment in the economy presents such a considerable risk for the laundering of illicit overseas funds that we have analysed the individual risks below.

AML risks for the UK’s Tier 1 investor visas

High net worth individuals can use the UK’s Tier 1 (Investor) visa system to secure a residency visa in the UK, thereby receiving an implicit endorsement from the UK state of their money’s legitimacy. Migrants who invest £2 million into the UK economy can apply for permanent residency after 5 years. By investing £5 million the waiting time can be reduced to 3 years, and those investing £10 million are awarded residency after 2 years.²²⁹

The TI-UK research paper: “*Gold Rush: Investment visas and corrupt capital flows into the UK*” (2015) provides an in-depth review into weaknesses in the Tier 1 (Investor) visa system.²³⁰

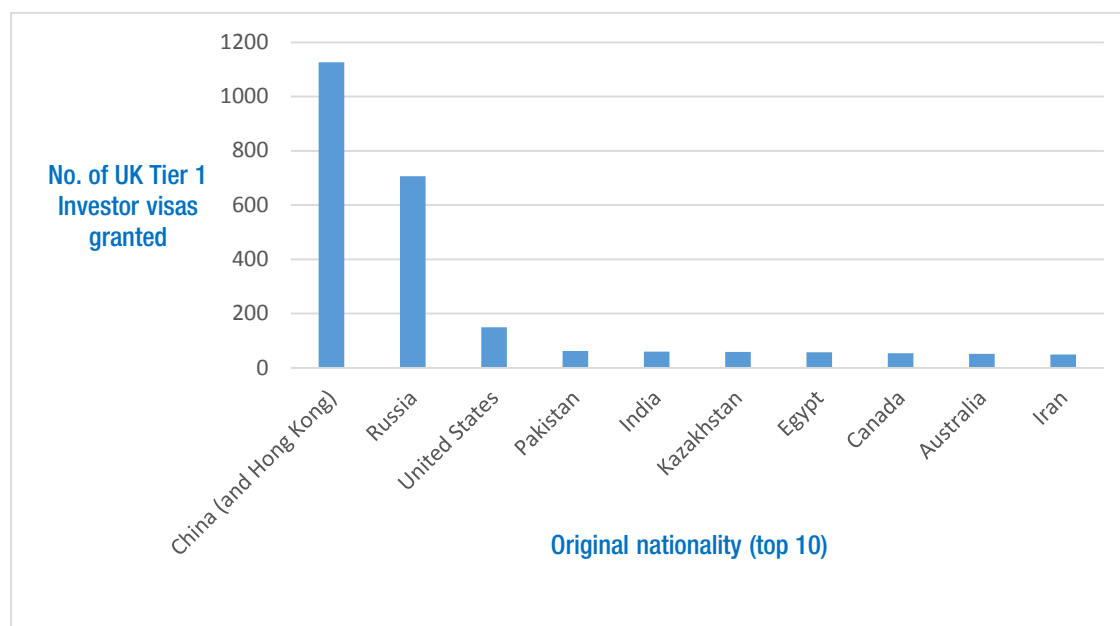
Of the 3048 Tier 1 (Investor) visas recorded between Q3 2008 to Q2 2015, 37 per cent have been awarded to Chinese (and Hong Kong) nationals and 23 per cent have been awarded to Russian nationals. These two groups, both high corruption risk countries, dominate the total number of the visas granted.

While the Home Office data does not include the sums invested, given the minimum investment, the very minimum brought into the UK from China and Russia alone is £1.13 billion and £706 million respectively, and the true figure is likely to be far higher in view of the probability of numerous investors bringing in sums of more than £5 million and £10 million.

²²⁹ <https://www.gov.uk/tier-1-investor/overview> [accessed 12 Nov 2015]

²³⁰ Transparency International UK “Gold Rush: Investment visas and corrupt capital flows into the UK” (October 2015)

Figure 2 - Tier 1 Investor Visas issued between Q3 2008 to Q2 2015



Limited oversight

Despite the clear risk of money laundering through the Tier 1 Investor visa process, there is no dedicated system of money laundering checks for Tier 1 applicants.

