

Money Laundering Compliance for Law Firms

DIANE PRICE & MATTHEW MOORE



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DIANE PRICE & MATTHEW MOORE



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Executive summary

THIS MAJOR new report examines the key compliance issue for law firms arising from their obligations in relation to combating money laundering and terrorist financing. Written to coincide with the first anniversary of the coming in to force of the Money Laundering Regulations 2007, along with the related changes made at the time to the main statutes, this title provides a deeper analysis of the practical issues facing commercial law firms than has been available to date.

Money Laundering Compliance for Law Firms combines an in-depth analysis of the statutory provisions contained in the Proceeds of Crime Act 2002 and the Terrorism Act 2000, along with the numerous changes made to both Acts since they were first introduced. Unusually, the text will assist reporting officers by covering the equivalent provisions from the money laundering and terrorism provisions together. Issues addressed include:

- How the duty to report is wider in terrorism legislation than the Proceeds of Crime Act 2002;
- Why privilege should be viewed as having been misapplied in the reporting regime;
- Why improved compliance with the regime can mean fewer disclosures to SOCA, and not more; and
- How to make sense of the new statutory defences to tipping off following the removal of privilege as a defence for those in the regulated sector under the Amendment Regulations 2007.

The title also provides a compendium of practical information and guidance on the processes required by the Money Laundering Regulations 2007. Delving into the source materials of the Financial Action Task Force (FATF) and the Joint Money Laundering Steering Group (JMLSG), as well as the most recent version of the Law Society practice note, the book provides invaluable guidance on the practicalities of checking the more complex client details. Numerous tips on helpful websites and other information sources are provided. The report also considers the regime from the standpoint of each major legal discipline – company commercial, dispute resolution, private client and property.

In keeping with the practical nature of this title, risk assessment forms, along with a draft policy, related procedures and client assessment forms, are also provided on an accompanying CD ROM. These expertly-prepared precedents will be invaluable for any firm that is reviewing its compliance materials.

About the authors

DIANE PRICE is director of human resources and compliance at the regional law firm Martineau. She studied law at University College, London and Clare College, Cambridge where she specialised in commercial areas of law including company law, EC law, and tax. After attending the College of Law at Guildford, she undertook her training contract with Ryland Martineau. On qualification as a solicitor she specialised in corporate commercial work until she decided to take up academic life at the University of Birmingham. At Birmingham her specialist areas of law were intellectual property and competition law. Whilst lecturing, she became involved in training for the legal profession and was appointed recruitment and training manager for Martineau Johnson (now Martineau). Her interest in this area of work grew and she developed a human resources department for the firm and is now the human resources and compliance director. She is also a member of the Chartered Institute of Personnel and Development

Diane has a keen interest and expertise in risk, quality and compliance. She was instrumental in the firm's ISO 9001:2000 accreditation and has developed risk, business continuity and anti-money laundering policies and procedures for the firm.

Diane has written many articles on legal topics and wrote the money laundering section in *Sale of Shares and Businesses: Law, Practice and Agreements* (Sweet & Maxwell 2006). She has also spoken at

local and national events on areas relating to HR, quality and anti-money laundering and is currently the chair of the Education and Training Committee of the Birmingham Law Society.

MATTHEW MOORE is a law teacher and solicitor by background. He joined the then M5 group (later NRM5) as its first employee in 1985 and oversaw the period of the group's most dramatic growth with responsibilities that included training, recruitment and marketing. Since leaving the group in 1989 he has operated as a management consultant and trainer for a wide variety of firms and legal organisations, at various stages also holding the posts of head of management training at Central Law Training and quality manager at Pannone. Internationally he advised the Singapore Law Society in the development of its quality standard and the Law Society of New South Wales on its first adaptation of ISO 9001 to legal practice.

His particular specialisms are risk, quality and professional compliance issues, including the planning of and training in anti-money laundering programmes. He was for many years the principal trainer for the Law Society in its Lexcel scheme and is the main author of the Commercial Risk and Quality Standard, a programme which converts generic standards such as ISO 9001 and BS 31100 to commercial legal practice.

Matthew is a director of Web4Law and is also a member of the Chartered Institute

of Personnel and Development. His other publications include the *Web4Law Money Laundering Reporting Officer Compliance Manual* which has also been adapted for use by Jersey firms under the equivalent provisions in place in that jurisdiction. He has written and edited the *Lexcel Office Procedures Manual* (Law Society Publishing 2007) – the standard template manual for law firms’ office and risk manuals – which is now in its fourth edition. He is also the author of *Compliance for Law Firms* (Ark Group 2008) which examines the key regulatory obligations in legal practice and examines the usefulness of formal risk and quality programmes for commercial firms.

