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# **HM TREASURY CONSULTATION ON TRANSPOSITION OF FOURTH MONEY LAUNDERING DIRECTIVE**

## **Response of the Law Society of Northern Ireland**

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## **Introduction**

The Law Society of Northern Ireland (the Society) is a professional body established by Royal Charter and invested with statutory functions primarily under the Solicitors (NI) Order 1976 as amended. The functions of the Society are to regulate responsibly and in the public interest the solicitor's profession in Northern Ireland and to represent solicitors' interests.

The Society represents over 2,800 solicitors working in approximately 520 firms, based in over 74 geographical locations throughout Northern Ireland and practitioners working in the public sector and in business. Members of the Society thus represent private clients in legal matters, government and third sector organisations. This makes the Society well placed to comment on policy and law reform proposals across a range of topics.

Since its establishment, the Society has played a positive and proactive role in helping to shape the legal system in Northern Ireland. In a devolved context, in which local politicians have responsibility for the development of justice policy and law reform, this role is as important as ever.

The solicitor's profession, which operates as the interface between the justice system and the general public, is uniquely placed to comment on the particular circumstances of the Northern Irish justice system and is well placed to assess the practical out workings of policy proposals.

**November 2016**

Consultation Question: Setting an absolute turnover threshold.

1. Do you agree with the proposed turnover threshold of financial activity being set at £100,000.00 as one of the criteria to comply with in order to be exempt from the Directive? Please provide credible, cogent and open source evidence (where necessary) to support your response.

Yes, subject to the ability to review for efficacy this criterion periodically or as reasonably may be required, taking into account the type and nature of financial activity engaged, and the continuing adequacy of the threshold being sufficiently low so as to ensure minimum burden (regulatory and administrative) on small, legitimate businesses.

2. The government would welcome views on whether a maximum transaction threshold per customer and single transaction should remain at £836.00 (EUR 1,000.00). Please provide credible, cogent and open source evidence (where necessary) to support your response.

Agreed: to allow the maximum transaction threshold per customer and single transaction to remain as set out above, will not only reduce administrative and regulatory burdens on qualifying businesses for reasons set out, but may also have the additional benefit of protecting small, legitimate businesses not otherwise obliged entities, from being exploited by or exposed to criminality.

Consultation Question – CDD measures.

3. When do you think CDD measures should apply to **existing** customers while using a risk-based approach?

It is axiomatic that obliged entities should know who are their customers, where they operate, what they do and their expected level of activity with them. Obligated entities should conduct timely, reasonable CDD measures on a risk-sensitive and appropriate basis, centred inter alia on their knowledge of their client, the type and structure of client, their business (to include typical transactional business) and risk profile, within the context of their (unqualified) understanding and monitoring of their client's business, instructions, development of each retainer, even if on occasion below the threshold, and issues arising out of the provenance of funds. The risks posed by individual customers and any underlying beneficial owners will be assessed differently.

However, where the identity of an existing customer has already been verified to a previously applicable standard then, in the absence of circumstances indicating the contrary, the risk is likely to be low. A range of trigger events might prompt a firm to seek fresh CDD information,

It is right that CDD of existing customers should be subject to periodic review, without prescription, to allow obliged entities' agile assessment and amelioration of risk in a specific business setting. Supervisors are best placed to assess sector specific compliance with a dynamic risk based approach to CDD, which should inter alia be articulated in firms' AML/CTF documented policies which too should be

periodically reviewed to ensure they reflect not only consistency in the standard level of CDD that will apply to the generality of their clients, but also the changing nature of the practice's business. This might be augmented by consideration of in-house training and education of fee earners in the application and importance of CDD measures to existing customers within their firms. CDD measures may include use of publicly available information.

To make prescriptive a period when CDD measures must be applied to existing customers while using a risk-based approach would be counter-intuitive, administratively burdensome and may impact adversely on the client/consumer. A high level approach for government would be more effective and comprehensive.

4. What changes to circumstances do you think should warrant obliged entities applying CDD measures to their existing customers? Eg name, address, vocation, marital status etc.

The Money Laundering Regulations 2007 already require solicitors to conduct CDD when establishing a business relationship, carrying out an occasional transaction, where they suspect money laundering or terrorist financing or where they doubt the veracity or adequacy of documents, data or information previously obtained for the purposes of CDD, in respect of regulated activity from 15 December 2007.

It is likely that with the efflux of time, most clients will have been subject to CDD by now, and for those clients inactive from before 2007, CDD should be applied afresh.

While for all existing clients solicitors should ensure ongoing monitoring of the business relationship to identify risk, factors that may trigger a need for refreshing CDD measures for existing clients include a gap in retainer (the Law Society of England and Wales's Anti-Money Laundering Practice Note, October 2013 approved by HM Treasury suggests a period of three years or more), new instructions on a higher risk retainer, a suspicion of money laundering or terrorist financing by the client or an existing high risk client – some material change or material event. (Complex) changes to corporate entities or new multiple jurisdictional transactions should attract CDD measures per se. Use of agents or avoidance of personal contact or unusual familiarity with AML requirements may raise a red flag about an existing client.

It is interesting to consider the position where a firm acquires a business (and the clients) of another firm, and consequential CDD obligations arising in such circumstances. One would anticipate that the acquiring firm will have undertaken due diligence enquiries before acquisition, which will have included dip sampling of the vendor's customer records, to ensure these have been carried out in accordance with the United Kingdom's regulatory requirements.

This is not exhaustive, nor can it be. However, it is important to remember that requesting more and more identification does not always provide adequate assurance about AML/CTF risk: 'it is sometimes better to reach a full and documented understanding of what the customer does, and the transactions it is likely to undertake. Some business lines carry an inherently higher risk of being used for ML/TF purposes than others' (Prevention of Money Laundering/Combating

Terrorist Financing, JMLSG, 2014 Revised Version, Guidance for the UK Financial Sector Part 1).

