Solicitors Regulation Authority

Preventing Money Laundering and Financing of Terrorism

A thematic review

March 2018

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Glossary

AML	Anti Money Laundering
CDD	Customer Due Diligence
CFT	Countering the Financing of Terrorism
DAML	Defence Against Money Laundering
EDD	Enhanced Due Diligence
FATF	Financial Action Task Force
GDPR	General Data Protection Regulation 2018
MLCO	Money Laundering Compliance Officer
4MLD	Fourth Money Laundering Directive
MLR 2017	Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017
MLRO	Money Laundering Reporting Officer
NCA	National Crime Agency
PEP	Politically Exposed Person
POCA	Proceeds of Crime Act 2002
PQE	Post Qualification Experience
PSC	Persons with Significant Control
SAR	Suspicious Activity Report
TACT	Terrorism Act 2000
UBO	Ultimate Beneficial Owner
UKFIU	United Kingdom Financial Intelligence Unit

Introduction

The strength of the United Kingdom's (UK's) legal and financial institutions has made it a centre of world commerce.

As a key stakeholder within the UK's financial market, solicitors of England and Wales are central to many transactions and must be vigilant to the risks of money laundering and terrorist financing. The government have acknowledged this and assessed the legal profession to be a high-risk sector.

The legal profession plays a vital role in tackling money laundering. Solicitors handle large sums of client money and the reputation of the profession can give a sense of credibility to any transaction carried out through a solicitor's firm. This makes solicitors' firms an attractive target for criminals seeking to launder the proceeds of crime into the legitimate economy. In addition to the damage done to wider society, security and the economy by failing to identify and address money laundering, any loss of confidence in the solicitors' profession could be catastrophic not only nationally, but globally.

Money laundering is not a victimless crime and effective anti-money laundering (AML) processes and procedures help to disrupt terrorism and crimes such as drug dealing and people trafficking.

The vast majority of firms take steps to prevent money laundering and play their part in tackling this issue. The tiny minority who fail to do so and damage the trust placed in the profession will be subject to robust enforcement action by us.

Our role

We set and enforce against the high professional standards we and the public expect from solicitors. The 186,000 solicitors and 10,400 firms we regulate must adhere to our principles and code of conduct.

In addition to taking action when solicitors or firms fall short of the standards we set, we provide guidance, raise awareness of risks, issue warning notices about activity that causes us concern and undertake thematic reviews of key parts of the legal market.

Money laundering is a high risk for both society and the profession. We have highlighted it as a Priority Risk in our Risk Outlook 2017/2018[1]. We also issued a warning notice to the profession in December 2014[2] (Warning Notice). The Warning

[1] https://www.sra.org.uk/risk/outlook/risk-outlook-2017-2018.page
[2] Money laundering and terrorist financing – SRA warning notice – December 2014

Notice identified an increasing number of firms failing to have adequate systems and controls to prevent, detect and report money laundering.

Solicitors must comply with their legal obligations under the Proceeds of Crime Act (POCA) 2002, the Terrorism Act (TACT) 2000 and, where applicable, the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (MLR 2017)[3]. This includes not facilitating money laundering, and applies to high risk services, such as conveyancing and offering trust and company services.

The Law Society is the named supervisor for solicitors in the MLR 2017 and delegates supervision of AML to us. The MLR 2017 places obligations on supervisory authorities to monitor and ensure the compliance, via regulatory measures, of their members with the AML and Countering the Financing of Terrorism (CFT) requirements.

In addition to our investigatory work, we also proactively visit firms to check compliance and understand the risks and difficulties the profession faces. We carried out a thematic AML review in 2015. During this exercise, we engaged with 252 firms in total and produced a thematic report in 2016 of our findings[4]. During July and August 2017, we visited 50 firms across the profession to examine their AML and CFT processes and procedures. This report contains our findings from those visits and builds on our 2016 thematic AML report.

The wider world

On 26 June 2017, the UK government introduced the MLR 2017. These regulations implement the Fourth Money Laundering Directive (4MLD) and reflect the standards required by the Financial Action Task Force (FATF).

The FATF is an independent international body which develops and promotes policies to combat money laundering and terrorist financing. In Spring 2018, the FATF will conduct a peer review of the UK to assess the effectiveness of our systems and legislation for preventing financial crime.

In 2013, the FATF produced a report highlighting the vulnerabilities of the international legal profession. It concluded that law firms are attractive targets for those wishing to launder the proceeds of crime or otherwise disguise improper transfers of money. The legal sector will come under further scrutiny during the 2018 visit.

[3] Outcome 7.5 of the SRA Code of Conduct 2011
[4] Anti-Money Laundering Report, May 2016
www.sra.org.uk/documents/SRA/research/anti-money-laundering-report.pdf

Summary of the new MLR 2017

The newly implemented MLR 2017 requires relevant firms to adopt a greater risk based approach to AML and CFT compliance. The new requirements are also more prescriptive and firms must make sure that decisions and policies are recorded in writing.

Some of the more substantial changes that have been introduced include:

- a requirement for a practice-wide risk assessment
- the obligation to appoint an individual at the level of 'senior management' as the officer responsible for compliance with the MLR 2017. This individual will be the Money Laundering Compliance Officer (MLCO) and is required by a firm where it is appropriate “with regard to the size and nature of its business[5]”
- amendments to the way in which simplified due diligence may be applied.

[5] Regulation 21(1)

Executive Summary

Our approach to the review

AML and CFT compliance is an important area and as the methods of criminals develop, so too must the response.

The MLR 2017 were introduced in June 2017 following a short lead-in time. We acknowledge that firms have been given a limited opportunity to implement the new requirements and will take a proportionate approach to enforcement. However, firms must make sure the new requirements are met as a matter of urgency. We expect firms to show us the steps they have and will take to meet their new obligations.

In July 2017, following the introduction of the MLR 2017, we began visiting 50 firms. During the visits we met with the management at each firm, interviewed 50 fee earners and reviewed 100 client matters. The firms were made up of 25 large firms and 25 medium and smaller firms (including two sole practitioners). Twenty-five of the firms we visited were revisits from our 2016 thematic AML review. We wanted to examine their progress in the last two years and build on our 2016 review and report. We also wanted to provide firms with self assessment questions to assist them with their work to fully comply with the MLR 2017.

Headline summary

- Overall, most firms we visited are taking appropriate steps to understand and reduce the risk of money laundering, and to comply with the new regulations.
- We were also encouraged that some firms are going beyond the minimum requirements, for example to test training and compliance.
- We found examples of good practice, including having a variety of ways to establish the source of a client's funds and wealth.
- Yet we did find areas of concern. Not all firms were keeping records of their decisions, and many had not made progress with putting a firm-wide risk assessment in place. We recognise that they had been given limited opportunity to implement the new regulations, but we expect firms to move towards compliance as a matter of urgency.
- Firms are generally carrying out appropriate customer due diligence (CDD).
- There were also a small number of firms who have a significant amount of work to do to improve both processes and practice. These issues ranged in scale. In six of the most serious cases we have taken firms into our

disciplinary process. We will take appropriate action against individuals and firms who fail to meet the minimum standards and fail to comply on an ongoing basis.

- We urge firms to be continually vigilant and review their systems and processes on a regular basis. Any weakness in a firm's systems or processes could have significant consequences.

Summary of findings by area

Our discussions during our visits centred around the following key areas:

Governance

Most firms we visited had appropriate systems in place to reduce the risk of money laundering and terrorist financing. From 2018, many firms will be required to register MLCOs with us. This is a new role and will be in addition to the Money Laundering Reporting Officer (MLRO). The MLCO will be at board level (or hold equivalent status) and will be responsible for AML and CFT compliance. Encouragingly, many firms had already considered and identified their likely nominees.

Risk based approach

Firms continue to respond to the new prescriptive requirements of the MLR 2017. Most firms had an appropriate understanding about the risks their firms faced. We encourage firms to consider the risks at a firm and department level. Although some firms must still make changes to meet the new obligations, we were generally satisfied by the plans and timescales we saw. It is important that firms prioritise these changes and in particular the newly required written risk assessment for the firm.

