Law Society of England and Wales - Chapter 3 - Money Laundering Regulations 2003

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(**NOTES**: (1) Please note that the Law Society's website contains numerous guidance on Money Laundering legislation, as well as related legislation - including recent amendments /updates

(2) All highlights and bold typeface text by NKDR)

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Introduction

3.1 The ML Regulations 2003 (Annex 2) will come into effect on 1 March 2004 and replace the Money Laundering Regulations of 1993 and 2001. The Regulations implement the Second European Second Money Laundering Directive ("the Directive") and cover a broad range of activities identified as being high risk in that Directive, including much of the work traditionally undertaken by solicitors. While previous regulations focused principally on financial services, **almost all solicitors will now be within the regulated sector.**

3.2 POCA and the Terrorism Act 2000 apply to all solicitors and their staff, and all activities carried out by them. The ML Regulations 2003 impose additional anti-money laundering compliance requirements when certain specified activities are undertaken. The purpose of these administrative requirements is:

to enable suspicious transactions to be recognised and reported to the authorities; and

to ensure that the audit trail is available if a solicitor, client or other party to a transaction becomes the subject of an investigation.

3.3 Failure to comply with the ML Regulations 2003 is itself a criminal offence which can be prosecuted by the Financial Services Authority and the Crown Prosecution Service. However the scope of the ML Regulations 2003 is as yet untested in the courts, and there is some uncertainty as to their application in some cases. Firms in doubt as to whether the ML Regulations 2003 apply to their work, or as to the scope of any exemption, are advised to take specialist legal advice. This lack of clarity means it would be wise to comply with the ML Regulations 2003 on a broad, rather than a narrow, basis as a form of risk management within your firm.

Solicitors may also wish to apply the requirements of the ML Regulations 2003 across the whole scope of their activities in order to protect against the committing of an offence under the statutory criminal law.

This law applies even if the particular activities are not "relevant business" and, therefore, are not covered by the ML Regulations 2003.

3.4 Those solicitors who conduct mainstream financial services work, and who therefore are regulated by the Financial Services Authority, are subject to the FSA Money Laundering Sourcebook. They should also refer to the guidance notes on the prevention of money laundering issued by the Joint Money Laundering Steering Group. The FSA has prosecution and disciplinary powers for breaches of its rules, including the Money Laundering Sourcebook.

3.5 Part 1 of this chapter deals with the scope and requirements of the ML Regulations 2003 and Part 2 looks in more detail at how client identity can be established.

PART 1 – SCOPE AND REQUIREMENTS OF THE ML REGULATIONS 2003

When do the ML Regulations 2003 apply?

3.6 The ML Regulations 2003 apply to persons who carry on "relevant business" as defined in Regulation 2 (see paragraphs 3.9 - 3.11 below).

3.7 In addition to those businesses covered by the previous regulations, i.e. financial services businesses, the ML Regulations 2003 apply to:

notaries and other legal professionals acting on behalf of their clients in any financial or real estate transaction;

real estate agents;

auditors, external accountants, tax advisers;

money transmission service providers;

dealers in high value goods, such as precious stones, metals, works of art, or auctioneers – wherever payment is made in cash (over Euro 15,000); and

casinos.

3.8 The purpose of the ML Regulations 2003 is to help set up barriers to prevent money launderers from using your firm. This Guidance considers in more detail which activities undertaken by solicitors fall into the scope of the ML Regulations 2003. POCA and Terrorism Act 2000 continue to apply even where the ML Regulations 2003 do not.

3.9 The types of "relevant business" which may be carried out by solicitors include:

Legal transactional services

"The provision by way of business of legal services by a body corporate or unincorporate or, in the case of a sole practitioner, by an individual, and which involves participation in a financial or real property transaction (whether by assisting in the planning or execution of any such transaction or otherwise by acting for, or on behalf of, a client in any such transaction)." Regulation 2(2)(l)

3.10 It is clear that the activities of solicitors acting on the sale or purchase of property fall within the scope of the ML Regulation 2003. What amounts to "participation in a financial transaction" is less clear. The Government has indicated that the ML Regulations 2003 are intended to reflect the identification of high-risk activities in the Directive. The text of the Directive should help in understanding the type of financial transactions which are included within the definition of Regulation 2(2)(l). The Directive provides that the following should be included:

"Independent legal professionals, when they participate, whether:

(1) by assiting in the planning or execution of transactions for their client concerning the:

buying and selling of real property or business entities;

managing of client money, securities or other assets;

opening or management of bank, savings or securities accounts;

organisation of contributions necessary for the creation, operation or management of companies; or

creation, operation or management of trusts, companies or similar structures; or

(2) by acting on behalf of and for their client in any financial or real estate transaction."

