

SRA BOARD
23 January 2019

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This paper will be published (except for the MLRO report at annex 2)

Our approach to preventing money laundering

Purpose

- 1 The purpose of this paper is to update the Board on our supervision of anti-money laundering (AML) and recent developments on the prevention of economic crime.

Recommendations

- 2 The Board is asked:
 - a) to note the findings of the Financial Action Taskforce (FATF) review (paragraphs 10 to 16);
 - b) to note the current approach to AML supervision (paragraphs 17 to 33)
 - c) to discuss and agree the 2019 approach to AML supervision (paragraphs 34 to 40).

If you have any questions about this paper please contact: Richard Collins, Executive Director Policy and Resources, richard.collins@sra.org.uk.

Equality, Diversity and Inclusion considerations

Consideration	Paragraph nos
The source crimes of laundered funds, for example people trafficking, have a disproportionate impact on the most vulnerable in society.	3
The impact of AML regulation, as well as the costs may have a disproportionate impact on small firms which have a higher BAME profile.	8
The money laundering regulations have the potential to have a disproportionate impact on sectors of society that do not have standard or official identification documents. This might include the elderly, the homeless or immigrants.	9

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Our approach to preventing money laundering

Background

- 3 The prevention of financial crime and money laundering are high profile issues for both the UK Government and the SRA. We have always taken our duties as an AML supervisor seriously and investigated issues on a reactive basis, but we have stepped up our approach over the last two years. More recently, there has been a political push for a greater focus on preventing financial crime and terrorist financing as a result of the Salisbury poisonings and we will continue to see Government interest and scrutiny in this area for the foreseeable future. Money laundering is how criminals use the profits from some of the worst crimes in society, for example drugs trafficking, people trafficking and arms dealing (which often affect the most vulnerable in society) so we take our duties as an AML supervisor very seriously.
- 4 The SRA has agreed a new more intensive approach to preventing and detecting money laundering. Nine months ago we began a more proactive and focused approach to AML supervision. The Board received an update on developments in March 2018 and updates on the first supervisory visit by the Office of Professional Body AML Supervision (OPBAS) in July, September and October 2018.

The regulatory and political landscape

- 5 The prevention of money laundering and terrorist financing is high on the political agenda, both in the UK and Europe. In Europe, the 5th Money Laundering Directive was agreed in spring of this year, and the UK has until January 2020 to transpose this into legislation. In October, the 6th Money Laundering Directive was agreed by Europe, and the UK will have until December 2020 to transpose.
- 6 Looking to the UK, in November 2018, the Security and Economic Crime Minister launched a Serious and Organised Crime Strategy backed by funding of at least £48 million in 2019 to 2020 to further improve enforcement capabilities in tackling illicit finance. The Minister has said that partnership with business and civil society will be central to success.
- 7 In addition, the new National Economic Crime Centre (NECC) was established in November 2018. This is designed to be the national authority for the UK's operational response to economic crime, maximising the value of intelligence, plus prioritising, tasking and coordinating to ensure the UK's response reduces economic crime.
- 8 The impact of all of this on the SRA, and our regulated population is a greater call on resources in order to consider, implement and communicate changes to our regulatory regime. We must take care to implement new regulations in a proportionate and targeted way to reduce regulatory burdens where possible, in particular small firms which have a higher BAME profile.

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- 9 This cycle of new legislation is likely to continue in the medium term while terrorism remains a high-profile threat, and the UK and EU seek a legislative solution to preventing money laundering and terrorist funding. The way in which our regulated population implements the new regulations could have an impact on those seeking access to justice. For example the requirement to identify oneself before certain transactions might be difficult for some consumers (for example the elderly). Some international examples of how lawyers are involved in money laundering are included at annex 1.