As a protection against the risk of facilitating money laundering, since 6 April 2015, the Home Office requires Tier 1 investors to establish UK bank accounts before making a Tier 1 visa application.²³¹ The Home Office also require that applicants continuously maintain their investment if and when their application is successful, for the entire period of their visa.²³² In addition, Home Office guidance states that applicants who have not held the investment funds for three consecutive months before the date of the application must also provide evidence of the source of the funds.²³³

In this way, the Home Office primarily relies on the effective operation of anti-money laundering (AML) checks being carried out by banks or asset management firms in the UK to identify whether there are grounds for suspicion of corruption. If the bank accepts the client's account, the Home Office assume that this means that effective AML checks have been carried out and any risks have been identified. There may be further intelligence agency or Embassy checks carried out, but these assessments are not made public, so it is impossible to assess their adequacy, and are not made available to support private sector due diligence on clients.

²³¹

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/407476/HC_1025_Immigration_Rules.pdf p.58 [accessed 15 Oct 2015]

²³² http://www.mishcon.com/news/briefings/changes_to_tier_1_investor_route_10_2014 [accessed 29 Sep 2015]

²³³

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/456009/T1_I_Guidance_09_2015.pdf p.11 [accessed 29 Sep 2015]

Since September 2015, the Home Office has strengthened the regime and now requires applicants to prove they have no criminal records before being granted a visa.²³⁴ While this is a welcome development for mitigating against some types of criminals, it will have no effect on individuals involved in grand corruption, where the highest levels of government are complicit and where no prior conviction may exist.

An acute concern with the Tier 1 Investor visa scheme is that, for the period from the scheme's inception to 6 April 2015, there was no necessity for an individual to obtain a UK bank account before applying and being awarded a Tier 1 Investor visa.²³⁵ During this period, which we describe as the 'blind faith' period, the Home Office relied on the commitment of the applicant to transfer his funds to a UK bank account *after* they were awarded the Tier 1 Investor visa. During this period, it was the *expectation* that AML checks would be carried out by a UK bank in the future that was the basis to provide the UK authorities with assurance against money laundering risk.

However, we understand through the course of interviews conducted during this research that it is highly likely that UK banks used the fact that an individual had been awarded a Tier 1 Investor visa as qualifying evidence to overcome due diligence concerns when assessing the applicant's legitimacy. As a result, not only would the corrupt have been attracted to a Tier 1 Investor visa in order to achieve UK residency status, but it would have also been attractive to help circumvent a bank's due diligence checks. Another gap in the authorities system of checks during this period was that Tier 1 investors were, generally, only assessed about their compliance with the rules of their visa three years after entering the UK. We have calculated that 97 per cent of all investors using the scheme invested their money in the UK during the 'blind faith' period.

It is worth noting that initial data for 2015 indicates that applications to the scheme have dropped sharply, with only 102 visas granted in the first two quarters of 2015, potentially indicating that the more stringent checks brought in 2015 – alongside the raising of the investment threshold – have significantly reduced the rate of application numbers.

²³⁴ <http://www.telegraph.co.uk/news/uknews/immigration/11748959/Foreign-criminals-face-new-crackdown-as-new-visa-rules-demand-police-checks.html> [accessed 15 Oct 2015]

²³⁵ <http://www.paynehicksbeach.com/media-events/publications/163/overview-of-recent-uk-investor-and-entrepreneur-visa-changes> [accessed 15 Oct 2015]

7. Conclusions

This report provides an in-depth analysis of the vulnerabilities in the UK's framework for overseeing anti-money laundering risks and, ultimately, the barriers to responding effectively to the threat of money laundering of the proceeds of international corruption.

The performance of the regulated sectors in terms of identifying and reporting money laundering – in all sectors apart from financial services – is very poor.

The cornerstone of the problem is that the UK's system of AML supervision is inconsistent and generally failing to meet the standards of effective regulation.

Out of 22 supervisors – that collectively cover financial services, legal services, accountancy, estate agents, luxury goods, and trust and company service providers – none are providing a proportionate or credible deterrent to those who may engage in complicit or wilful money laundering. 20 out of 22 supervisors fail to meet the standard of enforcement transparency demanded by the Macrory standards. Only 7 out of 22 supervisors in the UK control for institutional conflicts of interest affecting their enforcement responsibilities bestowed on them by the Government.

The UK's approach to permitting a large number of AML supervisors in the private sector appears to have contributed to an environment where standards of supervision vary widely. Ineffective supervision, in turn, is likely to lead to ineffective performance in the private sector.

If the threat of money laundering is to be properly mitigated, then the way AML standards are overseen is in need of radical overhaul.