The requirement for a practice-wide risk assessment is separate to the need to risk assess clients or transactions. Of the 100 files we reviewed, there was evidence that the level of risk was assessed on only 69 of these files, which was less than we would have liked to have seen. All firms should consider keeping written records of decisions, risk assessment processes and what due diligence was undertaken for each client/matter.

Customer due diligence

Overall, we were satisfied by the approach of firms to this area. Although the MLR 2017 has introduced significant changes, firms largely appear to be dealing with this area soundly. Firms acknowledge that this activity was an everyday practice and clients expected these checks.

Firms are obliged to continually monitor CDD and most firms dealt with these requirements well.

Source of funds and wealth

Most firms understood these areas and took steps to investigate the source and origin of client funds. Firms noted that clients largely expected these checks and client refusal to provide information about source of funds and wealth caused many firms alarm. Most firms understood the distinction between funds and wealth and we were pleased to see the depth of the fee earner's investigations. Some firms said that these checks, although onerous, could be turned into a positive marketing opportunity to cross market other services that the firm could offer.

Training

AML and CFT training was undertaken regularly and fee earners were universally positive about the firms' approach. Firms must continue to update their training and consider whether specific individuals require enhanced training. We also expect firms to consider how relevant and useful their training is. We saw good examples of firms tailoring training to address the specific risks that their staff faced in different areas of practice.

Suspicious Activity Reports

Many firms had developed effective internal processes and demonstrated appropriate AML/CFT risk tolerances. We were pleased to see that most MLROs took appropriate steps to safely record and store the decisions they took.

There was no typical number of Suspicious Activity Reports (SARs) and the nature of our visits did not allow us to make qualitative assessments about the number of reports made. However, firms should continue to challenge themselves and consider the implications of the volume of internal reports that are made. We consider the challenges and opportunities of the modern-day profession should inevitably lead to internal queries from fee earners.

We will continue to work with the National Crime Agency (NCA) to address individual concerns about the quality of SARs from law firms and promote best practice.

The future

This project represents just part of our ongoing work in this area. We will continue to work with firms who fall short of the expected standards, and take action where appropriate.

We also continue to respond to complaints and concerns raised by clients and other third parties. If you have concerns and would like to raise them with us, you can do this by e-mail (report@sra.org.uk) or anonymously via our red alert line on 0345 850 0999 or e-mail (redalert@sra.org.uk).

Governance

"It is very time consuming but that is fine. You have to be on the ball. The risks are too great and the impact of doing it wrong could end your career."

A strong AML/CFT culture reduces risk, aids compliance and protects reputation. Firms should create an environment where staff are aware of their AML/CFT responsibilities and can understand and fulfil them. Building a strong AML/CFT culture involves several elements. Key strands include having a well-briefed, trained MLRO and appropriate policies and procedures in place based on the firm's risk assessment. These need to be monitored, improved and enforced.

MLRO selection, preparation and support

Firms chose MLROs based on various qualities. This included selecting:

- a partner because of their seniority and level of responsibility (31 firms)
- individuals with previous MLRO/deputy MLRO experience (11 firms)
- individuals from a compliance background (20 firms)
- individuals with a senior management role (44 firms).

Firms also chose individuals because of their practice experience. Fourteen firms chose litigators and four chose a conveyancer. Some firms believed that a contentious background helped provide the MLRO with the skills to carry out the technical role and interact with third parties. Other firms preferred a conveyancing background because they felt this area represented the highest money laundering risk.

MLROs must make sure that they have sufficient time to devote to the role and consider any other positions they hold. Many MLROs had other roles:

- Compliance Office for Legal Practice (nine firms)
- Compliance Officer for Financial Accounts (four firms)
- both compliance officer roles (five firms)
- partner (20 firms)
- a management role (28 firms).

This is not necessarily a problem in principle, but might become a potential issue if an MLRO is overburdened. If the MLRO carries out several roles they may not be able to give sufficient time and consideration to the role.

The MLRO role is important and onerous. We expect individuals to properly prepare for the role. MLROs said they did this by:

- undertaking training
- serving as deputy MLRO
- reading AML/CFT legislation and guidance
- joining an AML/CFT group.

An effective MLRO needs time to carry out the role. Firms should consider offering practical support to MLROs by reviewing their workload and responsibilities. We saw various examples of this:

- MLROs could seek advice from external experts (28 MLROs)
- a reduction in billable hours (14 MLROs)
- no fee earning commitments (14 MLROs).

Sixteen firms did nothing specifically to assist the MLRO. We acknowledge that this may not always be necessary given the circumstances of each firm. Appropriate systems and processes can reduce the emphasis placed on the MLRO and help the firm build a coherent approach to AML/CFT compliance.

A deputy MLRO provides important support to the MLRO, cover in the absence of the MLRO and helps to address succession planning. We highlighted this in our 2016 AML report [6]. Six firms said they had no deputy MLRO. Firms should also make sure that everyone knows who the MLRO and deputy is. While 49 of the 50 fee earners were aware of the MLRO only 38 fee earners knew the firm's deputy MLRO. This highlights the need for firms to promote both roles. Firms should consider appointing a deputy MLRO if they have not already done so and address how they can mitigate the risks posed by the sudden and/or prolonged absence of an MLRO.

[6] Anti-Money Laundering Report, May 2016, pp.14
www.sra.org.uk/documents/SRA/research/anti-money-laundering-report.pdf

AML/CFT policy

All relevant firms should have:

- a clear and up to date AML/CFT policy in place
- undertaken a firm-wide written AML/CFT risk assessment of their business[7]. This should include consideration of their geographic areas of operation, customers, the types of services and products, and the nature of transactions. There should be a clear link between the risk assessment and the resultant policy.

This is a vital aspect of compliance. Not only is it a legal requirement but it also provides members of staff with a clear understanding about the firm's expectations. The policy should be accessible to all relevant staff and signposted so that it can be easily found.

Forty-eight firms had an AML/CFT compliance policy. One firm had no policy in place (although this was under review) and the other had extensive guides but no overall AML/CFT policy. We were encouraged that 45 firms had reviewed their AML/CFT policies in the last 12 months and 34 firms had reviewed the policy within the last month.

It was disappointing to note that only 11 firms said they had a firm-wide risk assessment in place and a further six firms were in the process of implementing one. This is a requirement under the MLR 2017 and firms must take urgent steps to comply.

Firms explained that they had taken various steps to incorporate changes brought in by the MLR 2017. Fourteen firms have purchased IT equipment and obtained specialist advice to help them comply. We were pleased to see that twenty firms have already considered and determined who will be the MLCO under the new regulations[8]. The level of progress amongst other firms varied.

We expect firms to comply with their legal obligations and are urging them to familiarise themselves with the new regulations and act as soon as possible. However, we recognise the short lead-in time businesses have been given to implement the new requirements and will take a proportionate approach with firms as they work to meet the requirements.

[7] Reg 18 MLR 2017
[8] Reg 21 MLR 2017

Monitoring and enforcement

We looked at what steps firms took to enforce their AML policies and procedures. Compliance is an ongoing activity and firms should make sure that staff meet the standards that are set. Enforcing a policy sends a clear message about expectation and is also a deterrent to individuals who might seek to cut corners or ignore the requirements. We consider this to be good practice and it helps evidence that firms are running their business in accordance with proper governance and sound risk management principles. Thirty-five firms had a designated audit function that monitored AML/CFT compliance:

- twenty-three firms said that the audit function was internal
- four said that it was external
- eight firms had both an internal and external audit function.

Thirty-three firms said they took other steps to test compliance with the firm's AML/CFT policies and procedures. That included:

- regular AML meetings with fee earners
- training and testing
- reviewing client opening forms
- undertaking an annual firm risk assessment
- technical file reviews
- monitoring by the finance/internal compliance teams
- weekly exceptions reporting.

