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Commission**
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MONEY LAUNDERING

Summary

SUMMARY

MONEY LAUNDERING

Money laundering, in general terms, describes the processing (or “laundering”) of criminal property in order to disguise its illegal origin. The scale of laundered criminal funds affecting the United Kingdom annually is estimated to be tens of billions of pounds.¹

Information provided by individuals and the private sector is crucial in helping law enforcement agencies to identify the proceeds of crime, and investigate money laundering and wider criminality. To enable this flow of information, the UK has a statutory regime which requires, or encourages, disclosure of information to law enforcement under relevant circumstances. Banks, for instance, monitor unusual activity across the accounts they administer. Relevant bodies are required under the Proceeds of Crime Act 2002 (“POCA”) to provide information to the UK Financial Intelligence Unit (“UKFIU”) (part of the National Crime Agency (“NCA”)) where they suspect the money concerned is linked to crime. See the Proceeds of Crime Act 2002, ss330-332 and Schedule 9.

The impact of money laundering domestically is estimated to cost every household in the UK £255 a year and allows criminals to profit from their crimes.

Required and voluntary disclosures provide the authorities with information and intelligence on money laundering and criminality in general. It also gives the authorities an opportunity to intervene at an early stage to freeze or restrain assets or simply disrupt criminal activity. In some circumstances, reporters who are dealing with suspected criminal property are protected from potential criminal liability for a money laundering offence if they make a voluntary disclosure and act with consent.²

It is vital that the UK has a robust legislative framework to facilitate the reporting of money laundering and related criminality. It is important that the system functions in a fair, effective and efficient way. However, there is good reason to think that the current regime is not working as well as it should.



¹ HM Government, Serious Organised Crime Strategy (2018), p 14.

² See Proceeds of Crime Act, s327(2)(a), 328(2)(a), 329(2)(a) and 338.

OUR REVIEW OF THE REPORTING REGIME

In 2017, the Law Commission agreed with the Home Office to review and make recommendations for reform of limited aspects of the UK's anti-money laundering and terrorist financing regimes. Specifically, we were asked to consider whether there is scope, within the existing legislative framework, for reform of the system of voluntary disclosures known as the "consent regime".

As part of our review of the consent regime we considered:

- Part 7 of the Proceeds of Crime Act 2002; and
- Part 3 of the Terrorism Act 2000.

The primary purpose of the review is to improve the prevention, detection and prosecution of money laundering and terrorism financing in the UK.

The full version of the Final Report can be found at www.lawcom.gov.uk

“We welcome this [review] and have engaged with the Law Commission team to help them understand the operation of the existing legal provisions. We recognise many of the perceived problems in the current regime and welcome many of the recommendations”

– Consultation response of the National Crime Agency.

HOW IS SUSPICIOUS ACTIVITY REPORTED?

The legislation distinguishes between two types of disclosure: “required disclosures” and voluntary (“authorised”) disclosures. The mechanism by which any such disclosure is made is by the submission of a “suspicious activity report” (“SAR”) to the UKFIU.

If a reporter knows or suspects, or has reasonable grounds to know or suspect that a person is engaged in money laundering they are obliged in certain circumstances to disclose their suspicion to the UKFIU. This is known as a “required disclosure”. If a required disclosure is not made, the person who ought to have reported (eg the relevant bank official) is liable to be prosecuted for a criminal offence.

“Authorised disclosures” are generated when an individual has a suspicion they have encountered criminal property. Most commonly this occurs in the course of undertaking business or providing professional services. An individual who suspects that they are dealing with the proceeds of crime can seek “appropriate consent” from the UKFIU to complete a transaction which might otherwise constitute a money laundering offence.³

The process of seeking and securing consent has a practical function, it is intended to protect those who will inevitably encounter suspected criminal property in the course of business or in a professional capacity. Where, for example, a bank official suspects criminal property is in an account, that fact can be disclosed to the authorities and consent might be obtained to continue to process relevant transactions.

Authorised disclosures have a dual function: they both provide intelligence to law enforcement agencies (police forces in the relevant region), and shield the reporter from relevant criminal liability by way of an exemption from the commission of a money laundering offence. This process is known as the “consent regime”.