Our analysis indicates that the Financial Conduct Authority leads the UK supervisors in terms of enforcement, transparency, accountability and resourcing a wide suite of risk identification supervisory tools. However, even including the FCA's enforcement record, across the UK there does not appear to be a 'credible deterrent' level of sanction given the scale of money laundering assessed to be flowing through the UK each year.

The lack of a presumption of personal responsibility by relevant senior managers for money laundering failings remains a key weakness in the UK's AML supervisory toolbox, as identified by the Parliamentary Commission into Banking Standards and the FCA.

8. Recommendations

Our recommendations to mitigate the risks identified in this report fall into three major categories. We believe that the UK Government should:

- Overhaul the way AML standards are overseen to achieve consistency, integrity and accountability in the supervisory system
- Ensure adequate levels of enforcement against AML failures
- Provide better information about money laundering risks to the private sector

Overhaul the way AML standards are overseen to achieve consistency, integrity and accountability in the supervisory system

Recommendation 1. Consolidate the number of AML supervisors in the UK. The UK Government should review the arrangements for AML supervision in the UK and examine options for consolidating the number of AML supervisors. The review should examine the merits of replacing the existing patchwork and inconsistent structure of AML supervisors with a single, well-resourced “super” supervisor that can provide a consistent approach to evaluating risk, raising compliance standards and communicating with regulated sectors.

Recommendation 2. Force supervisors to meet the Macrory standards of enforcement transparency. The current position where supervisors can refuse information to stakeholders on the basis of ‘commercial sensitivity’ is a symptom of a dysfunctional system. Regardless of any consolidation of the number of AML bodies with supervisory responsibilities, HM Treasury should direct supervisors to meet the Macrory standards of transparency by requiring them to:

- publish their enforcement statistics
- publish the details of individual cases of enforcement
- provide greater transparency over their current understanding of compliance gaps in the sector

Recommendation 3. Require all supervisors to meet the Clementi principle. For all relevant private sector supervisors, AML enforcement and investigations roles should be separated institutionally from the promotional and commercial aspects of the institution, as the Law Society in England and Wales largely achieved through the creation of the Solicitors Regulation Authority.

Recommendation 4. Require supervisors to respond to HM Treasury’s annual review of AML supervisory performance. For the last annual AML supervision report, several UK supervisors did not even respond to the Treasury’s annual request for information. Such a lack of reporting and accountability should not be tolerated. The Government should require all supervisors to submit accountability reports which are fully compliant with the Macrory standards of enforcement transparency. The Treasury Select Committee should also scrutinise the HM Treasury’s performance in overseeing AML supervisors with an annual hearing on the annual review of AML supervisory performance.

Recommendation 5. Consider the removal of legal privilege exemptions to report suspicions for accountants, auditors and tax advisors. The extension of professional privilege for client legal advice to accounting advice is an anomaly in UK law that exists only for anti-money laundering obligations. HM Treasury should review the legitimacy of such arrangements and their contribution to overall effectiveness of the AML regime.

Recommendation 6. Ensure fit and proper tests are applied consistently across all regulated sectors. The Government should ensure that HMRC has the power to apply a fit and proper test across all regulated sectors. Further work should be carried out to evaluate the effectiveness of the professional body requirements for the private sector supervisors.

Ensure adequate levels of enforcement against AML failures

Recommendation 7. Provide adequate resources to AML supervisors. Whether the AML supervisors are consolidated or not, they need to have the necessary resources to effectively monitor and ensure compliance with AML requirements. It is a false economy to continue to support a low cost supervisory model that is failing to deliver effective AML supervision. As a general rule, supervisors should have, at least, enough resources to:

- survey and understand the AML threat
- communicate with the firms they supervise
- adequately staff an effective whistleblowing regime
- meet the Macrory standards of effective and transparent sanctioning

Recommendation 8. Recognise the money laundering threat in the Strategic Defence and Security Review. The UK Government should follow through from its recognition in the 2015 UK national risk assessment of money laundering and terrorist financing – which identified money laundering as a strategic threat to the integrity of the City of London and a contributor to international instability – to the Strategic Defence and Security Review. Without joining up Government's efforts to combat the threat, the resources may not be available to address the money laundering vulnerabilities that have been identified in this report and by the UK Government itself.