It is important to ensure dynamic CDD as part of the armoury of effective, comprehensive AML/CTF measures, the objective of which is to protect society from crime and protect the stability and integrity of the international financial system. To be prescriptive about the change of circumstances that shall require CDD measures to be applied to existing customers would not best serve this objective. The government should continue to adopt a high level approach to matters of principle.

5. How much does it cost your business to carry out CDD checks? Please provide credible, cogent and open-source evidence to support your response.

The Money Laundering Regulations 2007 at present permit a risk based approach to compliance with CDD obligations, part of which is to have a system outlining CDD measures to be applied to particular clients when an obliged entity establishes a business relationship, carries out an occasional transaction, suspects money laundering or terrorist financing or doubts the veracity or adequacy of documents, data or information previously obtained for the purposes of CDD.

At present, the costs to obliged entities of carrying out risk based CDD checks can be significant: the higher the level of risk, the greater the rigour needed in CDD, ongoing monitoring and control to mitigate that risk.

Costs include both professional and back office time. It is estimated that initial CDD takes a minimum of 20 units of time (1 unit = 6 minutes) in which to ask for relevant documents from a reliable and independent source which will identify and verify the client's identity, the beneficial owner where relevant (and verify their identity) and to obtain information on the purpose of the intended nature of the business relationship or transaction which the practitioner must then take time to contextualise and understand. If a legal person or arrangement such as a trust, the obliged entity must take measures to understand the ownership and control structure of the company. This may lead to EDD measures. It is noteworthy that the verification requirements under the Money Laundering Regulations 2007 for a customer and beneficial owner are different, and that in dealing with trusts the beneficial owners may be a class of persons. In these cases, CDD is by definition more time consuming.

These checks must be assessed once produced; further documents may be required; all must be documented appropriately and retained centrally, while for those higher risk clients, enhanced due diligence will require more (e.g. PEPs, correspondent banking, government sanctions, consideration of refugees, asylum seekers, visas, work permits, corporate and vulnerable clients).

Costs of external verification checks (outlay) typically start @ £28.00 - £30.00 each. Further cost is incurred in continuing monitoring.

CDD cost must in any event be borne by businesses since it is not a cost incurred on behalf of clients, particularly where as a general rule, the verification of the identity of the client and, where applicable the ultimate beneficial owner, must take place before the establishment of a business relationship or carrying out of an occasional

transaction (subject to some exceptions). It may be possible to agree with the client that such costs will be payable by them as part of the firm's profit costs in certain limited circumstances.

It is logical to assume that larger practices will have higher charge-out rates. CDD checks during the course of a transaction will incur additional cost: queries about the source of funds are time-consuming and may lead to the request for and verification of additional independent documents, documentation of evidence, documentation retention. This may lead to the making of a Suspicious Activity Report to the National Crime Agency with additional time spent for example by the Money Laundering Reporting Officer who must consider reporting obligations, dealing with queries arising therefrom, the client and other parties, while awaiting consent or during a Moratorium, in accordance with obligations under the Proceeds of Crime Act and the Terrorism Act. The obliged entity may also have to make a report to local law enforcement.

It may be worthy to conduct an analysis of the percentage costs incurred in discharge of CDD obligations, their recoverability and the level of professional fee and the value of the transaction to consider properly the cost effectiveness, financial impact and burden on firms of varying demographics. Equally one must be mindful that effective CDD must be drawn from current, accurate information.

6. We welcome responses setting out how you have converted the Euro thresholds into GBP under the existing Money Laundering Regulations, for example is the currency exchange the subject of a set policy? We would also welcome your views on what would be helpful to you when dealing with a conversion from Euro to GPP.

The Law Society of Northern Ireland has no comment to make save to say that any conversion must be in accordance with the general law and accepted principles.

7. Do you agree that the government should remove the list of products subject to SDD as currently set out in Article 13 of the Money Laundering Regulations 2007? If not, which products would you include in the list. Please provide credible, cogent and open-source evidence to support inclusion. What are the advantages and disadvantages of retaining this list?

It appears common case among supervisors that the government should adopt a high level approach to SDD, and in so doing provide underpinning guidance on rather than prescribe circumstances in which SDD may be appropriate. This would achieve a more dynamic and effective sector specific approach.

#### Consultation Questions – Pooled Client Accounts

8. What are the money laundering and terrorist financing risk related to pooled client accounts and what mitigating actions might you take? Please provide credible, cogent and open-source evidence to support your response?

It is noteworthy that while there is always a (residual) risk attached to pooled client bank accounts, there is little empirical evidence that as a whole, pooled client bank

accounts are in fact being used for the purposes of facilitating money laundering and terrorist financing on a wide scale basis, if at all. Not all money in a pooled client bank account arises out of regulated activity. While pooled client bank accounts, like all bank accounts, pose a risk, given the regulatory framework within which they are required to operate, it is likely that the risk is a low risk per se. We note the FATF low risk criteria. Additional factors that make the risk low, is the regulatory framework within which such accounts must be operated.

In continuing efforts to mitigate risk, as a matter of principle it is proper that regulators such as the Society continue to support members whom they regulate to comply with their AML/CTF obligations in a proportionate, risk based way.

This comprises a blend of sector specific guidance and education within a regulatory context that includes enforcement and professional sanction, with on-going monitoring and audit of the operation of the client bank account. Firms are encouraged to embed good AML/CTF practice at every level within their organisations; they need to guard against seeing AML as a tick box exercise. MLROs must be informed, engaged and approachable: they need to be of sufficient status in the firm to allow them to make critical judgments. Additional mitigation of risk lies in the requirement to assess risk in the relationship with the client as appropriately low in the first place, to allow SDD thereafter, the basis of which firms may have to demonstrate

Regular training of all members of staff (professional and administrative) is essential to ensure a continuing awareness of the need for vigilance, monitoring and active awareness. AML/CTF policies and procedures should be reviewed regularly and updated as required.