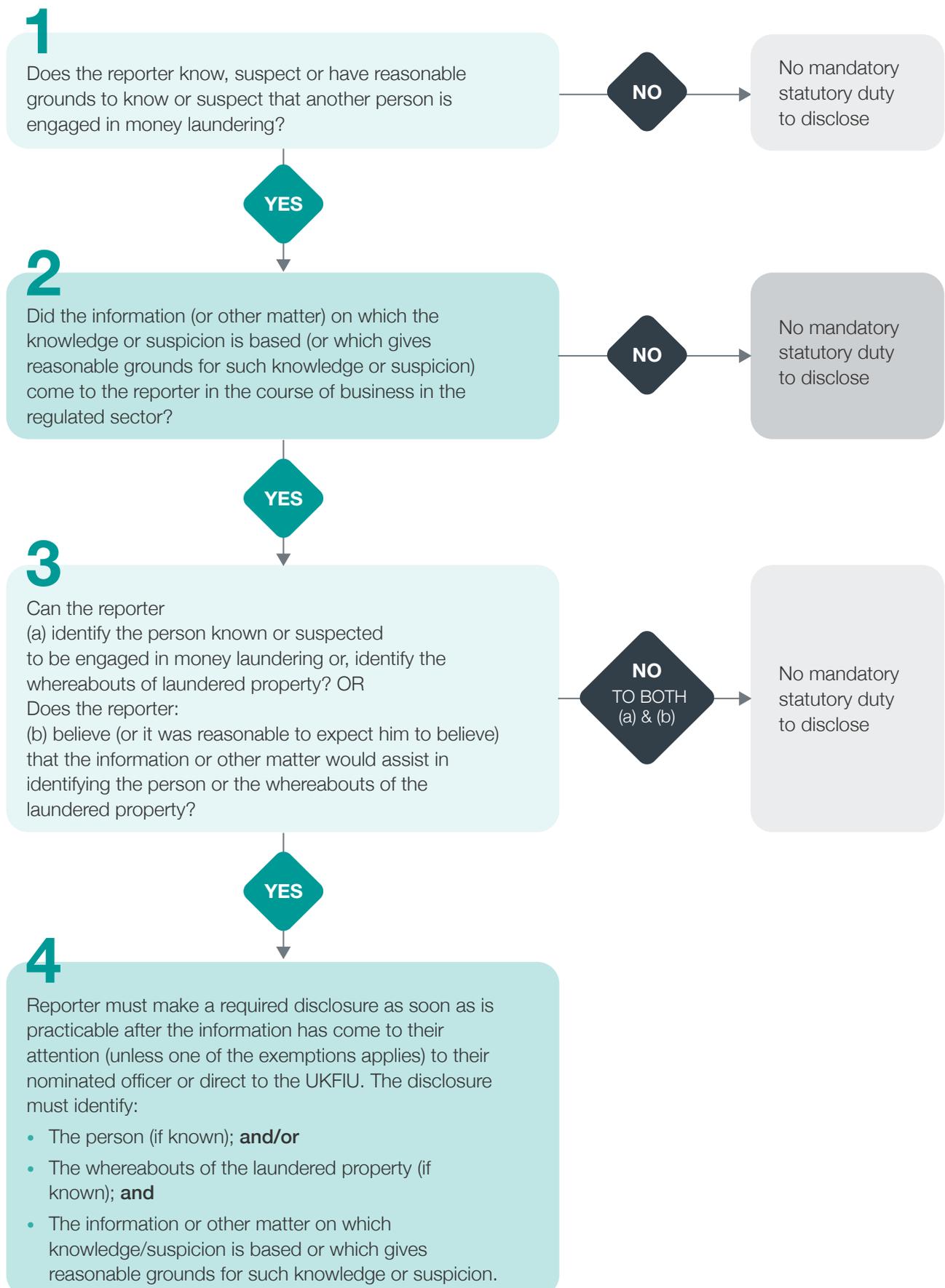
The UKFIU facilitates the disclosure process by acting as the intermediary for intelligence between the private sector and law enforcement agencies. Required disclosures need minimal processing. Authorised disclosures⁴ on the other hand must be analysed by UKFIU and passed on to law enforcement agencies who will investigate and decide whether to take further action. To allow the UKFIU to take a fully informed decision on whether to consent to the transaction, the reporter is prohibited, in effect, from processing the suspicious transaction once the SAR is submitted, and the account is frozen from that time. Acting without consent places the reporter at risk of committing a money laundering offence. A decision on consent must be reached by the UKFIU within seven working days.⁵

³ Proceeds of Crime Act 2002, Part 7 and Part 3 of the Terrorism Act 2000.