Financial Action Taskforce (FATF) review

- 10 In 2018, the effectiveness of the UK at preventing and detecting money laundering and terrorist financing was assessed by FATF. The review was a once-in-a-decade assessment of our regime and involved a team of international assessors evaluating the UK on technical compliance against FATF's 40 recommendations and its effectiveness against FATF's 11 immediate outcomes.
- 11 The intensive year-long evaluation involved FATF inspectors spending just under three weeks on site in the UK. We worked closely with the Treasury in the run-up to the UK's assessment and we fielded a team of three staff members for interview by FATF during the on site phase of the assessment.
- 12 In December 2018, FATF published the results of its evaluation¹ setting out its findings and recommended actions for reform. As a whole, the UK did very well, gaining the highest score of any country rated during this round of assessments and beating countries such as the USA, Spain and Australia, however FATF raised concerns about the legal, accountancy and trust and company services sectors.
- 13 The review identified strengths in the coverage of the regulations, the criminalisation of money laundering offences and the implementation of financial sanctions. FATF identified the need for improvements within UK's financial intelligence unit (part of the National Crime Agency) and on correspondent banking.
- 14 The two most relevant categories to our work are AML/Counter Financing of Terrorism supervision, and preventive measures in the private sector, and in both of these categories the UK scored 'moderate'. The assessment includes the work of all professional body supervisors in the legal and accountancy sector as well as the statutory supervisors in the first category. FATF considered AML supervision on the legal and accountancy sectors to be very mixed, however we were complimented in our work in some areas, for example risk, with the report stating:

¹ www.fatf-gafi.org/publications/mutualevaluations/documents/mer-united-kingdom-2018.html

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“While the main legal sector supervisor displayed a good understanding of risks facing their sector, there is a mixed understanding of risks amongst the other self-regulatory bodies (SRBs), particularly the smaller ones.”

- 15 FATF flagged the large and diverse nature of AML-regulated businesses and professions in the UK and raised concerns about a lack of consistency in supervision. As mentioned above, FATF raised concerns about a lack of consistency in assessing risk, and an application of the risk based approach by supervisors. The report also talks about under-reporting of suspicions of money laundering by lawyers, accountants and trust and company service providers and that reports submitted are often of a low quality.
- 16 Under FATF’s follow-up procedure the UK will report back to FATF on our progress in addressing deficiencies in three years’ time and improving the effectiveness of the regime in five years’ time. The Government will set out its response to the recommendations in the report in due course and this will likely be included within its proposed economic crime plan. We recognise that there is more to do and will work to incorporate any changes required from the FATF review into our regulatory regime.

Recommendation: the Board is asked to note the findings of the Financial Action Task Force (FATF) review.

The SRA’s regulatory approach

- 17 The most recent money laundering regulations to come into force are The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017. These were the first new money laundering regulations in the UK since 2007, so brought about a considerable change to the regulated sector as well as to us as an AML supervisor.
- 18 In addition, from January 2018 a new supervisor was set up to oversee all professional body regulators in the UK. The new Office of Professional Body AML Supervision (OPBAS) will encourage high standards of AML supervision and consistency amongst the 22 professional bodies it supervises.
- 19 In light of the new legislative requirements, and greater oversight of our activities, we set up an AML programme board to coordinate and direct our work in this area. We have worked towards creating a new system of regulation for the supervision of money laundering which has been in place since 1 May 2018.
- 20 The entirety of the AML regime is based on risk, and this is reflected in the legislation and our approach to supervision and should be embedded in firms’ own processes and procedures to prevent money laundering. We produce two major pieces of work on risk; firstly to assess how likely a firm is to be used to launder money; and secondly a published document² setting out what factors

² www.sra.org.uk/sra/how-we-work/reports/aml-risk-assessment.page

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we think make firms more vulnerable to money laundering. Our assessment of firms' risk decides what level of regulatory scrutiny the firm will receive and is based on an artificial intelligence model that is designed to learn and become more accurate as we give it more data.

- 21 From 1 January 2019 we will be using a more traditional, tick-box risk assessment, based on risk factors in the UK's national risk assessment and our sectoral risk assessment. We will also include how well a firm is mitigating their risk, where we have that information, within our assessment.
- 22 Our system of AML regulation falls into two broad categories: reactive work, including responding to concerns and breaches; and proactive work, including engaging with firms to prevent breaches, identifying potential issues and going into firms to assess their level of compliance.
- 23 The reactive work is triggered by information or intelligence that we receive which is added into the firm's wider regulatory profile. Reports coming into the SRA are assessed to take into account the nature of the allegation, its severity, the quality of information and our ability to investigate. Reports with a money laundering or terrorist financing aspect are prioritised and will generally result in an onsite investigation of the firm.
- 24 From 1 May 2018, we increased our range and scale of proactive engagement on money laundering issues. We use the following proactive tools:
 - Thematic visits
 - Regulatory management visits
 - Forensic investigation visits
 - Preventative communications
 - Engagement with external stakeholders.
- 25 Our thematic work is becoming more sophisticated and targeted. We have committed to doing one AML-related thematic review per year. In 2017, we undertook a general AML thematic, looking at how well firms were implementing the new money laundering regulations, which involved visiting 50 firms. We found that firms were mostly doing well with implementing the new requirements in the regulations, but that many hadn't fully embraced the risk based approach, for example by putting in place the firm's AML risk assessment.
- 26 In 2018, we focused our thematic review on trust and company services providers – an area of work deemed to be high risk by the UK's national risk assessment. We visited 60 firms and the results of the thematic will be published in summer 2019.
- 27 We have a more direct relationship with 89 of our largest law firms through our regulatory management team. The regulatory manager assigned to the firm has regular contact with those responsible for risk and compliance and reviews AML matters during the course of their engagement.