Recommendation 9. Establish a 'credible deterrent' across all sectors for money laundering failings. No sector supervisor in the UK is providing a proportionate and credible deterrent to those who may engage in complicit or wilful money laundering. Punitive fines in many sectors are completely absent, and there are no convincing examples of enforcement and punitive measures that are proportionate either to potential gains by corrupt professionals or proportionate to the harm caused by facilitating grand corruption with impunity. The Government should review the enforcement tools for tackling money laundering in the UK and ensure that AML supervisors have the necessary sanctions to provide a credible deterrent to money launderers.

Recommendation 10. Establish an effective system of personal liability for money laundering failings. All supervisors should consider the case for introducing individual as well as corporate liability for AML failings in firms. Senior managers who are allocated responsibility for AML checks should be subject to a 'presumption of responsibility'. If a firm breaches the supervisor's rules, the relevant senior manager should face a range of sanctions, including losing professional or 'fit and proper' accreditation and personal fines, unless they can satisfy the supervisor that they took reasonable steps to avoid the breach.

Recommendation 11. Raise awareness of responsibilities to report suspicions across the supervised sectors. Evidence from the banking sector shows that raising awareness of AML compliance within a supervised community can help encourage higher levels of SAR reporting. Other supervisors should consider how to raise awareness of reporting responsibilities and evaluate whether their sector is failing to identify and under-reporting threats. HMRC is responsible for all of the sectors with negligible or very low suspicious reporting rates: estate agents; high value dealers and trust and company service providers. If HMRC retains responsibility for AML supervision, it should be resourced to encourage AML training and awareness raising programmes for the relevant sectors.

Recommendation 12. Examine how the quality of SARs can be increased. Evidence from the Government suggests that SARs from the legal, accountancy and estate agency sector are often of poor quality and do not contain enough information about the suspicious activity for the NCA to take action.²³⁶ Supervisors should work with law enforcement authorities to provide greater detail about what constitutes a high-quality SAR and work to communicate and disseminate good practice amongst the supervised community.

Provide better information about money laundering risks to the private sector

Recommendation 13. Continue to expand corporate beneficial ownership transparency to support an effective AML system. While secrecy of company ownership in other jurisdictions may assist the laundering of corrupt capital, there are steps that the UK can take unilaterally that will create greater transparency over these risks, enable more effective law enforcement and have a deterrent effect on corrupt capital. The UK Government should work to ensure there is greater transparency over who owns the companies that hold assets in the UK. In the property market, any foreign company intending to hold a property title in the UK should be held to the same standards of transparency required of UK-registered companies. Before completing a purchase on a property, overseas companies should be required to submit to Land Registry the same details that UK registered companies must submit to Companies House. Consideration should be given to how the same levels of transparency can be achieved over foreign ownership of more portable assets.

Recommendation 14. Consider how to prevent British Overseas Territories facilitating the money laundering threat to the UK. Offshore corporate secrecy remains a principal barrier to effective private sector due diligence and high standards of compliance with the letter of the law of UK Money Laundering Regulations 2007.²³⁷ The UK Department for Business has made a laudable commitment to create an open public registry of corporate beneficial ownership. However, the requirements will only apply to UK registered companies, potentially missing foreign companies or offshore company structures holding UK assets or trusts holding assets. The UK Government should consider whether to legislate directly over British Overseas Territories in order to require them to establish comprehensive public registers of corporate beneficial ownership.

Recommendation 15. Incentivise transparent transactions. Those who conduct criminal business through offshore secrecy jurisdictions may achieve protections against due diligence and anti-money laundering investigations, as well as unfair tax benefits. The scales of cost/benefit analysis need to be tilted in favour of transparency. The UK Government and AML supervisors should create a 'transparency dividend' by publicly confirming existing case law, that transactions through secrecy jurisdictions necessarily infer a higher money laundering risk, and therefore should be accompanied with greater due diligence attention. In this way the 'cost of secrecy' can be explicitly recognised in the market, which in turn is likely to disincentivise jurisdictions to follow a secrecy model for their economies.

²³⁶ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) pp.41, 45, 55

²³⁷ <http://www.legislation.gov.uk/uksi/2007/2157/contents/made> [accessed 12 Nov 2015]

Recommendation 16. Strengthen intelligence sharing frameworks between law enforcement authorities, AML supervisors, civil society and key private sector entities. Following on from the success of the NCA's Joint Money-Laundering Task Force, HM Treasury should lead in designing forums for sector-specific exchanges of information that can help develop methods, risks and threat typologies of the money laundering issues observed by different stakeholders. This would allow industry to have access to up-to-date methods that would enable them to put in place governance measures to prevent further corruption. Secrecy barriers that constrain HMRC from engaging in intelligence sharing should be tackled or openly recognised by HMRC as a barrier.