The independent statutory reporting accountant's annual report (who has statutory reporting obligations) provides additional intelligence on the operation of the client bank account, which feeds into both proactive and reactive review and monitoring by the Society, in accordance with our regulatory framework.

Effective and timely sharing of intelligence between all parts of law enforcement and supervisors is another method by which risk may be mitigated, subject to data protection controls. Full and timely feedback on for example Suspicious Activity Reports would be helpful. The Society for example alerts members regularly on cyber-crime, working with Action Fraud and the brokers of the Master Policy of Professional Indemnity Insurance to gather and promulgate to members intelligence on risk, emerging trends and patterns of attack.

The regulatory framework governing the activities of obliged entities (for example prohibiting the use of the client bank account without an underlying transaction, removal of money from the client bank account upon conclusion of a transaction within time etc) provides assurance to other obliged entities about the regulatory obligations of solicitors which in turn mitigate the risk which a pooled client bank account may pose.

Possible, but non-exhaustive, risks relating to the potential misuse of pooled client accounts arise for example in the sale/purchase of real property, creation of trusts,

companies and charities, management of trust and companies, sham litigation, and provision of banking facilities through the client bank account. Inopportune release of pooled client account details may increase the risk that criminals may send money to a firm and then reclaim the funds on the purported basis that the transfer had occurred in error. It is not however possible to identify exhaustively what are the risks relating to pooled client accounts. Criminality is constantly evolving: cyber-crime is but one example of a rapidly changing manifestation of such risk.

9. What would be the effect of the removal of SDD measures on pooled client accounts? Please provide credible, cogent and open-sourced evidence to support your response.

There has been no change in the nature of pooled client accounts, events or data to suggest that these constitute a high risk. Under the revised FATF standards, pooled client accounts continue to be seen as low risk (see Interpretative Note 10, paragraph 17(a) of the FATF standards). The Thematic Review conducted by the Solicitors' Regulation Authority found most firms had effective AML/CTF compliance frameworks in place (2016). It is difficult therefore to justify any movement from SDD measures in respect of such accounts, particularly when balancing the need for effective, necessary and proportionate AML/CTF measures against any additional burdens on business and consumers.

Removal of SDD measures on pooled client accounts has the potential to create considerable disruption and cost to business, and ultimately cause significant harm to both the consumer and the independent legal professional who operates such an account, if in so doing the risk on non-compliance shifted to the financial institutions. There is the potential for problems arising where client funds are held 'on trust' or 'to the account of client' in such accounts. Even if it were possible for a financial institution to collect meaningful information about the identities of clients in a pooled account – the beneficial owners, the details of which change potentially hourly – such information would not per se add to the financial institution's understanding of the underlying transaction (see above). This would have significant resource implications for both banks and law firms. It is likely that banks would strive to mitigate their risk by seeking to impose its own CDD conditions on independent legal professionals.

The unintended consequence of this may in fact lead to particularly, but not exclusively, smaller firms becoming 'un-bankable', should the financial institutions levy further charges to facilitate their SDD, and increase costs (prohibitively) for the legitimate client/consumer. To require additional SDD on top of existing extensive regulations already operated by other obliged entities has the potential for one sector to (attempt to) influence, control, trespass on and indeed oversee the regulatory obligations of other sectors. It would be untenable for a bank to take a view for example on the adequacy of their customers' controls, policies and procedures. Independent legal professionals are already well regulated by regulators who understand the nature of their supervised population's business.

At worst, firms might be required to open specific accounts for each clients which would result in further duplication of compliance activities of both banks and law firms, with no actual added benefit in combatting AML/CTF.

Issues such as client confidentiality and data protection may come into play in such circumstances.

10. What are your views on the retention of SDD measures on pooled client accounts? Please provide credible, cogent and open-source evidence to support your response.

See above.

11. What are our views on the situations described by the ESAs where SDD may be appropriate on pooled client accounts? Please provide credible, cogent and open-source evidence to support your response.

Again, it is important to have high level oversight of SDD, and while it is most useful to have by way of example situations where SDD may be appropriate in respect of the pooled client accounts, these should not be viewed as either definitive or exhaustive. Nor should the omission of pooled client accounts from SDD be construed as meaning these are no longer low risk. It remains vital to understand the nature of the underlying transactions which give rise to the use of the pooled client account and the purpose for which money is held in that account.

Underpinning guidance may assist in teasing out SDD or indeed EDD factors in respect of regulated activity. Care must be taken not to overstep the requirements of 4MLD in respect of activity that falls outside its scope, or offend for example the principles of data protection.

12. Are there any other factors and types of evidence of potentially lower risk situations aside from those listed in Annex II of the Directive, that you think should be considered when deciding to apply SDD? Please support your response with credible, cogent and open-source evidence where possible.

It would be useful for reasons stated above, to re-consider the express provision for the application of SDD to pooled client accounts: Article 11(2)(b) of 3MLD refers. However, as stated above, it remains imperative to have high level oversight of SDD, to provide for a dynamic, effective AML/CTF regime.

13. Are there any other products, factors and types of evidence of potentially higher risk situations, aside from those listed in Annex III of the directive, which you think should be considered when assessing ML/TF risks in respect of EDD? Please support your response with credible, cogent and open-source evidence where possible.

Firms should hold sufficient information about the circumstances and business of their customers and where applicable, beneficial owners for two principal reasons: to inform its risk assessment prices and thus manage risk effectively, and provide a basis for monitoring customer activity and transactions. The extent to which additional information and monitoring is required will depend on the ML/TF risk that the customer is assessed to present to the firm. It is not possible therefore to be definitive about the potentially higher risk situations, although both Section 3 and the

list in Annex III are helpful in indicating factors and types of evidence of potentially higher risk which trigger EDD. For example, firms should understand the difference between sources of wealth and funds. However, mindful of the Data Protection legislation, firms must also remember only to seek information that is needed for the declared purpose, not to retain personal information longer than is necessary and ensure that the information held is kept up to date.