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- 28 We have a team of forensic investigators who visit firms in relation to serious regulatory matters and can go through an AML assessment form with the firm in certain circumstances. Any forensic investigation visit that has a money laundering concern element to it will mean that the investigator goes through the AML assessment form as part of the visit. In addition, if a forensic investigation visit is taking place as part of an unrelated matter, but the firm is rated high risk, the investigator will also go through the AML assessment form in addition to any other investigation that they are undertaking.
- 29 Our proactive work includes a considerable amount of outreach work, designed to help firms with compliance and prevent breaches of the money laundering regulations. We publish reports arising from thematic reviews, which include indicators of good and poor practice. We have published several warning notices related to money laundering. We have previously issued a warning notice about reporting suspicious activity and last year we issued an updated warning notice on the signs of money laundering and terrorist financing and on the improper use of a client account as a banking facility. We have a single piece of guidance for the UK legal sector, which is approved by the Treasury, meaning that it can provide a defence against money laundering allegations if the guidance has been followed.
- 30 We try, where possible, to share information to prevent and detect money laundering with other interested parties and seek information back from others about our regulated population. At a high level, we share information with other AML supervisors, both in the legal sector and beyond. This helps us to learn from others and have a broadly consistent approach throughout the legal sector. On a case-based level, we share information with the National Crime Agency (NCA), HMRC and other AML supervisors. We find sharing information with the NCA to be particularly useful, for example where it has concerns about the quality of suspicious activity reports that a firm is submitting. In the nine months of proactive supervision we made 11 referrals to other stakeholders and received 29 from external stakeholders.
- 31 We take our responsibility to report suspicion of money laundering or terrorist financing seriously. We have a dedicated money laundering reporting officer (MLRO), and in November 2018 appointed a deputy MLRO. The MLRO is appointed to receive internal reports of suspicious activity and either monitor or make a suspicious activity report to the NCA. The MLRO's annual report is attached at annex 2.
- 32 We have dedicated considerable training resource to make sure that staff are aware of their duties to report any suspicion to the MLRO and require all members of staff to attend face-to-face training on when and how to report suspicion. As a result, the number of internal reports and referrals has been increasing, with 63 reports in the most recent quarter and a total of 177 in the three quarters to date.

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- 33 We have devoted considerable resource to developing systems to be able to identify money laundering risk and spot where issues are arising. The greater scrutiny in this area has meant an increase in cases coming through to supervision. At the end of the reporting period, the Investigation and Supervision directorate had 190 open cases related to money laundering issues. It is accepted good practice for the MLRO to submit an annual report to senior management setting out how they have met their obligations under the money laundering regulations.

Recommendation: the Board is asked to note the current approach to AML supervision.

Recommendation: the Board is invited to receive the MLRO's annual report.

A forward look to 2019

- 34 Our proactive approach to AML supervision is still very much evolving. The first year of proactive work will be completed by May 2019. Our proactive approach to AML supervision will continue in 2019 and we will undertake an evaluation of the work in June 2019, once our proactive approach has been in place for over a year and the 2017 money laundering regulations in place for two years.
- 35 In the next quarter, the MLRO team will begin to review random samples of files to look at how well we are doing at identifying, investigating and closing money laundering cases. The MLRO will produce an annual report, setting out their activities throughout the preceding year.
- 36 From January 2019 we will implement the changes to our approach that we agreed with OPBAS after our first regulatory visit which took place in June 2018. We will alter our firm risk assessment as already described in this paper, to move from an artificial intelligence-based approach to a combined approach involving a more traditional risk matrix pulling through risk factors from the national risk assessment and our sectoral risk assessment.
- 37 From the start of the year we will also assess how well firms are mitigating their money laundering risk. Whilst we have done this on an informal basis in the past, we will now give firms that we visit a rating of compliant, partially compliant or non-compliant based upon how well they have implemented the processes and procedures to prevent money laundering required of them by the regulations. We will record the rating against the firm, and where we have this information it will feed into the firm's risk rating.
- 38 In 2019, we intend that our thematic work will focus on high value conveyancing, in particular looking at cash purchases of prime, or super-prime property. This is an area that has attracted much attention in the press, and the Government believes it to be a high-risk area. We are tentatively considering focusing our 2020 thematic on firms' AML risk assessments and the risk-based approach, although this might be overtaken by subsequent events or new areas of risk that come to our attention.