The MLR 2017 has introduced a formal requirement for some firms to appoint an independent audit function to assess the adequacy and effectiveness of its policies, make AML and CFT recommendations and monitor compliance with the regulations. These requirements are proportionate depending on the size and nature of the firm's business and not all firms may need to have these controls[9]. We also asked firms if staff had breached the firm's AML/CFT policies. Nineteen firms said staff had. Issues were mainly resolved by way of discussions with staff. Other actions included providing additional training, referring the matter to us or reprimanding the individual.

[9] Reg 21 MLR 2017

Develop and improve – self assessment questions

Roles

- Have you appointed a MLCO?
- Who is your deputy MLRO? How would others know?
- What support do you provide to the MLRO and the deputy?

Policies

- Have you updated your AML and CFT policies following the MLR 2017?
- Have you created a written firm risk assessment? Does it highlight the risks your firm faces and the mitigation you have taken?
- Is it easy for all staff to access and understand these policies?

Monitoring and Enforcement

- Could you prove staff understand and follow your policies?
- What do you do if staff fail to follow your policies?

Risk Based

"We do high volume work and the risk is too high to not do it properly. It isn't worth cutting corners."

Understanding money laundering and terrorist financing risks are an essential part of developing and implementing a rigorous AML/CFT strategy. Different clients and transactions will present different AML/CFT risks. The MLR 2017 require firms to take a risk based approach to the risks presented by a client or transaction to make sure they are identified, assessed and mitigated.

Identifying and assessing risk

Firms considered a variety of factors when assessing the risks presented by clients and matters. Common risk factors reviewed included the:

- geographical location of the client
- client being based overseas or in a high risk jurisdiction
- appearance of the client on any sanctions list
- source of funds and source of wealth
- area of work involved (for example property)
- identity of the client and the circumstances in which they are instructing the firm
- nature of the transaction including complexity, value and purpose
- involvement of any Politically Exposed Person (PEP).

We found that firms assessed client/matter risks in several ways. This included:

- a review of the client/matter by the fee earner as part of the file opening procedure. Firms used risk checklists, risk matrices, point based scoring systems or an overall risk rating. Files are then categorised as either low, medium or high risk. High risk files tended to be passed by the fee earner to a more experienced individual or the MLRO for approval
- a review of the client/matter by the central risk team
- the partner in charge taking responsibility for risk assessment

- designating every matter/client as high risk so Enhanced Due Diligence (EDD) is applied to all transactions
- categorising all clients/matters in a particular area of work (for example conveyancing) as high risk
- applying specific additional departmental risk guidelines to each matter
- the firm's business acceptance team undertaking detailed research and assembling a comprehensive profile of the client. This report is then sent to the MLRO with a recommendation on whether the firm should act and, if so, what ongoing monitoring is required.

Recording risk

Forty-six firms performed risk assessments on new matters and 21 firms said they recorded those assessments in writing. Reasons for not performing a risk assessment included:

- the firm knew all their clients
- there was no tick box risk assessment
- the partners were responsible for sourcing all new work and would not bring in risky work
- the firm only undertook general risk assessments for introducers.

It is important that firms can demonstrate a consistently compliant approach with the MLR 2017. There is an inherent danger of over reliance on individual partners or fee earners assumed knowledge of the client.

Of the 100 files we reviewed, there was evidence that the level of risk was assessed on only 69 of these files, which fell short of expectations. All firms should consider keeping written records of decisions, risk assessment processes and what due diligence was undertaken for each client/matter.

High risk matters

Firms should understand and respond to high risk AML factors. Firms may categorise risks differently but the rational should be clear. Firms should also consider how to mitigate the risk.

Firms considered the following factors when assessing if a matter was high risk:

- whether the client was a PEP

- whether the client was based overseas, in a high risk jurisdiction or appears on a sanctions list
- the area of work (for example property, sale of art or classic cars)
- the nature of the transaction including complexity, value and purpose
- unusual payment patterns.

Importantly, these factors need to be assessed at the outset and reviewed throughout the life of a matter.

Forty-seven firms said that senior managers at the firm had to approve certain high risk transactions. Firms also said that senior management approval was required for:

- any matter involving a PEP (14 firms)
- transactions with an overseas element (five firms)
- high-risk matters, for example unusual transaction, large value, high risk client or cash transaction (17 firms)
- high risk areas of work, for example commercial property (two firms).

Significantly, the MLR 2017 place a specific duty on firms where they seek to act for a PEP or their family or known associate. The fee earner must have approval from senior management, establish the source of wealth and conduct ongoing EDD. Firms must adhere to this process[10].

Develop and improve – Self assessment questions

- Does each file have a written record of the AML/CFT risk?
- Do you consider and review the client, the transaction and the funds in each matter?
- How do you acknowledge and monitor the unique AML/CFT risks in different work areas?
- How do you control and monitor high risk matters?

[10] Reg 35(5) MLR 2017

Customer Due Diligence

"It is built into our work. It all begins with the client."

CDD is the information that firms must gather about their clients[11].

Where the client is an individual, firms must do all the following:

- **identify** the customer unless the identity of that customer is known to the firm, and has been verified by the firm
- **verify** the customer's identity unless their identity has already been verified
- **assess,** and where appropriate obtain information on, the purpose and intended nature of the business relationship or occasional transaction.

Where the client is a commercial entity, firms must:

- **obtain** and **verify** the name of the body corporate, its company or registration number, and the address of its registered office, and if different, its principal place of business
- **identify and verify** the people with control of the body corporate, and the ultimate beneficial owner (UBO).

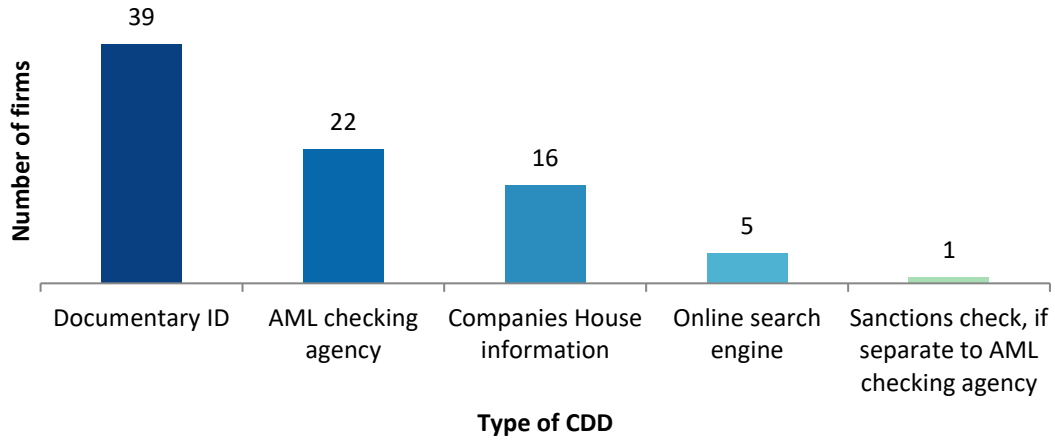
CDD information must be kept under regular review[12] to make sure that any transactions match the profile of the client and check the information is correct and up to date. This is referred to as 'ongoing monitoring'.

CDD must be completed as soon as practicable after first contact, however the identity of the client can be completed during the establishment of the business relationship if it is low risk and necessary not to interrupt the normal conduct of business[13]. A business relationship is one expected to have an element of duration[14]. In practical terms, this means even the shortest instructions will form a business relationship, due to the solicitor's continuing obligations to the client after the retainer has ended.