For further advice and training on the issues contained in this publication please contact Matthew at matt@web4law.biz.

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It is for each firm to consider its position carefully in the light of all the information sources that are open to it and to seek specific professional advice if appropriate. This book contains information and commentary that is appropriate so far as we are aware but must not be construed as specific legal information in any particular case or situation. The authors and publishers will accept no liability for any actions taken or not taken in consequence of anything appearing in the publication. This applies to the precedents also, which may not be appropriate in some or all cases.

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Introduction

ALTHOUGH THERE had been some earlier anti-money laundering provisions on the statute book, it was the introduction of the Proceeds of Crime Act 2002 that made the issue mainstream for most law firms, which in turn served to highlight the similar provisions in the earlier Terrorism Act 2000. The most significant element of these Acts is the need to disclose certain activities to the authorities, either because of the duty imposed upon the regulated sector to do so, or in order to gain a defence to other charges under the Acts. If it is proposed to continue with a suspect transaction, prior consent will be required from the Serious Organised Crime Agency in order to be able to continue to act. There are severe penalties for non-compliance, with sanctions of up to 14 years' imprisonment and/or a fine for the principal offences.

There is also a regulatory strand to the regime, supported by criminal penalties in the event of non-compliance. The much delayed implementation of the Money Laundering Regulations 2003 on 1 March 2004 brought most law firms into the regulated sector, with consequential obligations that included the need for identity checks on clients, the appointment of a reporting officer and the training of relevant personnel. A new version of these regulations took effect in 2007, introducing the 'risk principle' to the collection of information on matters, as well as a number of wider concepts such as beneficial ownership and politically exposed persons, thereby adding to the compliance

burden for law firms. The combined effect of these provisions has been to make combating money laundering and related terrorist financing amongst the most significant risk management issues for law firms in general, and for those partners or employees with compliance responsibility in particular.

From the outset, concerns over the operation of the regime have been widespread. Most obvious is the risk of conviction, and there have been advisers who have gone to jail for non-compliance with the regime. The number of convictions has been low but has included some who were merely deemed to have been negligent in not spotting warning signs or, in one case, naive for believing an estate agent's explanation for the sale of a property at an undervalue without further enquiries (see *R v Griffiths and Pattison* [2006] EWCA Crim 2155). Those who have faced the threat of prosecution or a trial have been much more numerous. On the collapse of one such action in the north west of England in 2005, one defendant was quoted in the *Gazette* as having undergone "25 months of anguish" which he considered had also wreaked "incalculable" damage to his reputation¹.

For most firms, however, it is the day-to-day regulatory burden imposed by the regulations and the need to consider when disclosures are necessary that remain the most significant problems. There have long been accusations that the ongoing costs for law firms of the identity checks and training required by the regulations are not merited

by the amount of serious crime detected as a result of the regime. Every potential disclosure will be a time-consuming exercise for those involved, whilst in larger firms there are significant additional personnel costs through the employment of risk professionals to ensure compliance in this area. Part of the problem is that the statutory provisions are vague and, in many cases, poorly drafted. The resulting uncertainty has been acknowledged by the government – a recent Home Office consultation on the consent regime acknowledged that the current legislation is “rather unclear”². As if to illustrate that point, the consultation paper itself was wrong, or at least misleading, on the operation of the statutory consent regime. In its response to the same consultation paper, the Law Society argued for a radical overhaul of the overly complex provisions that are in place, but there seems little prospect of this occurring in the immediate future.

All of the above causes particular problems for a profession where precision of wording is valued. The current state of affairs has to be seen as unacceptable – the Law Society has commented that “at best, the consent regime is just workable.”³ The criminal offences that can be committed by professional advisers are based on deliberately wide definitions – in particular of what amounts to ‘criminal conduct’ and ‘criminal property’ in the Proceeds of Crime Act 2002. This has led to numerous instances where non-reporting would technically amount to an offence, even though the criminal conduct involved is trivial or even theoretical. This poses an invidious choice for reporting officers – whether to disclose to the authorities in every case where technically they are obliged to, or to adopt what the Home Office has itself described a more ‘practical’ approach.