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- 39 We are considering what we can do to prepare for our next supervisory visit by OPBAS. We do not yet know what form our 2019 visit might take, as OPBAS is waiting to finalise and consider its first round of visits in 2018 before deciding upon its 2019 programme of work and can't yet tell us what to expect. OPBAS has broad powers to request information, and might consider sampling cases to undertake file reviews.
- 40 Overall, we believe our programme to tackle money laundering to be in good shape, and that we are at the forefront of work in this area. That is not to say that we cannot still make improvements and we will continue to examine and evaluate what we are doing in this area and make improvements where we are able.

Recommendation: the Board is asked to discuss and agree the 2019 approach to AML supervision.

Next steps

- 41 We plan to review how well the changes we made as a result of the OPBAS findings are working after 12 months, in January 2020. We are also planning a full review of our AML programme in June 2019, two years on from the implementation of the most recent money laundering regulations.

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Supporting information

Links to the Corporate Strategy and/or Business Plan

- 42 The Strategic Plan notes that the Government is challenging the outcomes and impact of regulatory activity in identifying and tackling financial crime and money laundering across all relevant professional services sectors. The plan notes the impact of OPBAS on our approach to regulation, we have a plan in place to liaise with OPBAS and to implement recommendations that it makes to us.

How the issues support the regulatory objectives and best regulatory practice

- 43 The proposals strive to improve our regulatory approach so that it is more proportionate and targeted, works better for consumers and those we regulate in the increasingly diverse legal services market and to reduce the burden on those we regulate.

Public/Consumer impact

- 44 Efficient AML supervision reduces the risk of terrorist financing and money laundering. An impact assessment formed part of the Treasury consultations into the implementation of the third money laundering directive and the creation of OPBAS.
- 45 The fees charged by OPBAS will place a financial burden on solicitors through the practising certificate fee, and these costs may be passed on to consumers. We have recently responded to a consultation by OPBAS setting out proposed fee levels, which are more than double the level it had originally set out in consultations. The consultation proposes implementing a fee structure that would have disproportionate financial impacts on small and large AML supervisors, and we have submitted a robust response.
- 46 Poorly implemented AML regulation has the potential to place burdens on consumers wishing to access legal services, for example through overly prescriptive ID checks.

What engagement approach has been used to inform the work and what further communication and engagement is needed

- 47 There are several stakeholder groups that are affected by the issues within this paper. We work closely with the Treasury, the Home Office, the National Crime Agency, the Financial Conduct Authority and other legal services supervisors. The Law Society is another important stakeholder, as they are named in the money laundering regulations as supervisor for solicitors. It is particularly important that we engage with firms offering services that fall within the scope of the regulations. We have in place an overarching communications plan on AML.

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What equality and diversity considerations relate to this issue

- 48 The money laundering regulations have the potential to have a disproportionate impact on sectors of society that do not have standard or official identification documents. This might include the elderly, the homeless or immigrants.
- 49 The source crimes of laundered funds, for example people trafficking, have a disproportionate impact on the most vulnerable in society.
- 50 The impact of AML regulation, as well as the costs may have a disproportionate impact on small firms which have a higher BAME profile.

How the work will be evaluated

- 51 OPBAS will continue to monitor our efficiency as an AML supervisor, and may choose to make public any areas in which supervisors are not performing effectively. OPBAS can also make a recommendation to Treasury that a professional body should no longer be permitted to be an AML supervisor. We plan to review how well the changes we made as a result of the OPBAS findings are working after 12 months, in January 2020. We are also planning a full review of our AML programme in June 2019, two year on from the implementation of the most recent money laundering regulations.
- 52 The AML programme board will continue to oversee the delivery of the programme as a whole and individual project workstreams.

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Annexes

Annex 1 International case studies

Annex 2 Money Laundering Reporting Officer report

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Annex 1: International case studies³

Case study 1

In 2016, authorities from Germany, supported by EUROPOL experts, took action against an Iraqi organised crime group based in Germany that was suspected of performing money laundering services for international heroin traffickers.