3.11 Managing of client money" is narrower than simply handling client money. Simply operating a solicitor's client account is not intended to be caught within the scope of the ML Regulations 2003. By way of contrast, where, for example, solicitors are acting as attorneys, they may be managing money or other assets on behalf of clients. The activity of "opening or management of bank accounts" is wide and is likely to cover trustees, attorneys and receivers.

3.12 The Treasury has confirmed that the following would not generally be viewed as "participation in financial transactions":

a payment on account of costs to a solicitor or payment of a solicitor's bill (because the solicitor is not participating in a financial transaction on behalf of the client);

legal advice;

participation in litigation;

will writing; and

publicly funded work.

Company and trust services

"The provision by way of business of services in relation to the formation, operation or management of a company or a trust: "(Regulation 2(2)(m)).

Insolvency and tax services

"The activities of

a person appointed to act as an insolvency practitioner within the meaning of section 388 of the Insolvency Act 1986, or Article 3 of the Insolvency (Northern Ireland) Order 1989. (Regulation 2(2)(h)).

the provision by way of business of advice about the tax affairs of another person by a body corporate or incorporate or, in the case of a sole practitioner, by an individual. ."

(Regulation 2(2)(i))

Financial Services

Certain "regulated activities" under the Financial Services and Markets Act 2000 ("FSMA 2000") such as dealing in investments, arranging deals in investments, managing investments, safeguarding and administering investments, and advising on investments. (Regulation 2(2)(a)).

3.13 These activities were subject to the Money Laundering Regulations 1993. They include mainstream investment business (including activities for which authorisation is now required from the Financial Services Authority) and non-mainstream investment business i.e. business which solicitors can do as part of the DPB regime. These activities are explained in the Law Society guidance "Financial Services and Solicitors". (See chapter 1 paragraphs 1.20 – 1.25)

General comments on "relevant business"

3.14. In deciding whether their firms carry out “relevant business” and fall within the scope of the ML Regulations 2003, solicitors are advised to take a cautious approach. Thus, for example, although litigation or advice on seeking asylum or criminal law work might fall outside the ML Regulations 2003, supplementary work in making arrangements for the investment or management of any monies received by way of settlement or acting on a house purchase, will be regulated. If firms are uncertain as to whether they are required to comply with the ML Regulations 2003, they should take legal advice on the individual circumstances of their practice.

3.15 The UK Government decided that as activities which are identified as high-risk (including company and trust formation) are not undertaken solely by professional lawyers and accountants, it is appropriate to apply the ML Regulations 2003 to cover those activities rather than specific categories of professional. This approach ensures that, for example, the provision of legal transactional services is covered, even if performed by an unlicensed practitioner.

What do the ML Regulations 2003 require?

Overview and general requirements – Regulation 3

3.16 The ML Regulations 2003 require all persons carrying on relevant business to "establish such procedures of internal control and communication as may be appropriate for the purpose of forestalling and preventing money laundering". A person must be nominated as the “nominated officer” to receive internal reports of suspicious circumstances. It is important that all relevant staff know and understand what the procedures are. Procedures must be set up for:

training;

client identification;

record keeping; and

the internal reporting of knowledge or suspicion, or reasonable grounds for knowledge or suspicion, that a person is engaged in money laundering.

Further details of each requirement are set out below.

3.17 The ML Regulations 2003, including the requirements of client identification and record keeping, apply to firms carrying on relevant business in the UK. However, firms with overseas offices may wish to consider operating client identification and record keeping procedures in those overseas offices, particularly for instructions which may involve work in the UK or where clients may subsequently be referred by an overseas office to the UK office. See chapter 2 paragraph 2.7 on the extra territorial effect of POCA.

3.18 Failure to comply with the ML Regulations 2003 is an offence punishable on conviction by a maximum of 2 years’ imprisonment and/or a fine, irrespective of whether money laundering has actually taken place.

3.19 When deciding whether an offence has been committed, the court must consider whether the defendant followed any relevant guidance issued by a supervisory authority or other appropriate body, and approved by the Treasury. It is a defence to show that the defendant took all reasonable steps and exercised all due diligence to avoid committing the offence. The Law Society is a supervisory body for this purpose and, after the ML Regulations 2003 have been in force for some time and it is possible to assess the effectiveness of this Guidance, it may apply to the Treasury for approval of this Guidance. However, courts may take this Guidance into account, even if it is not Treasury approved.