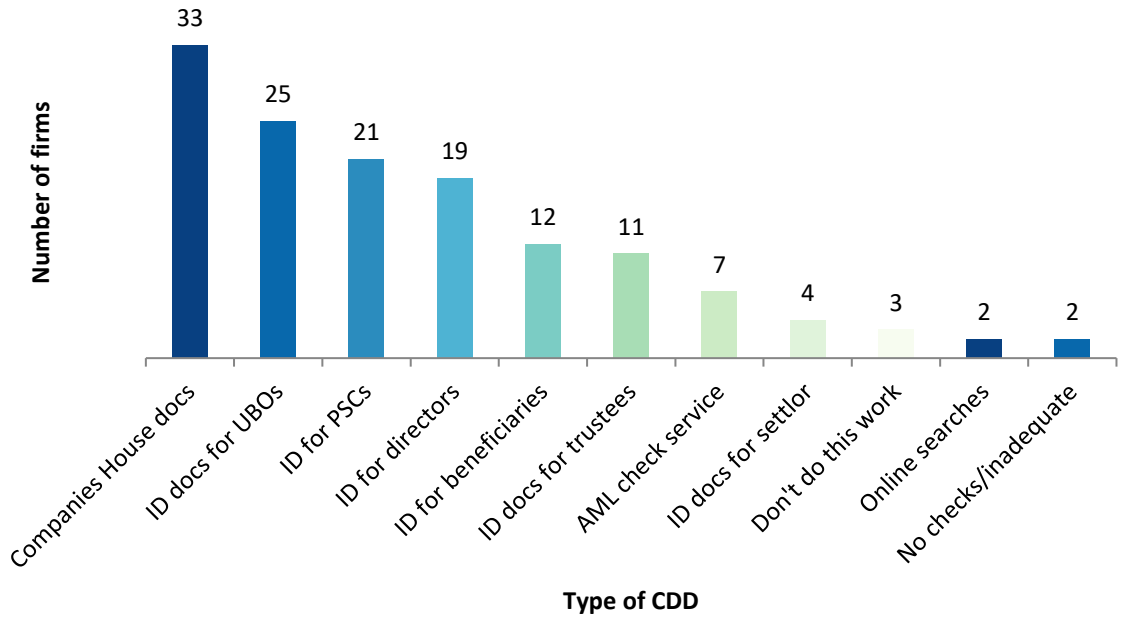
EDD is explained in the MLR 2017[15]. It must be applied where a customer is high-risk, for example if they are a PEP or from a high-risk jurisdiction. What constitutes EDD depends on the risk factors of the client.

[11] Reg 28 MLR 2017
[12] Reg 28(11) MLR 2017
[13] Reg 30 MLR 2017
[14] Reg 4 MLR 2017
[15] Reg 33 – 35 MLR 2017

How do you collect CDD about clients?



How do you collect CDD about corporate and trust clients?



As the graphs above indicate, most firms used more than one method to identify the client. Using a variety of methods means that firms can verify information between documents. This improves the understanding of the firm and reduces the risk of unwittingly being involved in money laundering.

Several firms emphasised the importance of identifying persons with significant control (PSC) and UBOs of corporate clients. They characterised this as understanding the people behind the companies. This is particularly important where a client company may have several layers of corporate ownership.

A minority of firms only collected CDD for work in the regulated sector. While this is within the letter of the MLR 2017, it may increase risk. Unregulated work is still within the scope of the POCA 2002. Firms should consider the risk profile of work falling outside the scope of the MLR and take a proportionate approach to CDD.

Occasionally, clients were unable to provide photo ID in person. In these cases, firms would accept copies certified by a professional, for example another solicitor, accountant or notary. Prudent firms insisted that the copies should be sent in by the person who certified them. It is important to be clear that a firm relying on the due diligence carried out by a third party remains responsible for any failure[16].

In most cases, CDD was completed when files were opened. Most firms had some form of system to prevent work being carried out before CDD was complete. This included:

- six firms not passing files to fee earners until CDD was complete, making work before this impossible
- twenty firms restricting all work, billing or receipt of funds prior to CDD completion
- four firms allowing only some administrative work, for example client care letters, before CDD was complete
- eight firms restricting the receipt of money on file until CDD was complete.

Although a firm may have a policy that prohibits work from being carried out, this range of measures physically prevented work from being carried out. We consider this best practice.

When we spoke to fee earners we found that 19 said they would do some work before CDD had been completed. Two of these said only administrative work was done, for example client care letters. The remaining 17 said that they would complete some substantive work, albeit with some restrictions, for example time limits or limits to money billed. CDD must be completed before a business relationship is established unless there is a low risk of money laundering and it's necessary not to interrupt the normal course of business[17].

Ten fee earners said that a client had put them under undue pressure to begin work before CDD had been completed. Although there may be a rational explanation for this urgency, our Warning Notice highlights this as a suspicious behaviour. We were pleased that each fee earner said that they had refused to take the matter further until CDD was complete. One had also come under pressure from a partner who had sided with the client, but she had been able to refer to the firm's policies for support.

[16] Reg 39 MLR 2017
[17] Reg 30 MLR 2017

One fee earner told us that in this situation he said to clients: "If it is really urgent, you will comply urgently".

Of the 100 files we examined, six did not have complete CDD on file, and two involved work where CDD was not required. Of the six files without CDD, most had it stored centrally or on a previous client file. Two files relied entirely on a partner's knowledge of the client acknowledged in a signed statement. We consider:

- it is questionable whether anyone but that person signing those statements can genuinely identify the client
- even where the statement may identify the client, it arguably cannot verify their identity.

Several of the files had some sort of complex factor to the CDD. These included:

- a substantial house purchase funded by the client's father who lived overseas
- some cases involving high net worth client companies, their directors and beneficial owners spread across several jurisdictions
- one PEP
- overseas trusts and their controllers.

In all, 14 firms told us that they had refused instructions from a client because of failing to meet CDD requirements. This was for a variety of reasons, including:

- the documents provided showed three different dates of birth for one client
- monies to complete a property transaction were supposedly received as gifts from various relatives who would not provide CDD
- name changes on documentation completed by the client
- a complex company structure where the identity of beneficial owners was unclear.

Where firms refuse to act, firms should also consider whether they should make a SAR. There is an obligation to make a report where an individual knows, suspects or has reasonable grounds to know or suspect that another individual or person is engaged in money laundering. This is a broad requirement and firms should be able to explain why a matter was not reported in these circumstances. This requirement is discussed further below.

We also asked firms whether they checked clients against HM Treasury's sanctions list[18]. Forty-five firms checked the sanctions list. Of the remaining five:

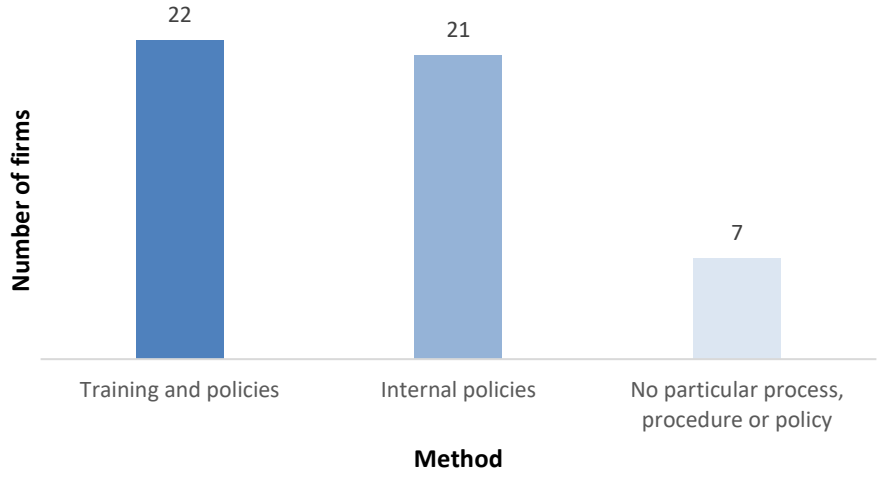
- three said that their clients would never appear on the sanctions list. We consider this to be a dangerous assumption
- one said that the matter had never arisen, but it was unclear how they would know without checking the sanctions list
- one said that their policy was under review.

The firms who did check the sanctions list tended to do so as part of an ID checking service, which typically also checked for media reports and creditworthiness. These agencies sometimes draw false positives as part of a search, for example when a client has the same name as a PEP. Firms said that when this happened, they would check the ID against the information they held, further online checks and/or speak to the client.

EDD is a live issue for many firms. Of the 50 we visited, 24 had clients who were PEPs.

Only 16 firms kept a central list of PEP clients. This is a useful practice which can help to assess and monitor the firm's risk more effectively. It may also speed up the CDD and EDD process for these clients.