Again, a high level approach is key to allow maximum flexibility in a risk based approach to EDD. It is important not to adopt a 'checklist' approach: risk should be approached in a considered and thoughtful way. Guidance will provide assistance to do this, consonant with a risk based approach, appropriate and proportionate to risk identified.

14. Are there any high-risk products from sectors other than the Financial Services sector that you think should be included in the Regulations?

It is important not to be definitive but rather adopt a flexible approach which will target high risk products as they emerge.

15. What EDD measures do you currently apply to clients operating in high-risk third countries, including those on FATF's black, dark grey and grey lists?

Firms should already make use of any government or FATF findings concerning particular countries or jurisdictions, particularly where their approach to money laundering prevention has been found by FATF to be materially deficient. Firms are expected to consider factors which vary the risk level of clients which includes acting for PEPs, clients without meeting them, and for clients affiliated to countries with high levels of corruption or where terrorist organisations operate. Transactions with a cross border element may attract higher risk. The Money Laundering Regulations 2007 require members to conduct on-going monitoring of business relationships. Retainers involving countries which do not have comparative AML/CTF standards equivalent to the United Kingdom's may trigger EDD.

It will be important to have consistency between FATF's lists and that being compiled by the European Commission.

16. How much does it cost your business to apply EDD measures? Please provide credible, cogent and open-source evidence to support your response.

See response 5. Clearly there may be additional costs incurred in obtaining additional searches, and in complicated transactions/structures, additional time may be taken not only in understanding the organic nature of the client and (ultimate) beneficial owner(s) but also in monitoring the transaction.

#### Consultation Questions – reliance on third parties.

17. What are your views on the meaning of a 'member organisation'? Please provide evidence in support of your answer.

For the purposes of this response, a 'Member organisation' means being a member of an obliged entity as listed in Article 2 4MLD. As such, the member organisation and members thereof are regulated by statute and Regulations made thereunder. Member organisations will include subsidiary branches.

For AML/CTF purposes, when acting in the course of business carried on by them in the United Kingdom, relevant persons are supervised by their respective professional bodies as set out in general and in particular listed in Schedule 3 of the Money Laundering Regulations 2007, which are responsible for inter alia ensuring the enforcement of rules relating to AML/CTF.

18. What are your views on the meaning of 'federation'? Please provide evidence in support of your answer.

A 'Federation' being an alliance of several groups or parties, it is important to ensure that the AML/CTF obligations on federations of obliged entities as per Article 2 4MLD are not diluted, that they remain obliged to apply CDD requirements and have their compliance with the 4MLD supervised in a manner consistent with that applied to obliged entities.

19. N/a

20. Do you rely on third parties to meet some CDD requirements? How much does this cost your business? Please provide credible, cogent and open-source evidence to support your answer.

As obliged entities conduct CDD on a risk based approach, part of their assessment of risk may include the issue of reliance on the CDD of a third party (being one of the 'obliged entities'). While firms will provide specific cost information in this regard, in principle firms should consider not only the third party's regulated status but also take into account matters such as public disciplinary record, to the extent it is available, the nature of the customer, previous (adverse) experience of the third party firm and any other knowledge of the standing of the third party to be relied upon, when considering if it is prudent to rely on their CDD. Reliance on a third party is not determined by a single factor.

The third party is required to consent to reliance, which is a serious matter: a firm must not confirm CDD on the basis of a generalised assumption that its systems have operated effectively; it has to be aware that appropriate steps have in fact been taken in respect of the customer subject of the confirmation. The provision of consent by the third party to reliance is often a barrier to reliance per se.

The requirement on the third party both to retain CDD or other relevant documents for the appropriate period and to produce these immediately, upon request, under the Regulations is another live issue. Data Protection issues are in play.

Ultimately, in any event, risk for meeting CDD requirements remains with the firm notwithstanding they have relied on a third party. It is therefore hard to see how in reality reliance on third parties to meet any CDD requirements is attractive. Conversely, third parties may be able to access relevant CDD documents more

easily in certain circumstances where for example it is not readily convenient for an obliged entity to access the client.

The issue is further complicated by the development of jurisprudence (under appeal) in which recent case law has seen both the firm and the third party held liable in damages where issues arose in respect of adequacy of their respective Money Laundering procedures, which seems to extend the application of the 4MLD for unconnected purposes. This is an unintended consequence for independent legal professionals in the United Kingdom, and will have implications for professional indemnity insurance. If it is the case that AML/CTF policies and procedures will be taken into consideration by the Courts in civil litigation, there is the potential for escalating insurance premium for practitioners, in addition to the costs of CDD.

#### Consultation Questions – assessment of risks and controls.

21. Should the government set a threshold of the size and nature of the business for the appointment of a compliance officer and employee screening? If so what should the government take into account?

While recognising the discretion of government to exempt some persons from the requirements of 4MLD in circumstances set out at para 3.9 of the Consultation Paper, it would not be prudent to dispense with the overall requirement to screen employees or to appoint a compliance officer.

Of course, appointment of a compliance officer may be otiose where a business comprises a sole practitioner. It is notable that a sole trader with or without employees is not absolved from compliance with the Money Laundering Regulations 2007 or obligations under the general law: this should be no different.

Sole practitioners and two-three partner firms comprise the largest sections of the Society's supervised population.

22. What should be taken into account when screening an employee?

Employers and obliged entities must operate within the general national law in respect of employees. The Rehabilitation of Offenders (Northern Ireland) Order 1978 et seq refers.

In principle, without being prescriptive, the prudent prospective employer should have regard to the position of a potential employee within a firm, which should include influence, access to money, and access to ICT in general, bearing in mind the increase in cyber-crime and vulnerability of (client) information. Note that qualified solicitors undergo strict screening requirements before admission to the Roll. It is also important to remember that all employees should be screened, where they are likely to have access not only to financial systems, but also sensitive data.