Training – Regulation 3

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Checking client identity – Regulation 4

3.28 Regulation 4 requires firms carrying out relevant business in the UK to obtain "satisfactory evidence" of the identity of each client (and, where the client is acting as agent to take reasonable measures to establish the identity of the underlying principal). For evidence of identity to be "satisfactory", the ML Regulations 2003 require it to pass two tests:

…an objective test in that the evidence must be "reasonably capable" of establishing that the client is the person he or she claims to be; and

a subjective test in that the person who obtains the evidence must be satisfied that it does in fact establish that the client is the person he or she claims to be.

A more detailed section on how identity can be established appears in Part 2 of this chapter. If the client is a money service operator then evidence must include his/her registered number (if any) (see paragraph 3.43). There are some exceptions to the requirement to obtain evidence and these are discussed in paragraph 3.40 – 3.49 below.

3.29 A firm's identification procedures must provide for the client's identity to be checked as soon as is reasonably practicable after contact is first made between solicitor and client.

3.30 The need to check identity arises:

if client and solicitor form, or agree to form, a business relationship; or

in respect of any one-off transaction, if the solicitor knows or suspects that the transaction involves money laundering, or payment of 15,000 Euro or more (excluding the solicitor's costs) is to be made by or to the client; or

if it appears to the solicitor, whether at the outset or subsequently, that two or more one-off transactions are linked and involve in total 15,000 Euro's or more.

As at 24 November 2003 the value of 15,000 Euros was just over £10,300 and the current value of the Euro can be found in the Financial Times. The correct figure is also featured on the monthly data page of the Gazette. The ML Regulations 2003 do not, unlike previous Regulations, provide a common date for a valuation of 15,000 Euros. The Treasury have indicated that it will be up to the Courts to identify what rate will apply. Courts may take the rate applicable when any business is entered into. In cases of doubt, when close to the limit it may be safest to make the identity check.

3.31 Solicitors should remain vigilant about clients avoiding identification checks by purposefully entering into a number of transactions below the 15,000 Euro limit. If such tactics are suspected, identification should be obtained, and the suspicions reported to the nominated officer or NCIS.

3.32 Where satisfactory evidence of identity is not obtained the business relationship or one-off transaction must not proceed any further.

3.33 In relation to relevant business carried out by solicitors, there are three key definitions in the context of Regulation 4:

an "applicant for business" is any person seeking to form a business relationship, or carry out a one-off transaction (e.g. a prospective client), with a solicitor acting in the course of relevant business in the UK;

a “business relationship” arises between a client and a solicitor when there is any arrangement between them the purpose of which is to facilitate the carrying out of transactions on a frequent, habitual or regular basis where the total amount of any payments to be made by any person to any other in the course of the arrangement is not known or capable of being ascertained at the outset. Examples of a business relationship might be acting for a company in the course of acquiring a series of businesses or shares, or acting for a wealthy individual in acquiring a portfolio of investment properties, or conducting all legal work as it arises for a company or unincorporated business;

a “one-off transaction” means any transaction other than one carried out in the course of an existing business relationship.

3.34 Many solicitors' firms will mainly be involved in one-off transactions, others are more likely to be involved in business relationships, most will be involved in a mixture of both. The distinction is relevant because different exceptions apply in relation to obtaining evidence of identity. Different record keeping requirements also apply. When deciding which category a transaction falls into, solicitors will need to be aware that what starts off as a “one-off transaction” may evolve into a “business relationship”, and arrangements must be made to ensure compliance at all times with the relevant identity and record keeping requirements. For some firms the most appropriate and practical course may be to treat all new matters as if they arise in the course of a business relationship notwithstanding the strict position under the ML Regulations 2003; others may wish to consider each new matter on a case by case basis. Whichever approach is taken it is the responsibility of each firm to ensure it is compliant. Where a one-off transaction with the client (below the threshold) may develop into a business relationship, firms may find it easier to ask for identification evidence early on, which will also have the benefit of ensuring that the firm is compliant when the nature of the retainer changes.

3.35 When a firm acts on instructions from two or more clients on a matter, satisfactory evidence of identity will be required for all clients.

3.36 Where a client acts, or appears to act, for another person (e.g. if the client is acting as agent or nominee), “reasonable measures” must also be taken to establish the identity of the other person. The requirement to establish evidence in relation to underlying principals appears to be less onerous than the evidential requirement for the "applicant for business" .