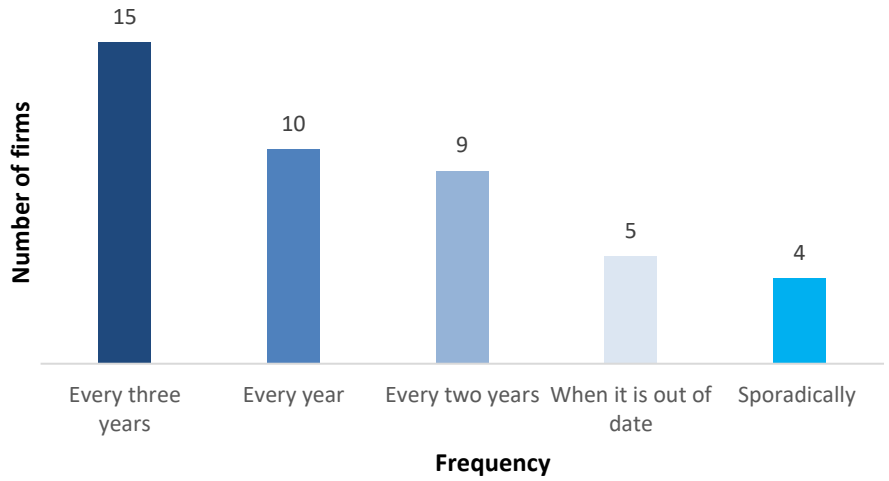
We asked firms how they made sure that staff knew what EDD was and when they should apply it:



Most of the firms had a process in place for monitoring CDD on an ongoing basis.

[18] www.gov.uk/government/publications/financial-sanctions-consolidated-list-of-targets

When we spoke to firms, the majority (43) said they renewed CDD at regular intervals:



Three firms also had a risk based approach to ongoing monitoring ranging from three years for cases deemed to be medium or low risk but quarterly for high-risk files. For life events, such as change of name, change of gender, or change of address, only 34 firms said they would renew CDD - a lower proportion than we expected given the requirement under the MLR 2017. Seven firms would renew CDD for each new matter a client opened, but not otherwise. One firm had no renewal procedure at all.

From 25 May 2018, firms will be subject to the General Data Protection Regulation (GDPR)[19]. These regulations will have an impact on the data which firms must retain for AML/CFT purposes. The rights to erasure and objection will have a bearing on what information firms can hold about their clients. Firms will need to consider how to balance the requirements of the MLR 2017 and GDPR.

The MLR 2017[20] states that firms must make provision for data protection policies in relation to AML. Firms must also train their staff in relevant data protection legislation[21]. This will naturally include GDPR once it comes into force, though prudent firms are already doing this.

[19] ico.org.uk/for-organisations/data-protection-reform/overview-of-the-gdpr/
[20] Reg 20(1)(b) MLR 2017
[21] Reg 24(1)(a) MLR 2017

Develop and improve – Self assessment questions

- Does each file show how you have identified and verified the client?
- How do you identify a PEP, a family member or known close associate?
- Do your staff access the sanctions list?
- Can you monitor how frequently CDD is undertaken on high risk clients?
- Can you show how and when you undertake ongoing monitoring?

Source of funds and wealth

"It's a major thing we have to deal with and it can take time for our clients to get the documents together."

Solicitors may need to investigate source of funds and wealth as part of CDD[22].

These terms are not defined in the MLR 2017, but the FATF gives the following definitions[23]:

- *The source of funds refers to the origin of the particular funds or other assets…Normally it will be easier to obtain this information but it should not simply be limited to knowing from which financial institution it may have been transferred. The information obtained should be substantive and establish a provenance or reason for having been acquired.*

- *The source of wealth refers to the origin of the…entire body of wealth (i.e., total assets). This information will usually give an indication as to the volume of wealth the customer would be expected to have, and a picture of how the PEP acquired such wealth. Although [firms] may not have specific information about assets not deposited or processed by them, it may be possible to gather general information from commercial databases or other open sources.*

We consider that establishing both the sources of funds and wealth are a key part of a risk based AML regime. They are particularly helpful in establishing ongoing monitoring of CDD and transactions.

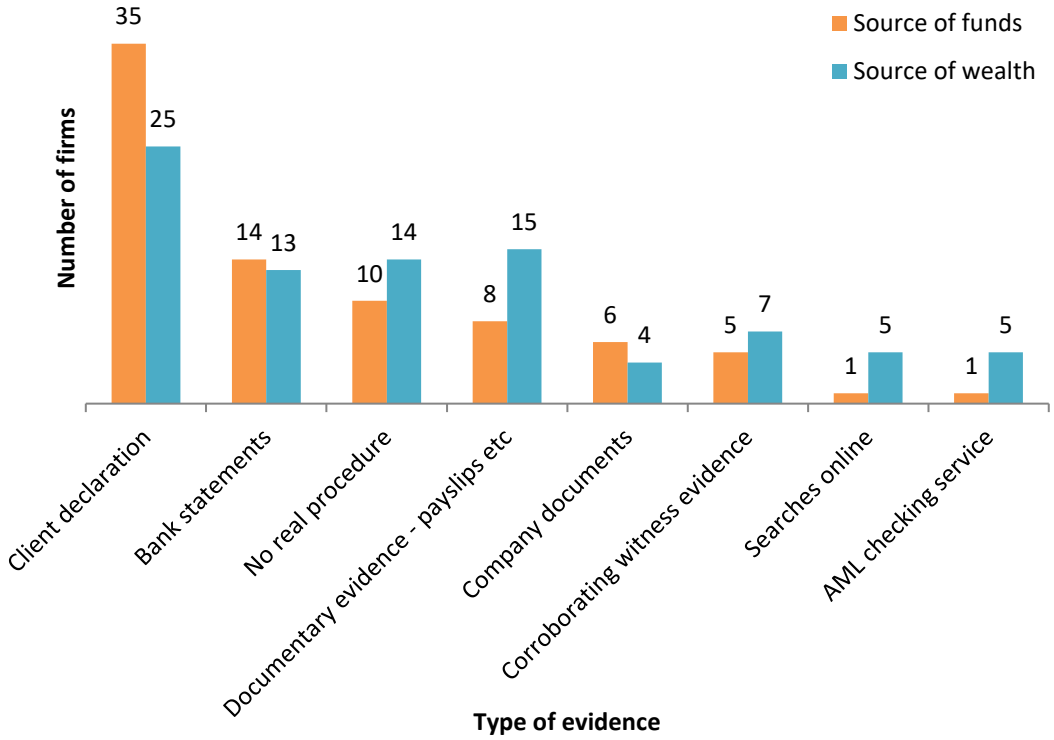
When reviewing files, we checked whether source of funds and wealth had been obtained:

	Yes	**No**	**Not applicable**
Source of funds	39	22	39
Source of wealth	28	28	44

Where firms answered 'no' to source of funds, this was for legitimate reasons, for example where clients were selling a house and purchasing another the source of funds was obvious.

[22] Reg 28(11) MLR 2017
[23] FATF Guidance: Politically Exposed Persons
www.fatf-gafi.org/media/fatf/documents/recommendations/Guidance-PEP-Rec12-22.pdf

What evidence is gathered?



Client declarations are gathered by firms and include information from clients about the transaction, their source of funds, or whether they consider themselves to be a PEP. While these discussions can be useful they should not be relied upon exclusively. A money launderer is unlikely to worry about making a false declaration.

When firms attempted to establish the source of wealth they were more likely to carry out searches online and seek corroborative evidence. Firms were, however, less likely to have a set of specific procedures for establishing the source of wealth. By contrast, firms investigating source of funds tended to rely more on client declarations. However, most firms employed more than one method of establishing source of funds and wealth. Using a variety of methods gives a more rounded view of the client.

Five firms had difficulties separating the concepts of source of funds and source of wealth, and did not distinguish them. Two of these firms were reported into our disciplinary processes (as there were also other concerns) and the matter was directly addressed with the other three. Firms must understand and record where funds will be provided from and how those funds were obtained. This is a legal requirement. If a client cannot satisfy either part of this requirement the firm should not act. This type of client behaviour is expressly mentioned in our Warning Notice.