Recommendation 17. Encourage more effective use of data to inform risk-based decisions. Many UK AML supervisors are failing to differentiate money laundering risks or take risk-based decisions, and in the few cases where supervisors have surveyed such issues, there appear to be significant inadequacies in their ability to assess the relevant risk. Transparency International recognises itself that tools like the Corruption Perceptions Index can be widely misapplied to private sector and supervisor AML-risk methodologies. The Government, law enforcement authorities, supervisors, international authorities, civil society and research organisations should all consider how they can contribute to a collective effort to help increase the sophistication of understanding of risk of proceeds of corruption money laundering and how high-risk PEPs are identified.

Recommendation 18. Require up front and public declarations of legitimate income by Tier 1 investors. The Home Office Tier 1 Investor visa scheme should support and contribute to a more effective AML system, instead of relying on the AML checks in the private sector to identify risks. Prior to issuing a Tier 1 Investor visa, applicants should be obliged to file a public declaration of their interests and assets and provide assurance in the legitimacy of their income. The Home Office should maintain a public register of legitimate sources of wealth for Tier 1 Investor visas. At the very least, up-front declarations should apply to PEPs and public officials who should expect to meet a high level of transparency, even after they have left office.

Recommendation 19. Establish a preventative visa denial list for high corruption risk individuals. The UK Government should maintain an anti-corruption visa denial list, in an intelligence-led and preventative framework. This list should be based on information provided by UK law enforcement authorities and security services about identifying individuals who are highly likely to be involved in systemic grand corruption, and against whom there is little immediate prospect of justice in their own country. Visa denial decisions should be subject to appeal and the process should comply with international humanitarian law. Within this framework, the UK Government should work with international partners to establish whether such a preventative visa denial list could be shared with other countries.

Recommendation 20. Publish jurisdictional risk reports. The UK Government should consider publishing jurisdictional risk reports to enhance the quality of due diligence professionals' assessments of risk in their own businesses. The UK Government has access to intelligence and information through the Embassy network that can inform a nuanced and sophisticated judgement on money laundering and corruption jurisdictional risk. The lack of effective meaningful jurisdictional risk indicators can undermine private sector assessments of risk and therefore undermine identification of money laundering.

Annex 1. Regulatory overview – How the UK should be protected in theory

In theory, the UK's AML legislation should act as a safeguard to deal with the risk of the corrupt and other criminals holding UK assets as a way to launder money.

The UK incorporates the offence of money laundering in two main pieces of legislation: the Proceeds of Crime Act (POCA) 2002 and The Money Laundering Regulations (MLR) 2007. The latter implemented the third EU Anti-Money Laundering Directive into the UK.

UK law – in compliance with international AML regulations – assigns a crucial role to the private sector in detecting and reporting incidents of suspected money laundering.

Financial, legal and accountancy firms all fall within the scope of both POCA 2002 and MLR 2007 as regulated sectors, as do estate agents, dealers in high-value luxury goods and trust and company service providers. In the case of the UK, not only are such regulatory regimes relatively recent, but they are often fragmentary and subject to frequent institutional change, such as the recent transfer of real estate regulation from the Office of Fair Trading (OFT) to HM Revenue and Customs (HMRC) in 2014.²³⁸

Regulatory supervision

There are 27 supervisory authorities overseeing different regulated sectors for money laundering. For instance, financial and credit institutions are supervised by the Financial Conduct Authority (FCA), while HMRC is the supervisory authority for estate agents.