23. Should the government set a threshold for the size and nature of the business that requires an independent audit function? If so what should the government take into account?

No: an independent audit function provides a vital source of intelligence into the activity of businesses. In the case of solicitors in Northern Ireland, this comprises an annual report from an independent accountant who is mandated to audit the books of account for compliance with the Solicitors' Accounts Regulations 2014. This is an important function, the benefit of which cannot be understated.

To introduce additional independent audit function would serve no useful purpose, would add to the regulatory burden and expense on obliged entities, and would be disproportionate to a risk-based approach to AML/CTF.

24. What do you think constitutes an 'independent audit function'?

An independent audit function is one prescribed by and enshrined in regulation. In the case of solicitors in Northern Ireland, an independent audit is conducted by accredited accountants who are in turn regulated by their professional body, in which core information must be provided to the Society as part of their statutory obligations. Failure to comply with such statutory obligations may lead to professional sanction, with consequential reputational damage.

25. How many of the controls listed at paragraph 4.34 are you already carrying out and what is your assessment of the likely costs of these procedures?

Businesses are monitored for compliance with their AML/CTF obligations and on request are required to produce to the Society evidence of for example retention of documents, CDD checks and underlying transactions where there appears money in the client account. The Society has operated a graduated educative approach to compliance but will now tackle systemic failure by regulated firms through referrals of recalcitrant practitioners to the independent Solicitors' Disciplinary Tribunal for breach of AML/CTF obligations. Fines and costs orders for non-compliance add to the financial and administrative burdens on firms.

#### Consultation Questions – Gambling Providers

26-32: While the Society is not best placed to respond to sector specific issues in respect of the providers of gambling services, and subject to AML/CTF requirements being applied on a risk-based approach, it is important to recognise and meet consistently vulnerabilities within the sector to ensure an effective AML/CTF regime.

#### Consultation Questions – Electronic Money

33-39: While the Society is not best placed to respond to these questions, we highlight the previously articulated concerns of the CCBE associated with innovation in financial services and technological change which, for all their benefits, create new opportunities and challenges in terms of combatting both ML and TF. The Society acknowledges the social value of electronic money and pre-paid instruments which allows vulnerable or financially excluded people to have a means of payment and to buy goods and services on the internet, or to limit exposure to fraud, or in which to receive social benefits, while protecting privacy. However it also recognises the risk arising out of these new modes of payment.

## Consultation Questions – Estate Agency Businesses

40 – 44: While the Society is not best placed to respond to these questions, in principle it is important to identify and address any relevant activity which has avoided capture in the AML/CTF regime, on a risk based, proportionate and lawful basis. The battle against ML/TF is a global issue. FATF (an independent inter-governmental body that develops and promotes policies to protect the global financial system against ML/TF) Recommendations are recognised as the global AML/CTF standard. European legislation provides a common legal basis for the implementation of the FATF Recommendations by Member States.

The Society endorses the submission of the Law Society of England and Wales which advocates the merits of a globally consistent approach in the fight against ML/TF, and risk inherent in other legislative bodies such as the EU trespassing on its role, in attempting to set new policy standards, albeit that FATF Recommendations are ‘minimum’ standards (to be applied on a risk based approach).

One must remain mindful of the scope of 4MLD when considering if the activities of any particular group are captured. Recital (8) of the Preamble to 4MLD provides ‘As concerns the obliged entities which are subject to this Directive, estate agents could\* be understood to include letting agents, where applicable’. This appears ambivalent even when taking into account margins of appreciation.

(\*emphasis writer’s own)

Letting agents remain amenable to the general law, in any event.

## Consultation Questions – Due Diligence and Intermediaries

45-47: While the Society is not best placed to respond to these questions, we endorse the principle of a proportionate and risk-based approach to AML/CTF, within the context of the relevant activities of obliged entities and the AML/CTF regime as a whole.

## Consultation Questions – Correspondence Banking Relationships

48-49: The Society is not best placed to respond to these questions.

## Consultation Questions – Politically Exposed Persons (PEPs)

50: How do you differentiate between risk management systems and risk-based procedures?

It is not clear what if any is the difference or significance of the distinction drawn in Article 20, between risk management systems and risk-based procedures, save that on a natural construction, it appears the term ‘risk management system’ is to be an umbrella term for general AML/CTF compliance in respect of PEPs which includes risk-based procedures. This seems unduly cumbersome and unwieldy.

51. Under the terms of the Directive, all PEPs are considered to be high risk. However, obliged entities may use a risk-based approach to both the identification of a PEP and the depth of EDD measures that are applied to them. What risk factors do you think are relevant when deciding how to identify a PEP and adapt EDD measures to them? Would more clarity in guidance be helpful to avoid disproportionate application of EDD measures to low-risk groups and their families?

It is important to acknowledge the importance of flexibility in use of a risk-based approach to both the identification of a PEP and the depth of EDD measures that are applied to them, commensurate with risk, as now defined in 4MLD. Not only will this allow obliged entities to tailor sensibly its proportionate approach to EDD, consistent with the requirements of the Data Protection Act, but also to explain to its clients, the basis on and purpose for which EDD is being applied.

(Sector specific) guidance would be helpful. Risk factors such as (local) nature and type of instruction, source of funds, and publicly available information would be relevant considerations.

It remains important for obliged entities to document its rationale for EDD in accordance with its AML/CTF systems.

52. The Directive specifically applies to members of parliament or of similar legislative bodies and to members of the governing bodies of political parties. In the UK the Electoral Commission maintains two registers of political parties: one for Great Britain and a separate register for Northern Ireland. There are 400 registered political parties, of which the vast majority are very small. Should there be some form of criteria or some examples set out in guidance the political parties to which this applies, e.g. those having elected members of Parliament, the European Parliament or the devolved legislatures? If so what is the reasoning behind the use of these particular criteria or examples? Would guidance on this issue assist and if so what should the guidance include to provide clarity?