⁴ Or a terrorist financing offence.

⁵ Deemed consent may also arise when (1) an individual who makes an authorised disclosure does not receive notice that consent to the doing of the act is refused before the end of the statutory seven-day notice period. See Proceeds of Crime Act 2002, s335(2) and 335(3); or (2) an individual who makes an authorised disclosure does receive notice of refusal of consent during the notice period but the moratorium period has expired (subject to any application to extend the moratorium period). See Proceeds of Crime Act 2002, s 335(2) and 335(4).

Required disclosure:



Authorised disclosure:

1

Is the reporter in possession of, or about to deal with property which they suspect is criminal in origin (ie constitutes a person's benefit from criminal conduct or represents such a benefit in whole or in part, directly or indirectly)?

NO

No offence committed

YES

2

Could the reporter's intended action in dealing with the property amount to one of the prohibited acts in sections 327-329 of the Proceeds of Crime Act 2002 in relation to the suspected criminal property?

- Conceal, disguise, convert, transfer or remove it from England and Wales, Scotland or Northern Ireland; or
- Enter into or become concerned in an arrangement which he or she either knows or suspects facilitates (by whatever means) the acquisition, retention, use or control of it by or on behalf of another person; **or**
- Acquire, use or have possession of such property.

NO

No offence committed

YES

3

The reporter may make an authorised disclosure to a nominated officer, constable, customs officer or UKFIU that the property in question is known or suspected to be criminal property prior to the prohibited act (ie movement of the property) taking place.

THEN

4

The reporter must await consent from the UKFIU:

- **Explicit consent;**
- **Deemed consent on expiry of statutory notice period** where a reporter does not receive notification of refusal within the period of seven working days starting with the first working day after the person makes the disclosure;
- **Deemed consent on expiry of statutory moratorium period** of 31 days (or other period as determined by a Crown Court judge)

PROBLEMS WITH THE CURRENT DISCLOSURE REGIME

High volumes of reports are submitted to the UKFIU every year. The number has doubled over the last ten years and continues to rise.⁶

The UKFIU received and processed 463,938 SARs between April 2017 and March 2018. This amounts to a 9.6% increase on the volume of SARs in 2016-17. The NCA describe it as a “record number”.

In our discussions with stakeholders early in the project, the Law Commission heard concerns that many of the SARs being submitted are of low quality. High quality SARs – in other words SARs which are data rich, and are submitted to the UKFIU in a format which is easy to process – can provide evidence of money laundering in action. Furthermore, they are one of the primary methods of sharing information to produce intelligence for law enforcement agencies to investigate and prosecute crime more generally. Low quality SARs, on the other hand, can require as much or more time to submit and process but contain limited, or even no, useful intelligence.

The Law Commission conducted an independent analysis of a sample of SARs that had been submitted to the UKFIU and found that these concerns were well-founded.

“While SARs of a high quality are being received, there are concerns about the low level of SAR reporting in many sectors, including some identified as being at high risk, and the large number of poor quality SARs being filed even among banks which submit 85% of SARs filed.”

– Financial Action Task Force Mutual Evaluation Report of the United Kingdom (2018) p 24.

We concluded that the large volume of disclosures was caused, in part, by a broad definition of “criminal property” in section 340 of POCA which requires that suspected laundering of the proceeds of any criminal conduct must be reported.

We also heard evidence that the threat of individual criminal liability for the relevant officials working in the reporting sector (eg bank officials and those in law firms and estate agencies) for a failure to make a disclosure encourages defensive reporting. Over-cautious reporting is more likely to produce low quality SARs, and even SARs which do not meet the threshold for reporting in the first place.