3.37 If satisfactory evidence of identity is not obtained about a client the business relationship or one-off transaction must not proceed any further. If a solicitor accepts money from a client before establishing identity, and then cannot proceed because identity is not established, care must be taken before returning the money to the client. If, by reason of the failure to produce evidence or for any other reason, the solicitor has formed a suspicion that the client or another may be involved in money laundering, it may be necessary to make a report and obtain NCIS consent before returning that money to the client or otherwise progressing the matter, and he may need to take steps to ensure that he does not inadvertently commit the criminal offence of “tipping off”. (See chapter 2)

3.38 Identification procedures must be undertaken for linked transactions that together equal or exceed the 15,000 Euro exemption limit. Whether transactions are linked depends upon any obvious connection rather than an arbitrary time limit. However, for lower risk work concerning transactions between which there is no obvious link, a 3 month period may be a useful yardstick.

3.39 New clients are sometimes introduced by partners or staff members. Records of evidence of identity should still be made and kept in such cases.

Exceptions – when checking client identity is not required – Regulation 5

3.40 There are a number of exceptions by which firms are not required to obtain evidence of clients’ identity. However, evidence of identity must always be obtained if you know or suspect that a one-off transaction involves money laundering, even if an exception would otherwise apply. Note that the “postal concession” contained in regulation 8 of the 1993 Regulations is no longer available.

3.41 The exceptions are very narrowly drawn and solicitors will in most cases need to obtain satisfactory evidence of identity. Where a solicitor wishes to take advantage of an exception, but is in doubt as to whether or not it applies to the particular facts of a case, then expert legal advice should be taken.

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Client subject to regulation

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One-off transactions

3.44 Evidence of identity is not required if the transaction involves less than 15,000 Euro, or if two or more linked transactions involve less than 15,000 Euro in total. This exception does not apply if there is any suspicion of money laundering.

3.45 Under Regulation 5(3), evidence of identity is not required where a solicitor carries out a one-off transaction with or for a client pursuant to an introduction from a person who has provided a written assurance that evidence of identity of all third parties introduced by him/her will have been obtained and recorded under procedures maintained by him or her and:

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Nominated officers and reporting procedures – Regulation 7

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3.57 In practice, most external reports will be made to NCIS.

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3.60 The ML Regulations 2003 place the responsibility for making an internal report on any person who knows or suspects that the client is involved in money laundering. If in doubt, that person may first wish to consult the supervising partner about the circumstances and whether privilege applies.

3.61 The nominated officer is responsible for ensuring that, when appropriate, the information or other matter leading to a knowledge or suspicion, or reasonable grounds for knowledge or suspicion, of money laundering is properly disclosed to the relevant authority. The decision to report (or not to report) must not be subject to the consent of anyone else. The nominated officer will also liaise with NCIS on the issue of whether to proceed with a transaction.

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3.63 In addition to any penalties for breach of the ML Regulations 2003, the nominated officer will commit an offence under section 331 of The Proceeds of Crime Act 2002 if he or she knows or suspects money laundering, or has reasonable grounds for knowing or suspecting, on the basis of information or other matters which have come to him or her as a result of an internal disclosure and fails to report this to NCIS as soon as is practicable. The only defence available is that the nominated officer has a “reasonable excuse” for the non-disclosure.

PART 2 – HOW CAN IDENTITY BE ESTABLISHED?

General principles

3.66 Solicitors must be satisfied that they are dealing with a real person or organisation (natural, corporate or legal), and obtain satisfactory evidence of identity to establish that the client is that person or organisation. For the purpose of the ML Regulations 2003, "satisfactory evidence of identity" is evidence which is reasonably capable of establishing (and does in fact establish to the satisfaction of the person obtaining it) that the client is the person he or she claims to be.

3.67 Some firms may wish to produce standard forms for use by their staff in relation to evidence of identity.

3.68 In deciding what evidence is satisfactory, and how much evidence is required, a common sense approach should be applied. There will be circumstances when it will be both necessary and permissible to apply commercial judgement to the extent of the initial identification requirements. Decisions will need to be taken on the number of persons to be identified within the client organisation, the identification evidence required, and whether additional evidence is necessary.