Guidance on the issue would assist, would aid consistency across sectors, and help explain to those captured in the broader definition of PEPs the basis on and purpose for which EDD must be applied under 4MLD. Equally it would be helpful for registered political parties to set out the requirement for EDD and PEPs, and who is included in the definition.

It would be important to ensure that all registered political parties are included in this requirement. Further, regard must be had to elected and co-opted members including those elected to local government, or those whose political exposure is comparable to those in similar positions at national or international level. Consideration should also be given to inclusion of Chief Executive Officers and other relevant officers in local government/public authorities (if they are not included already as members of administrative bodies of State owned enterprises) in this category.

53. The Society has no comments to make.

54. Does the extent of EDD on the family members of PEPs and individuals known to be close associates of PEPs correspond with the measures that are appropriate for the PEP themselves? Which risk factors do you think are relevant?

The Society welcomes the government's commitment to a risk-based approach to these people. Risk prima facie appears low where for example the sibling of an elected representative is purchasing property locally where there is otherwise evidence of source of funds, wealth etc. In the context of risk analysis, it would be appropriate that a firm's resources are focussed on transactions that are characterised by a high risk of ML/TF.

EDD checks in such circumstances may prove expensive, and yield little (useful/insightful) information. The Society agrees that PEPs, their family members and close associates should not be adversely affected by EDD, which may result in obliged entities declining to accept instructions if the costs of EDD are prohibitive for firms. See comments above: question 5 refers.

55. How much does it cost to identify and apply EDD to PEPs? Please provide evidence to support your response.

See comments above.

56. Is the guidance sufficiently clear about how EDD should be applied to PEPs, their family members and their close known associates? If not, what should they include to provide clarity? With regard to financial institutions, are there specific changes that could be made to the Financial Crime Guide or JMLSG guidance to clarify the treatment of PEPs? What specific changes could be made to the guidance in other related sectors?

It is important to ensure consistency insofar as possible across the relevant activities of obliged entities. Clearly with the broader definition of PEPs in 4MLD, further guidance is required nuanced to take into account these changes. Sector specific guidance is extremely helpful in assisting obliged entities to take a risk-based view of risk, and should be updated and approved at appropriate intervals, informed by on-going high level analysis of ML/TF typologies gleaned from financial intelligence reports.

It is important that approval is granted swiftly, to ensure guidance is current (so far as possible) and relevant.

57. The Society has no comment.
58. Should the government explicitly include senior members of international sporting federations as a category of PEPs, along with their family members and known to be close associates? How many senior members (in line with the definition of senior management in Article 3(12) of the Directive) of international sporting federations would you deal with, along with their family

members and known to be close associates? Please provide a source for your estimation if this is not data that you already hold.

The Society considers that the burden on businesses per se should be proportionate and reasonable, and that in its risk based approach, obliged entities are able to reach an informed, considered position about the circumstances in which to apply EDD. To include automatically senior members (with others) of international sporting federations in the PEP category may be a disproportionate response to the recent FIFA scandal and other reported cases of ML and corruption in sport.

59. The Society has no response: question 18 refers.

#### Consultation Questions – Beneficial Ownership of Legal Entities.

The Society has had the opportunity to consider the response of the Law Society of England and Wales to this invitation, which it adopts. It is difficult to provide a full response to this section in light of the present proposal to amend 4MLD, currently under debate in the European Parliament. We anticipate and welcome the opportunity to respond to consultation on the amending Directive in due course.

60. The government welcomes any views on the issues highlighted above and the PSC regime itself.

In principle, the Society recognises the government's commitment to transparency of corporate ownership and control, evidenced by its introduction of a publicly accessible central Register of Information on beneficial ownership, and requirement for Persons with Significant Control to both update their own register and the central public register at Companies' House, annually. Current accurate information about Persons with Significant Control is critical, and with accurate information in the central Register of Information, together both provide a fuller picture on the company's ownership.

61. How often should a trustee be required to update the beneficial ownership information that they hold?

It is important to note the jurisprudential difference in countries in respect of trust law. Any confusion about the meaning, purposes and uses of 'trusts' or similar arrangements must be identified and resolved, to ensure a comprehensive, integrated ML/TF approach across Member States with different legal systems. This would enable for example greater focus perhaps on restriction of access to information in relation to trusts set up for non-business purposes (if ultimately they are included in any amendment to the Directive) rather than reliance on the requirement of third parties seeking access to such information to demonstrate 'a legitimate interest'. A balance must be struck between the interests of beneficial owners and third parties.

We reiterate where like information is provided already to HMRC (identities of settlors, recipient beneficiaries to whom a distribution of income or capital from a trust is made, tax returns etc), one must be careful to avoid duplication of obligation to provide the same information to different bodies. This would be unwieldy and

serve only to increase administrative burdens and potential costs, while risking lack of synchronisation.

62. What other arrangements should the government consider as having a structure that is similar to express trusts?

63. What other arrangements should the government **not** consider as having a structure that is similar to express trusts?

The Society adopts the response of the Law Society of England and Wales.

64. Are there any further considerations that the government should take into account of when developing the central register of trust beneficial ownership information?

The Society adopts the response of the Law Society of England and Wales. It is difficult to envisage how at present the central register of trust beneficial ownership information will be developed with certainty in light of the current proposed amendments to 4MLD.

We await the opportunity to respond to further consultation on proposed amendments to 4MLD which appear to bite upon a great number of trusts or like arrangements in which there is little risk of tax evasion or ML. Given how the lives of ordinary citizens will be impacted by the proposed changes to beneficial ownership provisions, it will be essential to engage with the private sector with direct experience of the uses of trusts and similar arrangements set up for non- business purposes. The proposed amendments appear disproportionate.

