Protecting your firm against money laundering and terrorist financing

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Practice Compliance analysis: The importance of implementing safeguards against money laundering and terrorist financing in law firms was emphasised by the Solicitor Regulation Authority's (SRA) warning notice in May 2019, which raised concerns over the levels of non-compliance with anti-money laundering (AML) policy. Shaul Brazil, partner, and Caroline Mair, barrister, of BCL Solicitors, explore the risks these types of financial crime pose and why law firms are an attractive target to the perpetrators.

Original news

Many law firms fail to implement anti-money laundering risk assessments, LNB News 07/05/2019 76

A warning notice providing advice for law professionals on how to comply with money laundering and terrorist financing obligations has been published by the SRA. The notice sets out the SRA's concerns and expectations regarding how to prevent legal professionals from breaching policy and legislation on these areas. The warning notice is relevant to all regulated persons and firms who have a legal obligation to ensure that they do not facilitate money laundering or terrorist financing.

In what ways do money laundering and terrorist financing pose a threat to law firms?

Law firms are particularly vulnerable to being used to facilitate money laundering and terrorist financing because they can potentially provide legitimacy to 'dirty' funds by, for example, allowing use of their client accounts in transactional work and more generally by acting as regulated 'professional enablers'. Law firms are most vulnerable to being used in this way when acting in certain high-risk areas—not least, for example, when offering trust and company services.

Without robust AML policies and procedures being put into place—which provide law firms with the capability of preventing them being used to facilitate money laundering or terrorist financing—serious regulatory disciplinary action and even criminal culpability may follow. Failure to properly implement robust AML policies and procedures is therefore capable of causing serious damage to the reputation of the legal sector as a whole.

Money launderers and terrorist financers may look to target law firms with poor client due diligence processes such as:

• weak identification checks

• poor efforts to establish the beneficial ownership of corporate clients

• lack of commitment to establishing the true origin of the client funds

Without adequate AML policies and procedures being put into place (in accordance with the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017, SI 2017/692) law firms heighten the risk of this kind of criminal activity occurring.

What prompted the SRA to issue a warning notice?

The warning notice—'Compliance with the money laundering regulations—firm risk assessment', issued on 7 May 2019—follows the SRA's Thematic Review published on the same date (the review), which assessed the AML policies and procedures of 59 law firms who provided trust and company services—considered a particularly vulnerable sub-set of law firms. The review resulted in 26 of those firms being referred to the SRA's disciplinary processes—albeit that no evidence of actual money laundering or intention of becoming involved in criminal activities was found by the SRA.

The warning notice is a consequence of the SRA's concerns following what they see as the shortcomings of 'a significant minority who are not doing enough, with some falling seriously short' (despite the fact that the SRA also concluded that 'most law firms who carry out trust or company service providers work are adequately meeting their obligations to tackle money laundering'). It serves to remind all law firms of their statutory AML duties and has the dual purpose of enabling the SRA to make a public declaration of its commitment to its own statutory AML duties—they have since the review created a dedicated AML team to focus on such issues.

This public declaration might also be a consequence of the criticisms that the SRA has faced from the newly created Office for Professional Body AML Supervision (OPBAS) which is housed within the Financial Conduct Authority (FCA). In March 2019, the Office for Professional Body Anti-Money Laundering Supervision strongly criticised 22 Professional Body Supervisors (including the SRA) responsible for the AML supervision of legal and accountancy sectors for 'significant weaknesses'.

What was the focus of the SRA's recent warning notice?

The warning notice highlights the importance of law firms undertaking adequate firm-wide risk assessments (RA), which the SRA describes as the 'backbone of a firm's AML approach'. It serves to remind law firms of the serious repercussions that they may be faced with should they fail to comply with SI 2017/692—in particular the importance of compliance with regulation 18. Under SI 2017/692, reg 18, firms must consider the level of risk arising from:

• its sector

• the types of clients it transacts with

• the countries in which it operates

• its products and services

• the types of transactions it undertakes

• its delivery methods

The SRA complains within the warning notice that it is 'seeing too many firms that do not have a risk assessment in place' and reiterates the fact that the SRA will not hesitate to take 'robust enforcement action' in response to such breaches.

In its 2018 Thematic Review, the SRA found that 'many firms have not implemented the new requirement to have a firm based AML RA in place'. In what way were the firms inadequate in their approaches to firm wide RAs?

The SRA found that the firms' inadequacies in relation to firm-wide RAs were wide-ranging, but perhaps the strongest criticism was that some RAs were not in written form. This meant that the SRA was unable to understand the conclusions that firms had reached in relation to assessed risks—and so effectively those firms could not show that they had an RA in place at all. Whether having an RA in formalised written form or not—while 35 of the firms reviewed were found to have addressed the main risk factors required by SI 2017/692, reg 18—it found that the remainder of the firms' RAs failed to fully address each of those areas. Those failings meant that the procedures and policies flowing from the assessments were also lacking—for example, two firms failed to have a politically exposed person process in place, and five firms failed to address how they would scrutinise complex or unusual transactions. In addition, while it was not addressed in the warning notice itself, it is important to note that the review also concluded that some firms were not carrying out ongoing client due diligence, nor were they being proactive enough in submitting suspicious activity reports (SAR)—with only ten of the 59 firms having submitted a SAR in the last two years.

What makes a good firm wide RA?

While it is clear that a good firm-wide RA must address the six risk factors contained in SI 2017/692, reg 18—it should not be seen as a 'tick-box' exercise. A strong firm-wide RA should take a holistic approach to the risks that the firm faces, and the RA must consider those real risks. The RA should be reviewed regularly as it will naturally need to be adapted over time as the firm's circumstances, such as its client base, (and thus risk exposure) evolve—making ongoing monitoring of RAs (and the related policies and procedures) of critical importance. The process requires a critical view of the work undertaken by the firm and a practical, common sense and proactive approach in ensuring that the firm is protected from unwittingly facilitating money laundering or terrorist financing.

The RA is the first step in being able to foster a firm's culture of compliance. Once a robust RA has been established, the policies, procedures and training which flow from that will more likely be adequate to address the real risks.

Interviewed by Samantha Gilbert.

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