Under this latter approach there is a consideration of whether the facts before them are worth reporting, regardless of the strict requirements⁴. Most commercial firms seem to have increasingly adopted this more pragmatic approach, in which case the reporting officer has chosen to accept the risk of prosecution or professional censure for not following the strict letter of the law. This may be one of the reasons why the numbers of disclosures by solicitors to SOCA have recently declined from a high point of 11,400 in 2006/07 to 6,460 in figures contained in SOCA’s report from November 2008. The Law Society has further suggested that the downturn in the economy may have contributed to this decline in numbers, as well as its efforts to educate solicitors on the implications of privilege in the regime and enhanced screening for problem cases, as a result of the more stringent processes contained in the Money Laundering Regulations 2007, having a preventive effect.

For many the problems are even more basic. The combined effect of the statutes and regulations is to require banks and other professionals, including most lawyers, to report to the authorities suspicions that they may have on their customers or clients. Since there is a specific legal duty to make disclosures, in many instances professional concerns have, in effect, been made an instrument of the state in detecting crime. True, the defence of legal professional privilege does feature in these provisions, but the more basic duty of confidentiality that is the hallmark of any professional relationship is no excuse for non-disclosure. A further complication for lawyers is that the operation of privilege within the regime is, as we shall see in Chapter 4, one of the most bewildering aspects of the entire anti-money laundering regime. It is questionable whether most private citizens realise that

their professional advisers are under various legal duties to disclose their confidential instructions to the authorities, including the Inland Revenue, but this is very clearly the case. There are occasional cries about the erosion of traditional liberties that such enactments bring – John le Carré was widely quoted on this theme in 2008 – but little in the way of wider public outrage.

The net effect of these problems is to make the writing of a practical book on the topic quite a challenge. This report draws on Matthew Moore's earlier handbook *The Web4Law Money Laundering Reporting Officer Compliance Manual* (Web4Law, 2008). That publication provides a series of practical exercises for reporting officers to undertake as they address the need to ensure compliance with both the statutes and the accompanying regulations. This report provides more by way of commentary and includes precedents that may be of assistance. There are other texts on the market that simply reproduce the provisions and the accompanying Law Society guidance, but avoid commentary on the practical problems of interpretation that reporting officers face in practice. We have set out to express opinions on the most difficult issues that we have both faced in our respective involvements in this area of work – one of us as a law firm consultant and trainer and the other as a lawyer responsible for risk and compliance in a major regional commercial firm and a former academic. This makes the traditional disclaimer that appears in all text books, and as set out above, all the more important. We have expressed our views on many situations that are still unresolved and may yet be proved wrong if test cases are ever brought to court, or if further guidance is issued on these points by the Law Society or the Solicitors Regulation Authority. A further

distinctive feature of this publication is that we have examined the law first but have then also examined the requirements of both statute and regulations as they apply to the main specialisations to be found in most firms. Throughout, our aim has been to produce explanation and guidance that is as practicable as possible. We would both welcome your feedback on this publication and hope that it will be of practical assistance to you.

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Further advice on the application of precedents contained in this publication can be obtained from Matthew Moore.

References

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2. Home Office consultation document 'Obligations to report money laundering: the consent regime', para 5.8
3. Law Society response to the Home Office consultation document, see http://www.lawsociety.org.uk/documents/downloads/dynamic/lspresp_consentregime.pdf
4. Home Office consultation document, *ibid*, para 4.18 in relation to the issue of fungibility

Abbreviations used throughout this publication

Anti-money laundering	AML
Corruption Perception Index	CPI
Counter terrorist financing	CTF
Financial Action Task Force	FATF
Financial Services Authority	FSA
First EU Directive on Money Laundering	First Directive
Joint Money Laundering Steering Group	JMLSG
Limited information value report	LIVR
Money Laundering Regulations 2003	MLR 2003
Money Laundering Regulations 2007	MLR 2007
Money Laundering Reporting Officer	MLRO
National Criminal Intelligence Service	NCIS
Proceeds of Crime Act 2002	POCA
Second EU Directive on Money Laundering	Second Directive
Serious Organised Crime Agency	SOCA
Serious Organised Crime and Police Act 2005	SOCPA
Solicitors Regulation Authority	SRA
Suspicious activity report	SAR
Terrorism Act 2000 and Proceeds of Crime 2002 (Amendment) Regulations 2007	Amendment Regulations 2007
Terrorism Act 2000	TA
Third EU Directive on Money Laundering	Third Directive