In some cases, the supervisory power may be delegated to professional associations, such as the Solicitors Regulation Authority (SRA) (the regulatory independent arm of the Law Society that covers legal professionals in England and Wales), the Law Society of Scotland, the Law Society of Northern Ireland, and many others. For the accountancy sector, there are at least 14 different supervisors taking some responsibility for AML supervision, which raises the prospect of inconsistent approaches to managing AML risks with varying standards of enforcement and oversight. This was recognised in the UK's national risk assessment on money laundering and terrorist financing, in which the Government concluded that "the effectiveness of the supervisory regime in the UK is inconsistent".²³⁹

²³⁸ <https://www.gov.uk/government/publications/april-2014-supervision-of-estate-agency-businesses-by-hmrc/april-2014-supervision-of-estate-agency-businesses-by-hmrc> [accessed 3 Jun 2015]

²³⁹ HM Government, National Risk Assessment on Money Laundering and Terrorist Financing (Oct 2015) p.5

Customer due diligence

All regulated sectors are expected to monitor their clients and, to some extent, the source of the money that will be accepted. This is done by performing a series of checks called customer due diligence whenever entering into a business relationship or undertaking an occasional transaction with a prospective customer. To comply with these obligations, a regulated business must:

- assess the risk of the business being used by criminals to launder money
- check the identity of customers
- check the identity of relevant 'beneficial owners' of corporate bodies and partnerships
- monitor customers' business activities and report anything suspicious to the NCA by filing Suspicious Activity Reports (SARs)
- make sure necessary management control systems are in place
- keep all documents that relate to financial transactions, the identity of customers, risk assessment and management procedures and processes
- make sure that employees are aware of the regulations and have had the necessary training²⁴⁰

For some low-risk customers – such as UK public authorities, listed companies or those already supervised institutions such as banks – a simplified due diligence process can suffice. This means that no information on the nature and purpose of the business relationship or regarding the identity of the beneficial owners is required. In high-risk cases, on the contrary, Enhanced Due Diligence (EDD) is required.

EDD is required when:

- **The customer is not physically present for identification.** In these circumstances further measures need to be undertaken in order to identify and verify the identity of the customer. These measures can include requesting additional documents; requiring confirmatory certification by a credit card or financial institution subject to AML supervision; and ensuring that the first payment is carried out through an account opened in the customer's name with a credit institution.
- **The customer is a politically exposed person (or PEP).** The decision to accept a PEP customer must be taken by senior management, reasonable steps have to be taken to establish the source of funds involved is legitimate and ongoing monitoring of the relationship must be conducted. The vast majority of PEPs will not be associated with illegitimate activity, but do represent a higher risk category for money laundering linked to corruption.

²⁴⁰ <https://www.gov.uk/money-laundering-regulations-introduction> [accessed 16 June 2015]

Who is a PEP?

The 2007 Money Laundering Regulations, in accordance with internationally-agreed rules, define a PEP as an individual who is or has, at any time in the preceding year, been entrusted with a prominent public function by:

- a state other than the United Kingdom;
- a Community [EU] institution; or
- an international body.

Close associates or family members are also considered PEPs

The Fourth EU Anti-Money Laundering directive, which is due to be implemented across all member states by 2017, eliminates the exclusion of domestic PEPs from the definition.¹

¹<http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52013PC0045&from=EN> Art. 19 [accessed 12 August 2015]

In the case that the customer is a legal person (a company, a trust, a partnership, a foundation, etc.) those undertaking due diligence checks must obtain the company's:

- full name
- registration number
- registered address
- country of incorporation

In theory, regulated businesses must also establish all beneficial owners of such entities. For private companies this would imply the identification of all directors, individuals owning or controlling more than 25 per cent of the shares or voting rights, or any other individual who otherwise exercises control over the company. Again, in theory, when it is impossible for a regulated sector to comply with the required due diligence obligations, no business relationship should be undertaken and any existing one must be terminated. The failure to do so could be interpreted as a criminal or civil offence under the MLR 2007. Nevertheless, in 2011, the FSA (predecessor to the FCA) found that a third of banks sampled failed to take adequate measures to understand and verify their customers' ownership and control structure.²⁴¹

²⁴¹ <https://www.fca.org.uk/static/documents/fsa-aml-final-report.pdf> p.25 [accessed 29 Sep 2015]

Submitting Suspicious Activity Reports (SARs)

Besides screening their clients, regulated sectors are also legally obliged to disclose any suspicious behaviour that they observe. Suspicious Activity Reports (SARs) must be filed with the NCA every time that a staff member in the business suspects or has reasonable grounds for knowing or suspecting that a person is engaged in money laundering.