We also found both anecdotal and empirical evidence to support our provisional conclusion that a significant number of reporters misunderstood their legal obligations under Part 7 of POCA. One of the reasons for this is that there is fragmented supervision of the anti-money laundering regime. Despite best efforts, this has resulted in a lack of uniformity across approved guidance with conflicting interpretations of the key principles underpinning the anti-money laundering regime. This lack of clarity adds to reporters’ confusion and misunderstandings when they are applying the principles of the regime.

This has a cost to both the private sector and law enforcement agencies. Valuable resources are wasted by law enforcement agencies processing unnecessary, defensive or poor quality authorised disclosures.

However, the regime is required to perform a difficult balancing act between three sets of interests: those of law enforcement agencies in receipt of the intelligence, reporters who shoulder the burden of monitoring for suspicious activity and reporting to law enforcement and those who are the subject of a report (for example, the bank customer whose account is frozen when an authorised disclosure is made).

For the law enforcement agencies there is a balance to be struck between receiving huge volumes of intelligence about suspicious activity and information containing more details of the activity.

⁶ National Crime Agency, SARs Annual Report 2017 and National Crime Agency, “[Suspicious Activity Reports \(SARs\) Annual Report 2018](#)”, p 3.

For those subject to the reporting requirement, the burden can be substantial. Compliance with reporting obligations is expensive. UK Finance⁷ estimates that its members are spending at least £5 billion annually on core financial crime compliance.⁸

There is also a risk of reputational or economic harm for the subjects of disclosures. This disruption may be anything from a temporary inconvenience to severe economic hardship if the subject of a report has their bank account frozen and can no longer access their funds. In an extreme case, an individual may find that their bank account has been closed.

One barrister that we consulted during this project had his access to his personal and business accounts temporarily restricted during the Christmas period. He was left with only £20 in cash and unable to access any funds. Fearing that he would be unable to pay his mortgage or pay his employees, he sought an urgent injunction to gain access to his bank accounts. He was only able to obtain the injunction with the assistance of a lifetime friend who paid the necessary court fees. He was granted access to his accounts, however, the bank promptly served him with a notice of closure informing him that they would no longer be providing him with personal, or business, banking services. Reflecting on this, he reported great difficulty in opening new accounts with a high street bank.



OUR PROCESS

In approaching this task, we met regularly with those working within the anti-money laundering sphere to hear about how the regime operates. We engaged with staff at the UKFIU, representatives from other law enforcement agencies, and members of the regulated sector⁹ to hear first-hand about their experience of the consent regime in particular.

In addition, we drew on the expertise of government officials, academics, legal practitioners and members of the judiciary to understand how the existing system might be improved. We learned of the personal experiences of those who, as the subject of a disclosure, had a personal or business account frozen and then subsequently re-opened.

In July 2018 we published a consultation paper, and ran a public consultation period in which we invited stakeholders and individuals to comment on our provisional proposals.

Following the launch of our consultation, we held a symposium to share our provisional proposals. The event was attended by 100 individuals working in the field.

The consultation period ran until 5 October. In total we received 56 consultation responses. These responses came from:

- 12 organisations in the regulated sector;
- 19 supervisory authorities, other appropriate bodies or trade organisations;
- 5 police and prosecuting authorities;
- 16 individuals, practitioners and academics;
- 3 non-governmental organisations; and
- a joint response from the Home Office and HM Treasury.

⁷ A trade association representing the banking and finance industry operating in the UK, formerly known as the British Bankers' Association.

⁸ The British Bankers' Association (now UK Finance) estimated that its members spend at least £5 billion annually on core financial crime compliance, <https://www.bba.org.uk/policy/bba-consultation-responses/bba-response-to-cutting-red-tape-review-effectiveness-of-the-uks-aml-regime>. This figure is not limited to compliance generated by the Proceeds of Crime Act 2002 ss 327 to 329 and 330 to 332.

⁹ The regulated sector is defined in Schedule 9 to the Proceeds of Crime Act 2002. The term is used to describe business whose activity presents a high risk of money laundering or terrorist financing. It is a criminal offence for a person "acting in the course of business in the regulated sector" to fail to make a required disclosure to the UKFIU.

The responses we received have informed our conclusions, and we are grateful to the individuals and organisations for their contributions throughout.