Thirteen firms requested both sources of funds and wealth at the same time and as part of the same process. This can be time-saving and beneficial and reduce requests of information from the client. A few firms provided clients with a sheet showing what evidence was likely to be asked for in different transactions.

One firm stated that: "*if the transaction makes sense, and there are no grounds to suspect that the monies are the proceeds of crime, there's no need to investigate the source of funds or the source of wealth"*. This is a misconception. For example, where a client is a PEP, source of funds and wealth must be established in each case regardless of suspicion. The decision whether to establish source of funds and wealth should also be based on risk, rather than suspicion. Solicitors and firms do not need to decide whether the client is guilty of money laundering, but they must assess the risk.

Develop and improve – Self assessment questions

- What is the difference between source of funds and source of wealth?
- Does each file record in writing where/who funds are from and how they were originally created?
- Do the fee earners understand the client, the transaction and the funds? If not, how do they continue to monitor and assess this information during the lifetime of the transaction?

Training

"Fee earners don't view AML as exciting but they understand and appreciate the importance of doing it."

Firms must provide staff with appropriate training about AML/CFT. The MLR 2017 requires that relevant employees are:

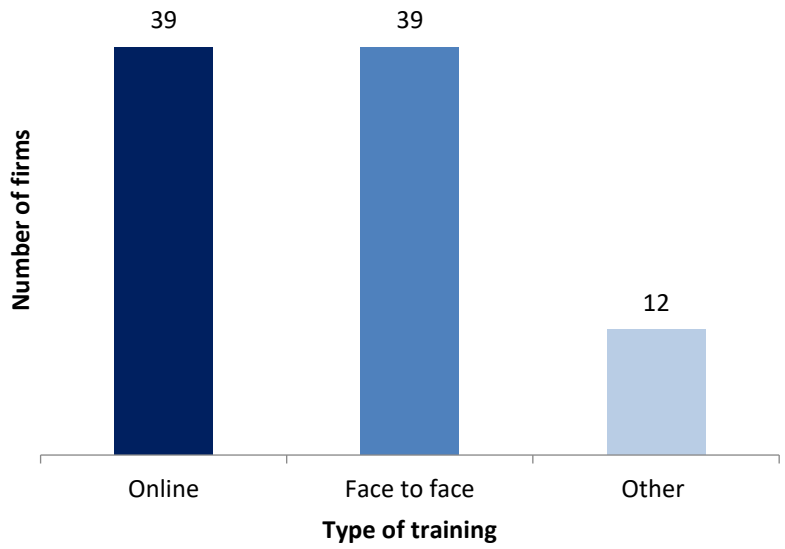
- made aware of the law relating to money laundering, terrorist financing and the requirements of data protection; and
- regularly trained about how to recognise and deal with transactions and other activities which may be related to money laundering and/or terrorist financing[24].

Firms must keep a record in writing about:

- how employees have been made aware of the law relating to AML/CFT; and
- the training given to employees.

AML/CFT training

Firms delivered training to staff in a variety of ways:



[24] Reg 24 MLR 2017

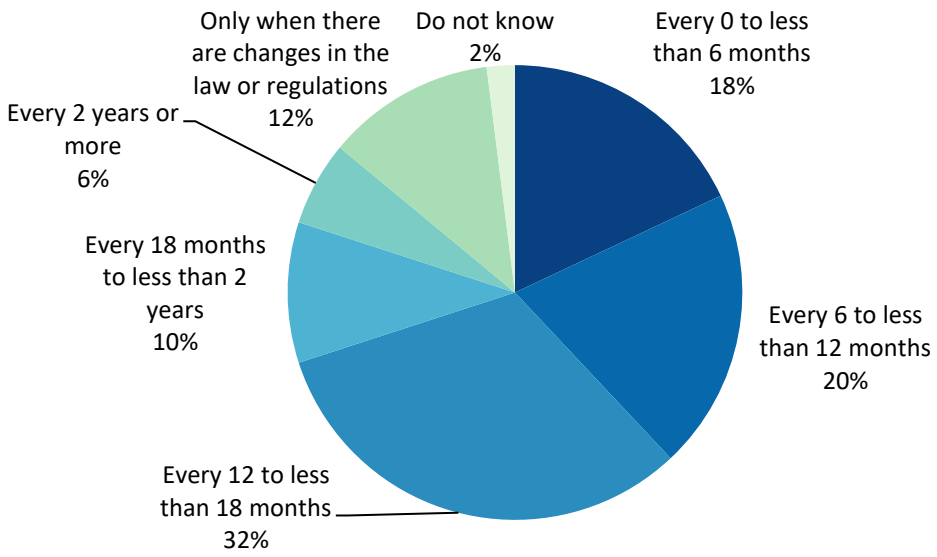
Other training included attending courses, circulating updates by email and memo as well as the use of training booklets and newsletters.

Forty firms said that AML/CFT training was compulsory for all staff including accounts and secretarial staff. Some firms delivered training to individuals based on their level of exposure to AML/CFT. For example, introductory training was provided to IT and facilities staff and fee earners and finance staff received advanced training.

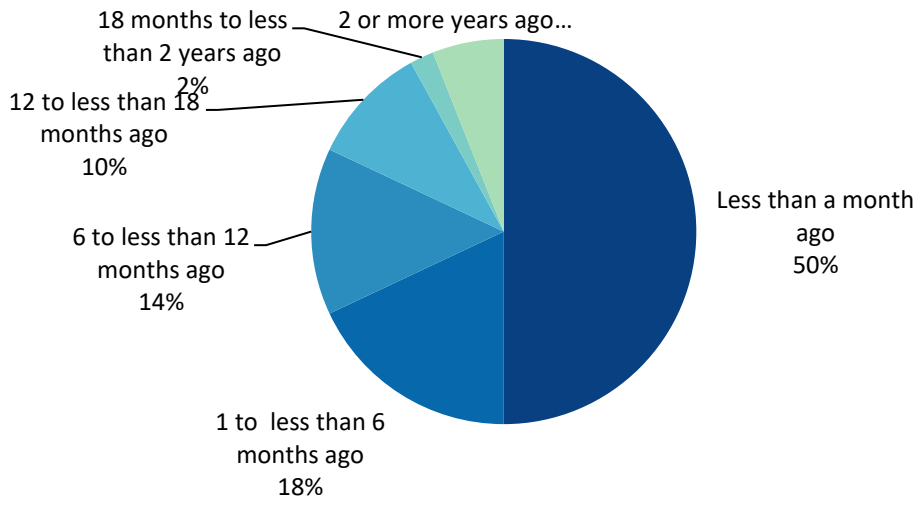
Ten firms did not make AML/CFT training compulsory for all staff because they had no, or limited, exposure to AML/CFT issues, for example staff working in IT, the post room or on reception were not given AML/CFT training. All staff who could potentially be involved in AML/CFT prevention should receive training. At one firm, for example, we found that secretaries were not trained in AML/CFT, even though they played a key role in collecting and processing CDD.

Frequency of training

Firms provided AML/CFT training with the following frequency:



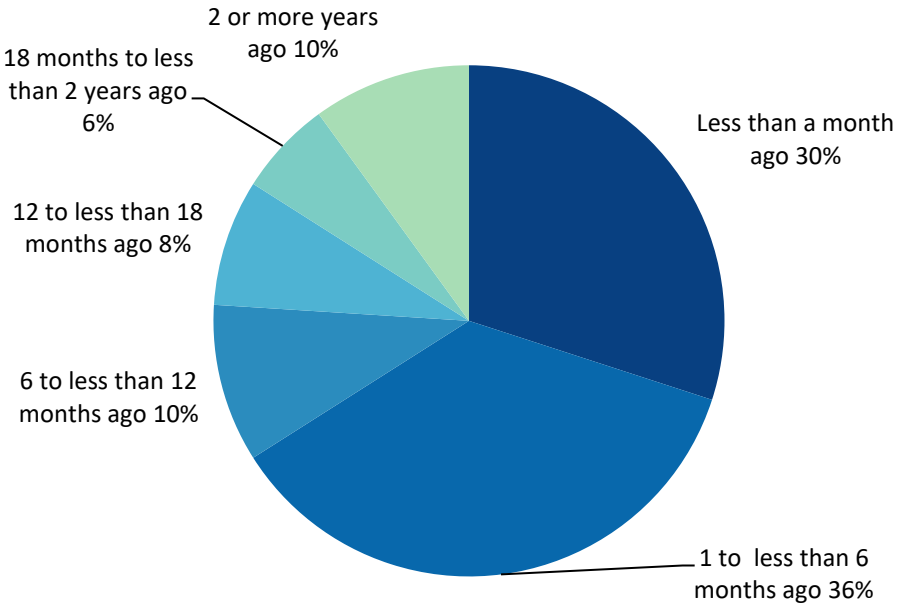
Staff were last provided with AML/CFT training:



Twenty five firms provided AML/CFT training less than a month before our visit which reflects steps they have taken to update staff on the changes introduced by the MLR 2017. Other firms confirmed they would provide further training once the guidance issued by the Legal Sector Affinity Group, which comprises the AML supervisors for the legal sector, was published.