An officer responsible for submitting reports must be nominated. Failure to report suspicious activities is a regulatory offence, and also is potentially a criminal breach, unless the regulated professional is able to provide a “reasonable excuse for not making the required disclosure”²⁴² or is a legal professional adviser, accountant, auditor or tax adviser²⁴³ to whom the information came under “privileged circumstances”.²⁴⁴ Although these exceptions have been introduced with the purpose of addressing privacy concerns and expressly exclude information given with the intention of furthering a criminal purpose, they are still problematic. Their overly wide scope represents a considerable legal loophole, which ultimately shields key sectors from the duty to report potentially useful SARs.

²⁴² POCA 2002, S.330 (6)(a): <http://www.legislation.gov.uk/ukpga/2002/29/section/330> [accessed 11 Aug 2015]

²⁴³ Amendments introduced by the S.I. No. 308 of 2006 have added to the category of “professional legal advisers” also “relevant professional advisers”, hence extending the exemption also to non-legal advisers such as accountants, auditors or tax advisers who are “member of a professional body”. See POCA 2002, S.330(14): <http://www.legislation.gov.uk/uksi/2006/308/regulation/2/made> [accessed 11 Aug 2015]

²⁴⁴ POCA 2002, S.330 (6)(b) and (c): <http://www.legislation.gov.uk/ukpga/2002/29/section/330> [accessed 11 Aug 2015]

Annex 2: Full list of UK AML supervisors

Supervisor	Sector Responsibility
Association of Accounting Technicians (AAT)	Accountants
Association of Chartered Certified Accountants (ACCA)	Accountants
Association of International Accountants (AIA)	Accountants
Association of Taxation Technicians (ATT)	Tax advisers
Chartered Institute of Management Accountants (CIMA)	Accountants
Chartered Institute of Legal Executives (CILEX)	Legal executives
Chartered Institute of Taxation (CIOT)	Tax advisers
Council for Licensed Conveyancers (CLC)	Licensed Conveyancers
Department of Enterprise, Trade, and Investment Northern Ireland (DETNI)	Insolvency Practitioners in Northern Ireland
Faculty of Advocates (Scottish bar association) (FoA)	Barristers in Scotland
Faculty Office of the Archbishop of Canterbury (AoC)	Notarial profession in England & Wales
Financial Conduct Authority (FCA)	Credit and financial institutions
Gambling Commission (GC)	Non-remote and remote casinos
General Council of the Bar (England and Wales) (GCBEW)	Barristers in England and Wales
General Council of the Bar of Northern Ireland (GCBNI)	Barristers in Northern Ireland
HM Revenue & Customs (HMRC)	<ul style="list-style-type: none"> • Money Service Businesses • Bill Payment Service Providers • Telecommunication, digital and IT Payment Service Providers • Trust and Company Service Providers • Estate Agency Businesses • High Value Dealers • Accountancy Service Providers (for those not registered with a professional body)
Insolvency Practitioners Association (IPA)	Insolvency Practitioners
Insolvency Service (SoS)	Insolvency Practitioners
Institute of Certified Bookkeepers (ICB)	Bookkeepers
Institute of Chartered Accountants in England and Wales (ICAEW)	Accountants in England and Wales
Institute of Chartered Accountants in Ireland (ICAI)	Accountants in Northern Ireland
Institute of Chartered Accountants of Scotland (ICAS)	Accountants in Scotland
Institute of Financial Accountants (IFA)	Accountants
International Association of Book-keepers (IAB)	Bookkeepers
Law Society of England and Wales (LSEW) regulating through the Solicitors Regulation Authority (SRA)	Solicitors and Solicitor firms in England and Wales
Law Society of Northern Ireland (LSNI)	Solicitors and Solicitor firms in Northern Ireland
Law Society of Scotland (LSS)	Solicitors and Solicitor firms in Scotland

Associated recent publications from Transparency International

Closing Down the Safe Havens: Ending Impunity for Corrupt Individuals by Seizing and Recovering their Assets in the UK (2013)

Global Corruption Barometer (2013)

Corruption Perceptions Index (2014)

TI-UK Submission to HM Treasury National Risk Assessment on Terrorist Financing & Money Laundering (2014)

Corruption on Your Doorstep: How Corrupt Capital is Used to Buy Property in the UK (2015)

Empowering the UK to Recover Corrupt Assets: Unexplained Wealth Orders and other new approaches to illicit enrichment and asset recovery (2015)

TI-UK Response to the UK National Risk Assessment of Money Laundering and Terrorist Financing (2015)

Gold Rush: Investment Visas and Corrupt Capital Flows into the UK (2015)

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