The operation was preceded by extensive and complex criminal investigations, supported by EUROPOL, which coordinated the law enforcement authorities in France, Spain, Germany and the Netherlands, mirrored by EUROJUST's co-ordination of judicial authorities. This criminal syndicate, composed mainly of Iraqi nationals, was responsible for collecting the proceeds of heroin sales throughout Europe (Spain, the Netherlands, Italy and the UK) and laundering these funds to the Middle East through Germany, with an estimated total amount of EUR 5 million already laundered.

The criminals' modus operandi involved the use of cash couriers traveling by car to pick up dirty cash all over Europe. This was followed by the use of trade-based money laundering techniques to transmit the value to the Middle East, primarily through the shipment of second-hand cars; heavy machinery and construction equipment purchased in Germany and exported to Iraq, where the goods were ultimately resold in exchange for clean cash.

The organised crime group was then able to make use of money or value transfer services and unregulated financial channels (the hawala system) to integrate and further transfer funds into the regulated financial system. This left virtually no paper trail for law enforcement.

Professional service providers, such as solicitors, accountants and company formation agents, provided the skills and knowledge of financial procedures necessary to operate this scheme.

Although, few groups are known to provide these services, they launder large amounts of money, and have a considerable impact on the ability of other organised crime groups to disguise and invest criminal proceeds. These syndicates are a significant obstacle to tracing criminal assets.

Source: EUROPOL (Germany)

Case study 2

A lawyer in Texas was convicted for laundering money for an organised crime group and engaging in a variety of fraud schemes. The organised crime group operated in the US, Canada, Africa, Asia and Europe.

A complicit bank employee was also convicted for her role in creating counterfeit checks and monitoring money flows between the numerous accounts controlled by the organised crime group. All of the victims of these various fraud schemes were

³ <http://www.fatf-gafi.org/publications/methodsandtrends/documents/professional-money-laundering.html>

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instructed to wire money into funnel accounts held by other co-conspirators (money mules), who then quickly transferred the money to other US accounts as well as accounts around the world before victims could discover the fraud. Several millions of dollars were laundered in this manner.

The numerous bank accounts opened by the mules served as the initial “layer” in the laundering process, which allowed co-conspirators to distance or conceal the source and nature of the illicit proceeds. For example, during a one-year period, a key money mule opened 38 fraudulent bank accounts.

The fraud schemes took several forms. Many victims were law firms that were solicited online and were provided with counterfeit cashier’s cheques for deposit into the firms’ trust accounts. The law firms were then directed to wire money to third-party shell businesses controlled by the co-conspirators.

The fraud conspiracy also employed hackers who compromised both individual and corporate e-mail accounts, ordering wire transfers from brokerage and business accounts to shell accounts controlled by co-conspirators. The shell companies were incorporated in Florida with fictitious names and then used to open bank accounts at banks in Florida in those names.

The licensed attorney in Texas worked for the co-conspirators by laundering victim money through an interest on lawyer’s client account. He also met with individual money mules to retrieve cash from their funnel accounts. The lawyer recruited his paralegal and others to open accounts used in the laundering scheme.

Source: United States

Case study 3

This case was initiated by a special currency police unit within the Guardia di Finanza as a follow-up investigation to a judicially authorised search conducted on the boss of a major organised crime group La Cosa Nostra in Palermo, Italy. This investigation was aimed at identifying those individuals acting as nominees, as well as individuals who facilitated the movement of criminal proceeds on behalf of La Cosa Nostra.

The investigation identified that a well-known lawyer was the beneficial owner of the companies used to launder funds via a Palermo-based construction company, which was linked to family members of the organised crime boss. The lawyer performed a “money box” function for the La Costa Nostra, which consisted of managing the financial resources of the crime group with the purpose of concealing the origins of the illicit proceeds and avoiding detection by authorities of any assets purchased from these proceeds.

Through his professional relationships, the lawyer developed and tapped into an elite social network, which he also made available to the organised crime group. The lawyer, who was operating as a professional money launderer, conducted a number of services, such as: (a) obtaining a mortgage to purchase an apartment with EUR 450 000 in criminal proceeds on behalf of an organised crime family member; (b) using a fictitious contract to purchase an apartment with EUR 110 000 on behalf of the organised crime group; and (c) layering and integrating legal funds with criminal

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assets derived from construction work carried out on land purchased with criminal proceeds.

This investigation led to confiscation proceedings against nine individuals totalling EUR 550,000 as well as seven properties owned by the lawyer.

Source: Italy