MLRO training

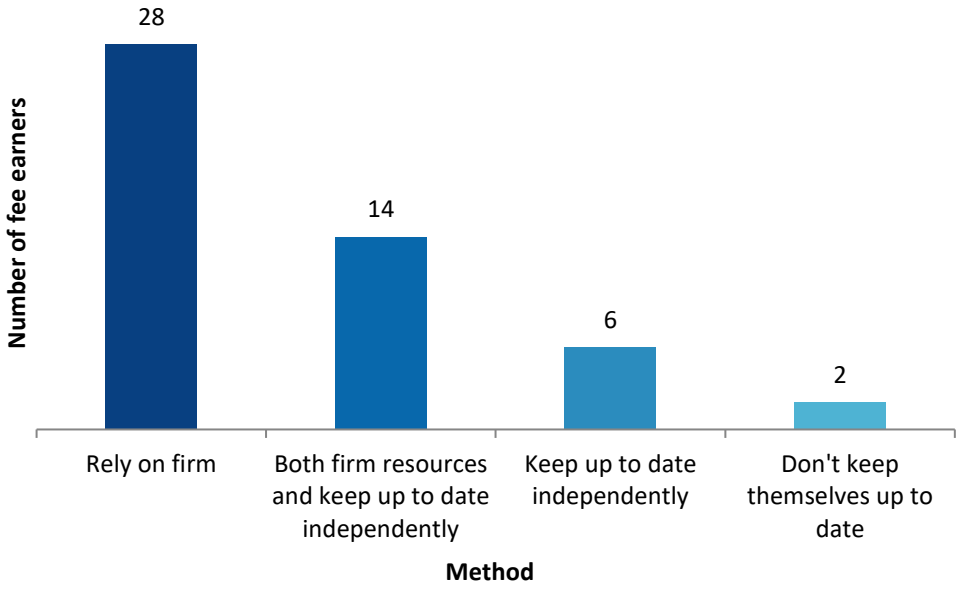
MLROs provided details of when they last attended AML/CFT training:



Thirty-eight MLROs attended training in the last 12 months which, in part, was to better understand the changes brought about by the MLR 2017.

Fee earners

Fee earners said they kept up to date with AML/CFT in different ways:



Record keeping

Forty-three firms kept records of staff attendance at AML/CFT training. Those who did not keep records gave a variety of reasons for not doing so including that the MLRO could easily identify these individuals or that the firm was a small practice so attendance records were unnecessary. Other firms stated that while they did not currently keep records they are in the process of introducing a new centralised record. Keeping a written record of attendance at AML/CFT training serves as a useful way of recording what AML/CFT training has been given to staff and will show the steps the firm has taken.

Testing knowledge

Thirty-six firms said they undertook testing to make sure that staff members understood the training. Thirteen firms did not undertake any testing and one firm did not know. Testing usually comprised of an assessment, file reviews/audits or a review of the client inception forms. Firms used one or a combination of these methods. Thirty-three firms did online tests, seven firms undertook audit/file reviews, one firm did it by reviewing CDD inception forms and two firms had a verbal test after the training had been completed. Firms that did not carry out any testing gave a variety of explanations:

- their online AML/CFT training package did not offer an assessment
- they felt they were too small for it to be necessary
- testing is not part of the firm's culture
- a test is not a fair reflection of understanding
- they prefer to do regular refresher training.

Testing knowledge is significant. It encourages individuals to invest time and effort in to the training and provides firms with an overview of where further training may be necessary. We consider this to be good practice.

Develop and improve – Self assessment questions

- Who is the vulnerable link at your firm and are they trained?
- Does the training relate to the specific risks at your firm?
- How long can a member of staff avoid AML/CFT training?
- Do you record if people have completed training? If so, when do you review the record?
- Does the MLRO review and contribute to the training?

Suspicious Activity Reports

"I see AML/CFT as an important component in a lawyer's wider responsibilities - it builds integrity into the legal system."

A core part of the AML/CFT system is the reporting of suspected money laundering activities.

The United Kingdom Financial Intelligence Unit (UKFIU)[25] is responsible for gathering reports about these activities. To make a report an MLRO must make a SAR. Firms may make either a defence against a money laundering (DAML) SAR or an intelligence SAR.

There are two parts of the process:

- internal reports by staff to their MLRO
- reports by the MLRO to the UKFIU.

Significantly, a report by an employee may not necessarily result in a referral to the UKFIU. It is part of the MLRO's role to decide which reports should be taken forward.

Making referrals

There are several obligations that individuals at firms must meet:

- staff must make a disclosure to the MLRO where they know or suspect a person may be involved in money laundering
- the MLRO must make a disclosure to the UKFIU where they know or suspect a person may be involved in money laundering
- it is an offence to bring a disclosure to the subject's attention – this is known as tipping off.

The NCA has produced detailed guidance on how to make an effective SAR[26].

Overview

As expected the large firms in the sample have greater experience of this area because of the amount of work they carry out and this was reflected in the data:

[25] The UKFIU is part of the NCA
[26] www.nationalcrimeagency.gov.uk/publications/732-guidance-on-submitting-better-quality-sars?file

- 59% of MLROs had submitted a DAML SAR (this included 78% of MLROs at large firms and 46% of MLROs at other firms)
- 38% of MLROs had submitted an intelligence SAR (this included 50% of large firms and 30% of other firms)
- A total of 337 DAML SARs had been made (large firms: 156 DAML, the remaining firms had made 181). We asked firms whether they had ever had a DAML SAR refused by the NCA. Three large firms had been refused consent to act on four occasions. Five small/medium firms had been refused consent on six occasions
- A total of 92 intelligence SARs had been made (large firms: 49).

We asked firms about two specific scenarios and whether they had ever made a report:

1. Have you ever needed to stop acting for a client due to a risk factor? (Yes: 66%). Did you make a report? (Yes: 28%)
2. Have you ever ended a business relationship as a result of being unable to satisfactorily apply CDD? (Yes: 28%). Did you make a report? (Yes: 21%).

Firms did not believe that either scenario automatically required a report to the UKFIU. Firms told us that they might turn away a client due to the work exceeding the firm's risk appetite. This is particularly likely where firms calculate risk scores with a mathematical matrix. Despite exceeding the risk threshold for the firm, they told us that this did not mean that the individual was suspected of carrying out criminal activities. However, each firm commonly assessed whether there was any suspicion of criminality.

Firms also explained that clients might not complete the firm's CDD process for numerous reasons. Clients may have decided not to carry on the transaction or continued the matter at another firm. Again, firms did not suspect that clients were engaging in criminal activity.

As mentioned above, there is an obligation to make a report where an individual knows, suspects or has reasonable grounds to know or suspect that another individual or person is engaged in money laundering. While firms may consider that individuals are not carrying out criminal activities, we consider this to be a broad requirement and firms should be able to explain why a matter was not reported.

Tipping off

It is an offence for a person in the regulated sector to tell a person suspected of money laundering that a SAR has been made or that a money laundering

investigation is under way. The penalty for tipping off can be an unlimited fine and/or up to five years' imprisonment.