We conducted our own independent analysis of SARs. We examined a statistically significant sample of authorised disclosures, allowing us to draw robust conclusions.¹⁰ The results of our analysis were broadly consistent with the detailed submissions we received at both the fact-finding and consultation phases of the project.

We discovered a substantial variance in the quality of SARs. There was clear evidence that some reporters misunderstood their legal obligations under POCA. Around 15% of authorised disclosure SARs did not meet the threshold of suspicion. If we assume that this proportion is representative across all 27,471 authorised disclosures submitted between October 2015 and March 2017, approximately 4,121 would have been submitted unnecessarily.¹¹

The interpretation of suspicion in *R v Da Silva*¹² has been adopted by the courts and is relied upon as a guiding principle by those with reporting obligations. In order to meet the threshold of suspicion:

“The defendant must think that there was a possibility, which was more than fanciful, that the relevant fact existed.”

15% of authorised disclosure SARs did not meet the threshold of suspicion equating to approximately 4,121 SARs would have been submitted unnecessarily between October 2015 and March 2017.

Source: Final Report, para 5.30

In addition to this, reporters only articulated reasonable grounds to suspect, by demonstrating one or more objective grounds, in 52.4% of the sample we analysed. This represents a substantial proportion of authorised disclosures which are lodged without objective grounds in support.

The data analysis project findings overwhelmingly supported our initial observation that reporters misunderstand their legal obligations under POCA.

Source: Final Report.

OUR RECOMMENDATIONS

We considered a series of legislative and non-legislative options for reform. We make 19 recommendations in our report, and summarise the most significant below.

Advisory board

Our overarching recommendation is that an Advisory Board is created to oversee drafting of guidance, to continue to measure the effectiveness of the reporting regime and to advise the Secretary of State on ways to improve it. A Board with responsibility for the oversight of the regime will make the anti-money laundering regime more responsive to new and emerging threats, by bringing together experts in both the public and private sectors.

We also recommend that the Advisory Board, constituted by those with relevant expertise, have input into the analysis of SARs at regular intervals. This will ensure the effectiveness of the regime is being monitored.

¹⁰ Using ‘Cochran’s formula for minimum sample size, with our sample size of 536 SARs we can claim a 95% confidence level with a 5% margin of error.’

¹¹ Source: Final Report, para 5.30.

¹² [2006] EWCA Crim 1654, [2007] 1 WLR 303.

Retaining the consent regime

In our Consultation Paper we set out the issues created by the consent regime and the arguments in favour of its retention. Against this backdrop, we asked consultees whether they believed that the consent regime should be retained.

The vast majority of consultees who responded to this question favoured the retention of the consent regime. In light of the overwhelming support, we recommend retaining the consent regime with improvements to render it more efficient and effective.



Guidance

Common misunderstandings and a lack of clarity around reporting obligations can result in wasted time for both the reporter and for those processing SARs. To rationalise the existing fragmented and sometimes conflicting guidance across industries we also recommend that POCA be amended to impose an obligation on the Secretary of State to issue guidance covering the operation of Part 7 of POCA so far as it relates to businesses in the regulated sector.

In particular, we recommend guidance should be provided on a number of key statutory concepts:

- (1) Suspicion: to assist reporters in understanding and applying the Da Silva test¹³. This should encourage the provision of more detailed information in SARs and reduce unnecessary delays for in the process of seeking consent.
- (2) “Appropriate consent” and “arrangements with prior consent”: to clarify the effect of consent and allay confusion about the existing terminology;
- (3) The reasonable excuse exemption: to clarify what may amount to a reasonable excuse and address inconsistency across different industries; and
- (4) Ringfencing: to complement our proposed reforms which would enable a different approach to dealing with identifiably criminal property in particular circumstances.

Guidance will assist the regulated sector in complying with their legal obligations under POCA.

“The MPS agree that it would be beneficial for the UK to develop a single authoritative source of guidance, if it is developed by all actors... It is apparent, from engaging with individual reporters, that many need assistance.”

– Consultation response of the Metropolitan Police Service.

13 “A possibility, which was more than fanciful, that the relevant fact existed”; [2006] EWCA Crim 1654, [2007] 1 WLR 303.