3.69 The first step in the identification process is to think about exactly who your client is. In some cases it will be immediately obvious but in others it may be necessary to consider the position and, on occasion, to discuss and agree this with the client(s). For example, if you are acting for one of a group of companies, exactly which company or companies will you be acting for? If another professional firm or a bank asks you for advice, are you acting for them or for their underlying client? If acting on a domestic house purchase, are you acting for one individual or for both partners within a relationship? You must obtain satisfactory evidence of identity in relation to all persons for whom you intend to act. In the case of joint instructions from two or more clients, the identity of all the clients must be checked (but see paragraph 3.120 below in relation to partnerships).

3.70 You must also consider whether your client is instructing you as principal or agent. Where the client is or appears to act for another person then, in addition to obtaining evidence of identity in relation to the client, under Regulation 4(3)(d), you must also take reasonable measures to establish the identity of any principal for whom that client is acting, and under Regulation 6 you must maintain records in relation to that evidence. This obligation to take reasonable measures is rather less than the obligation to obtain satisfactory evidence in relation to the client, but it must still be complied with.

3.71 You may make checks by looking at actual documentary evidence such as passports and certificates of incorporation issued by Companies House, or by making electronic checks of suitable databases such as the FSA register, the Law Society database of practising solicitors, and the electoral register. Where you rely on an electronic check it may be advisable to print out and retain a copy of the evidence with your records.

3.72 You may also ask third parties, such as investigation and information service providers, and credit reference agencies, to obtain the evidence for you as long as you are reasonably satisfied that they are reputable, and that the evidence they produce will be reliable, and that you ensure that your records of the evidence are complete. For example, you may rely on a copy of the details page of a passport as part of the evidence of identity if it has been certified by a reputable lawyer (for details as to who may photocopy UK passports see paragraphs 3.79 – 3.80).

3.73 When using a combination of electronic and documentary checks, you must ensure that different original sources of information are used. For example, a physical check of a mortgage statement and an electronic check of the same mortgage account come from the same source, so one does not corroborate the other.

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Trusts

3.104 Trusts do not, of course, have separate legal personality. There are many different types of trust. Firms are advised to adopt a risk based approach in determining what evidence should be obtained and the nature of the evidence that is appropriate, recognising that trusts are popular

vehicles for money launderers. The classic long established family settlement may raise different issues to an offshore discretionary trust.

3.105 When acting for trusts, the firm's client will be the trustees whose position can be checked by referring to the document establishing the trust (and, if appropriate, documents dealing with the appointment of the current trustees). Their identities need to be established using procedures for individuals or companies summarised elsewhere in this Guidance. When acting for more than one trustee it will be necessary to establish the identity of at least two individual trustees. Whether all the trustees, and/or the identity of any living settlor should also be established will depend on your assessment of the risk which will itself depend on your knowledge of the nature, purpose and original source of the funding for the trust. When acting for trustees who are based in offshore jurisdictions with strict bank secrecy and confidentiality rules or in jurisdictions without equivalent money laundering procedures, you may need to make fuller enquiries of the trustees to obtain details (for example, full name and business or home address) of the settlor.

3.106 When acting for the settlor to form the trust, it will be necessary to establish his or her identity using procedures already mentioned.

3.107 Except where the firm is acting for beneficiaries, there is no need to establish the identity of beneficiaries for the purpose of the ML Regulations 2003, although it would be normal practice for a firm of solicitors to check the identity of beneficiaries before making any distribution.

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CORPORATE CLIENTS

3.109 Company structures are attractive to money launderers and firms should take a risk based approach in determining what evidence should be obtained, and the nature of the evidence that is appropriate. Dealing with a listed company presents a different risk to a private company. The following paragraphs set out minimum requirements, and firms may need to seek further evidence in higher risk situations.

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Other corporate clients: general

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Overseas corporations (unlisted)

3.117 Evidence of identity will be required in relation to the company itself. Where it is obtainable in the relevant country this will usually include the certificate of incorporation, but can also include the lists referred to above in relation to UK companies. In countries where there is no certificate of incorporation, or equivalent, other evidence that reasonably satisfies you that the corporation is in existence should be obtained (for example a copy of the most recent audited accounts).

3.118 You may use an extract from a reputable online information provider, or the services of a reputable directory or information search agency. In addition, where it is reasonably practicable, you should obtain evidence of identity in relation to one of its directors or shareholders, one of whom should usually be the person instructing you or alternatively appears to you, on the face of it, to be active in the management or control of the company. Where it is not reasonably practicable to obtain such additional identification evidence you might consider establishing a list of any shareholders holding 20% or more of the shares in the company or, if there are none, the principal owners.

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