#### Consultation Question – Trust Beneficial Ownership

65. The government welcomes your views on the approach to beneficial ownership information as set out above.

See above.

#### Consultation Question – One-Off Company Formation

66. The government welcomes your view on clarifying, through appropriate guidance, that a one-off company set up is a business relationship that has an element of duration.

The Society welcomes clarification through appropriate guidance that a one-off company set up is a business relationship that has an element of duration.

#### Consultation Question – Data Protection

67. The government would welcome your views on retaining documents necessary for the prevention of ML/TF for the additional 5 years. What do you think the advantages and disadvantages are of doing so?

This question must be seen within the context of coterminous professional, ethical and legal obligations on members in their treatment of documents per se for example under the Data Protection legislation, statutory limitation periods, balanced against the rights conferred on citizens and obligations under the European Convention on Human Rights and Fundamental Freedoms. The Society refers also to our response to question 20: reliance on third parties and any obligation on a third party to retain such documents that may be necessary for the prevention of ML/TF for an additional period.

### Consultation Questions – Supervision of Regulated Sectors

68. Do you think that where registration is a requirement, the supervisor should be given an express power to refuse to register or to cancel an existing registration?

Registration is not a requirement for solicitors qualified to practice in Northern Ireland. It is reasonable that where registration is so required supervisors should be given appropriate adequate powers to refuse to register or cancel an existing registration. It would be proportionate to endow supervisors with a range of regulatory options which would include the power to impose proportionate, reasonable terms and conditions and suspensions on registrations.

69. The government welcomes views on the reasons for a supervisor to refuse a registration or to cancel an existing registration. Are there any other reasons you think should be captured? Do you foresee any problems with the conditions identified?

Supervisors should adopt a fact sensitive approach to registration, mindful in the exercise of their regulatory function, they are amenable to challenge. Supervisors are required to act rationally, reasonably, proportionately and in accordance with the law. It is not prudent to state definitively the circumstances in which a registration is refused or cancelled, although it is reasonable to suggest that supervisors must meet a high evidential burden, on the balance of probabilities, to meet the most serious allegation.

70. The government welcomes views on whether a supervisor should have the power to add conditions to a registration or whether they should have the power to suspend an existing registration.

See above. Supervisors should have a raft of powers to include these.

71. The government welcomes view on the test that should be applied by a supervisor when seeking to refuse to register, cancel an existing registration, add conditions to a registration or suspend an existing registration.

The appropriate test is the civil test: the balance of probabilities.

72. Where there is more than one supervisor, we welcome views on preventing the resubmission of an application for registration with another supervisor.

Supervisor shopping is to be deplored. Information sharing gateways should be promoted within supervisors, for example by way of Memoranda of Understanding or a centralised (restricted access) register to which supervisors would have access to relevant information when considering any request for registration. Publicly available information should form part of supervisors' due diligence checks.

Supervisors should however include a specific question(s) on previous registration and regulatory history, putting a disclosure burden on applicants who are required to co-operate with potential supervisors to whom they owe a duty of candour. Consideration should be given to the levy of a reasonable application fee, to be revised periodically.

Careful thought must be given to publication issues.

#### Consultation Question – Fit and Proper Test

73. Do you agree with the government's approach to a 'person who holds a management function' in paragraph 12.13 – namely those who make a decision about a significant part of the entity's activities or the actual managing or organising of a significant part of those activities? Do you think it will encompass all individuals that should be subject to a fit and proper test?

The Law Society of England and Wales's response refers. We await the outcome of their enquiries with HMRC, with interest.

While in principle it is welcome that individuals who hold a management function should be amenable to a fit and proper test, the practical outworking of this requires further elucidation, particularly where not all activity in obliged entities is subject to 4MLD.

Employment law and enforceability issues are engaged. In practice however it is unlikely that those holding a management function will hold less than senior positions within obliged entities. If the converse were found, questions would arise about control within obliged entities.

Before admission to the Roll of Solicitors in Northern Ireland applicant must submit to fit and proper testing as a matter of statutory requirement. This proposal aligns with what is already being done by the Law Society of Northern Ireland as a Regulator. It is important to note that alternative business structures are not permitted in Northern Ireland. The government should permit a flexible, dynamic and continuous approach to screening those who hold a management function in obliged entities.

74. Should the government extend the fit and proper test to agents of MSBs? Please explain your response and provide credible, cogent and open-source evidence where possible.

Save to urge consistency, the Society has no response to make.

## Consultation Questions – Criminality Test

75. What are your views on the meaning of ‘criminals convicted in relevant areas’?

It is important not to be prescriptive about the convictions that will automatically prevent those with convictions from holding a management function in, or being the beneficial owners of obliged entities, in the interests of natural justice and due process. It is axiomatic that those convicted of particular offences must overcome high hurdles when applying for example for admission to the Roll of Solicitors in Northern Ireland, to the Lord Chief Justice for the termination of suspension of a Practising Certificate, or to the independent Solicitors’ Disciplinary Tribunal for removal or variation of restrictions on practice. Particular relevant offences might include dishonesty, economic crime and Proceeds of Crime offences, fraud, bribery, corruption, blackmail, sexual offences, some of the other offences involving violence, drugs and other trafficking offences, modern slavery, perverting the course of justice and perjury.

One must be mindful of due process and the obligations on (quasi) public authorities who are amenable to administrative challenge in the exercise of their functions when considering cases on a fact sensitive basis, noting the position of primary legislation and (the (limitations and qualifications on) the European Convention on Human Rights and Fundamental Freedoms. The right of appeal is a further key protection and balance.

The types of criminal convictions cited in the Consultation Paper would be relevant considerations when assessing the probity of applicants. Consideration should be given to the treatment of convictions in other jurisdictions.