“We agree that the Government should produce guidance on the suspicion threshold. We recommend, in particular, compiling a list of indicative factors which might contribute to or detract from, a finding that there is a suspicion of money laundering.”

– Consultation response of Freshfields Bruckhaus Deringer

Prescribing the form

To enhance the quality of reporting we recommend that the Secretary of State uses his existing power to prescribe the form of a SAR. We recommend making the best use of new technology to devise an online form which would assist reporters to make more effective disclosures to the UKFIU. This would also present the information to the UKFIU and law enforcement agencies in an easy to read, accessible format. The layout of the prescribed form will direct reporters to provide law enforcement agencies with essential information. Coupled with guidance, a prescribed form will enable reporters to be more confident articulating the basis on which they formed a suspicion.

Prescribing the form will also have a positive impact on how SARs are used by law enforcement agencies. By encouraging the information contained in SARs to be inputted in a consistent format, the UKFIU and law enforcement employees will be able to ascertain more quickly the nature of the reporters suspicion and key details underpinning it.

“We are working together on SAR reform, because we both want quality not quantity of SARs to be made.” – Rt Hon Ben Wallace MP the Minister of State for Security in reference to working with reporters to improve the reporting of suspicious activity.

Limiting the scope of reporting

A number of categories of case that trigger the obligation to make a disclosure were identified to us as failing to provide intelligence of significant value to law enforcement agencies. Without the means of exempting those cases from the reporting obligation, even in circumstances where both the reporter and the UKFIU consider that the information provided is unlikely to be useful, resources are wasted processing unhelpful and unnecessary disclosures.

In chapters 4 and 7 of our report, we considered whether there was merit in reducing the scope to eliminate those with little intelligence value by:

- (1) limiting the scope of reporting all crimes to just serious crimes as defined; and
- (2) extending the circumstances in which a reporter may have a reasonable excuse not to make a disclosure.

Ultimately, we concluded that it would be desirable to maintain the status quo for the reporting of all crimes. This is principally because the intelligence value of suspected criminal property will not necessarily correspond with how serious the crime is, or how valuable the intelligence is. This is particularly true of suspected terrorism financing SARs. A threshold of seriousness may also create additional burdens for reporters who would be required to identify the underlying offence.

“We believe that a serious crimes approach would not solve the challenges of the all crimes approach without creating substantial new problems.”

– The Law Society of England and Wales

“We agree that it would be unwelcome to add an extra layer of unnecessary analysis, when considering whether it is necessary to file a SAR, as to whether the underlying conduct fell within the definition of “serious crimes”.

– Slaughter and May

The need for a balanced regime

In chapter 8 we make two recommendations aimed at redressing the balance of the competing interests of the regime (law enforcement agencies, reporters and those who are the subject of a SAR). We explain that the practice of freezing entire bank accounts, regardless of the value of the property that is suspected to be criminal, can have severe economic consequences for an individual or a business. We therefore recommend that POCA is amended to create an exemption to allow criminal property to be ringfenced by credit and financial institutions. This provides for a more proportionate response to the nature of the (suspected) criminality.

We also recommend the addition of a provision allowing for funds to be released by a Crown Court Judge when an application for an extension to the moratorium period is made.

Additional reporting requirements

In chapter 10 of our report, we considered whether it would be appropriate to recommend the introduction of new powers for thematic reporting or Geographical Targeting Orders. These reporting mechanisms remove the reporter’s discretion to assess suspicion, instead requiring them to make reports if certain specified criteria are met. For example, an obligation to report may be triggered if a transaction occurs in a prescribed geographical location. Not all consultees were persuaded that additional reporting requirements were necessary and we ultimately felt the case for change had not yet been made out. Accordingly, we recommend that further research into the utility of targeted reporting to be undertaken, coupled with a detailed cost-benefit analysis. Any such new order could be piloted to assess its effectiveness. This will confirm whether the additional burden of reporting would be proportionate to the benefits of an expanded pool of data.

Our proposals:

- (1) Work towards a more proportionate and user-friendly regime**
- (2) Clarify the scope of reporting**
- (3) Reduce the burden of making and processing disclosures for both the regulated sector and the UKFIU**
- (4) Produce better quality reports for law enforcement agencies**

The full version of the Final Report can be found at www.lawcom.gov.uk