When a MLRO makes a DAML SAR, progress on a client's matter must be suspended until the NCA provide consent to act. During this time period, the firm are unable to carry out any further work which would be a principal money laundering or terrorist property offence, or explain the true reason for the delay. This problem is likely to increase as recent changes to the law extend the amount of time that the NCA may take to reply to a DAML SAR. The NCA have seven working days following the working day after the disclosure to process the transaction. If consent is refused, the NCA have a further 31 calendar days to carry out further work.

Most firms – 88% – had specifically addressed the risk of tipping off. This included providing specific training or processes that were designed to help staff. Given that many firms had faced this practical issue it is important that firms and fee earners understand the risks and their obligations.

Records about internal disclosures

We expect many firms will have to deal with an internal SAR. This simply reflects the nature of the work. The data we gathered suggested our assumption was correct and firms had taken steps to prepare themselves:

- 88% of MLROs had a system in place to record internal discussions with staff
- 72% of MLROs had received an internal SAR within the past five years from staff (this included 90% of MLROs at large firms and 60% of MLROs at small/medium firms).

We consider it good practice for MLROs to keep records about the referrals they receive and the reasons for onward reporting, or not, regardless of whether they subsequently refer the matter to the UKFIU. Significantly, these records may provide the MLRO, fee earner and firm with a defence to an allegation of failure to disclose, so they should be thorough, clear and stored somewhere securely and safely.

Develop and improve – Self assessment questions

- Are you registered with SAR online?
- Do all staff understand tipping off?
- Can you show which matters have not been referred to the NCA and why?
- In the event of an emergency how would referrals be made and/or reviewed?

Conclusion

There is no substitute for reading and understanding the MLR 2017. The AML and CFT obligations are required by law for those firms within scope and they must be followed. We also encourage firms to go beyond the minimum requirements of the MLR 2017 and consider best practice.

Significantly, it is not possible to prescribe a universal method or system of compliance because the size and nature of firms varies. However, the new rules are clear. Firms must consider the risks they face and take steps to record and mitigate them.

We were satisfied generally that most firms had showed the right approach to AML and CFT compliance. Despite the relatively new legislation, the majority of firms had already made changes to their systems and procedures. This was encouraging and we expect all relevant firms to prioritise complying with the new AML and CFT requirements. Firms must take steps to comply with the new obligations as soon as possible and in the meantime be in a position to show progress and future plans.

We were encouraged by the number of firms who had decided to implement policies and procedures well above the minimum requirements. These firms recognised that good AML and CFT processes and procedures could generate business opportunities. Where firms took time to know their client, it provided them with a chance to market other services to individuals such as private client and conveyancing work.

There are a small number of firms that will require additional attention from us and we will continue to work with them. A failure to meet the minimum standards required by the MLR 2017 is a serious issue and we will take appropriate regulatory action against individuals and firms who fail to implement them. As a result of this review, we have referred six firms into our disciplinary processes.

Appendix 1 – Sample data

We visited 50 firms with a combined total of 11,731 fee earners (the largest firm we visited had 1390 fee earners). Further information about the firms and fee earners are provided below.

Firms

(i) Type of firms

Type of firms	Percent	Count
Partnership	12.0%	6
Limited Liability Partnership	72.0%	36
Limited Company	12.0%	6
Sole Practitioner	4.0%	2

(ii) Firms by number of managers

Number of managers	Percent	Count
1 to 5	34.0%	17
6 to 10	10.0%	5
11 to 25	14.0%	7
26 to 50	16.0%	8
50 +	26.0%	13

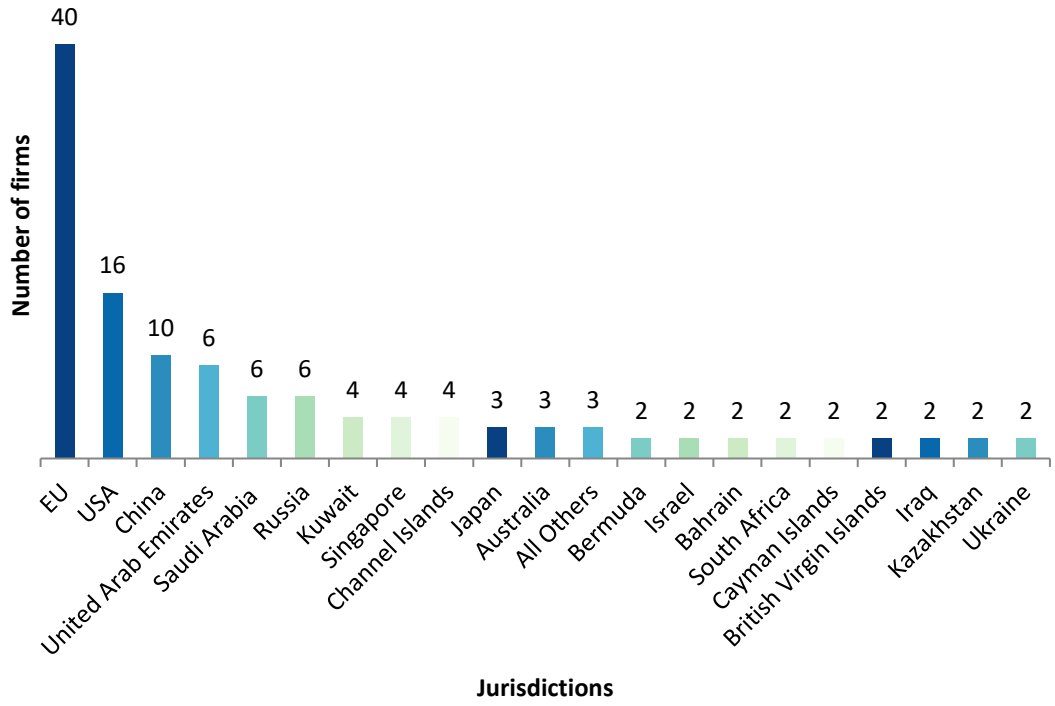
(iii) *Firms by client location*

3. Forty-one firms had overseas clients. Of these firms:

- Eleven did not keep a specific central record of where their clients were located. A record of a client's location is useful because it might help firms to assess and monitor various compliance risks.

- Twelve had clients from high risk and non-cooperative jurisdictions designated by the FATF.

We asked firms to provide information about the location of their top three overseas clients:



(iv) Firms by work type area

Firms operated in a broad range of areas:

Area	**Total responses**
Bankruptcy/insolvency	31
Civil litigation	40
Commercial	39
Corporate	39
Consumer	26
Criminal	28
Debt collection	28
Discrimination/civil liberties/human rights	26
Employment	41
Family/matrimonial/children	38
Financial advice and services	28

Intellectual property	33
Landlord & tenant	35
Litigation - other	36
Mental health	27
Immigration	30
Personal injury	30
Planning	28
Probate and estate administration	38
Property - commercial	45
Property - residential	43
Social welfare	28
Trust and company service providers	28
Wills, trusts and tax planning	42
Other	35

Fee earners

We interviewed 50 fee earners and viewed 100 client files. They ranged in experience and work type:

(i) Fee earner by Post Qualification Experience (PQE)

Number of years PQE	**Percent**	**Count**
0 to less than 1 year PQE	12.0%	6
1 to less than 3 years PQE	14.0%	7
3 to less than 6 years PQE	14.0%	7
6 to less than 9 years PQE	18.0%	9
9 to less than 12 years PQE	14.0%	7
12 or more years PQE	28.0%	14

(ii) Fee earner by time at firm

Time at firm	Percent	Count
0 to less than 1 year	6.0%	3
1 to less than 3 years	26.0%	13
3 to less than 6 years	38.0%	19
6 to less than 9 years	4.0%	2
9 to less than 12 years	8.0%	4
12 or more years	18.0%	9

(iii) Fee earner by main practice area

Practice area	Percent	Count
Corporate law	16.0%	8
Property - commercial	22.0%	11
Property - residential	50.0%	25
Wills, trusts and tax planning	2.0%	1
Other	10.0%	5