76. What are your views on the meaning of ‘associates’?

While endorsing the objective, that criminals should not have the opportunity to access, control or derive benefit from the activities of obliged entities, one must be careful not to discriminate against or stigmatise associates of (known) criminals by precluding them from assuming managerial functions or becoming beneficial owners thereof on this basis.

It is noteworthy that Regulation 3(11) qualifies associates for the purposes of EDD measures to refer to ‘persons known to be close associates’ being natural persons known to have joint beneficial ownership of legal entities or legal arrangements, or any other close business relations with a PEP.

For the sake of consistency, it would be prudent to adopt a like definition. Again, decisions must be made on a risk-based, proportionate and fact sensitive basis must be taken when considering the impact of 4MLD on individuals not convicted of relevant criminal offences. Significant issues under the European Convention on Human Rights and Fundamental Freedoms are in play. As a balance, and additional protection, it may be prudent to provide for enhanced enquiry in such circumstances.

77. Do you agree the criminality test should be extended to High Value Dealers?

If there is sustainable, strong evidence that High Value Dealers are a vehicle for ML/TF and it is intended to achieve a legitimate objective and proportionate to the end to be achieved, there is a compelling argument they should be amenable to the criminality test: see above.

78. What are your views on spent convictions and cautions being taken into account for those new sectors in paragraph 12.18, in particular estate agents, letting agents, accountants and, if there is to be an extension, HVDs? How would the disclosure of spent convictions and cautions maintain public protection and mitigate risks to the public?

While wholly endorsing the philosophy underpinning the rehabilitation and treatment of offenders, there are legislative exceptions to when in certain circumstances convictions may become 'spent' and a convicted person may be considered 'rehabilitated'. These exceptions cover a wide range of offices, professions, occupations and employments. Failure to disclose a spent conviction or ancillary circumstances may be a proper ground for dismissing or excluding a person from a profession.

The right to privacy and other rights under the European Convention on Human Rights and Fundamental Freedoms may be engaged in this consideration: see above.

It is difficult however to envisage circumstances in which the new sectors and potentially HVDs would not be obliged to disclose spent convictions and cautions if there is robust evidence to bring them within the scope of 4MLD: see above

79. Are there any specific offences you consider relevant to the risk of money laundering and terrorist financing?

See question 75.

80. Should the government extend the criminality test to other entities covered by the directive? Please provide evidence to support your response.

If there is strong evidence that other entities should be covered by 4MLD, by reason of their regulated activity, then provided this achieves a legitimate objective and is proportionate to the end to be achieved, then there is a compelling argument that the criminality test should be so extended.

81. Do you think that a transitional period is needed to complete the criminality tests?

Yes. These have resource implications for supervisors: see question 82.

82. Do you think a transitional period of two years affords sufficient time to complete the criminality test on the appropriate existing persons who are already on the supervisors' registers?

It is hoped that such criminality tests could be implemented in this jurisdiction within this timeframe, subject to our general comments in this regard.

83. What are the expected transitioning and ongoing costs in your sector/business for applying a criminality test?

The Society anticipates there will be significant costs for firms if checks for appropriate existing persons must be conducted. Costs are measured in both actual cost and time. Where solicitors are officers of the Court, and are expected to cooperate with the Society to whom they owe a duty of candour as their statutory regulator, it is anticipated that consideration will be given to the adequacy of members reporting the outcome of criminality test to the Society, which may in turn conduct 'dip sampling' of responses for accuracy, if this requirement is backdated to existing members.

Lack of candour may lead to regulatory sanction.

To make retrospective this requirement to existing members may be vulnerable to challenge where in the absence of evidence, it is unclear what will be achieved by this exercise, which will bring significant cost implications for members.

#### Consultation Questions – Administrative Sanctions

84. What are your views on there being no upper limit on the imposition of an administrative pecuniary sanction?

It is important to note the underpinning legislation and powers of supervisors and the independent Solicitors' Disciplinary Tribunal, and the requirement to act in accordance with the law in both general and sector specific terms. Equally important is to ensure that sanctions are appropriate, effective, fair, proportionate and dissuasive. Part of the effectiveness of sanctions is the right of appeal against them which ensures due process.

While it remains important to refrain from prescription on sentencing, it is helpful to set out aggravating factors which may be taken into account when considering fact sensitive and appropriate sentencing. Additionally, there may be mitigating factors which should be considered also, in accordance with the principles of natural justice.

The imposition of unlimited fines may in practice lead to increase in appeals, and somewhat incongruously lead to inconsistency among supervisors.

85. Should the government consider whether additional sanctions and measures should be made available to those set out in 13.4 and 13.5?

These additional sanctions and measures should be seen within the context of the existing range of sanctions and measures already available to supervisors.

## Consultation Question – Breach of the Fund Transfer Regulations (FTR)

86. The Society has no comment.

## Consultation Question – Further Views

87. Do you have any further views not specifically requested through a question in this consultation that would help the UK provide effective protection for the financial system? Please provide credible, cogent and open-source evidence to support your views, where appropriate.

The Society takes this opportunity to urge government to continue to consider the ML/TF regime adopting a risk-based, proportionate and evidence based approach, mindful of the on-going need to balance the legitimate purpose of compliance against the existing regulatory requirements and administrative burdens already imposed on obliged entities, and the resource implications (both financial and time) on legitimate business. One must balance the risk of putting legitimate business at an economic and competitive disadvantage in the market place against the imperative to ensure the integrity of the economic system in the United Kingdom, and to deter criminality at local, national and international levels.

## **Conclusion**

The Society welcomes the opportunity to submit a response in respect of the HM Treasury Consultation on The Transposition of the Fourth Money Laundering Directive.

We trust our contribution is constructive and we are happy to meet with HM Treasury to discuss any of the issues raised in our response.

We would like to be kept informed of any subsequent proposals formed as a result of this consultation and also any changes to the overall policy direction of the topic under discussion along with a stated rationale.