

Cleaning up

Law firms and the risk of money laundering

November 2014



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Executive summary

It is estimated that up to £57 billion is laundered through the UK every year.¹ Law firms are one of the key targets for those wishing to launder money.² If even one percent of this amount were to go through law firms, it would still equate to hundreds of millions of pounds.

We are working with the National Crime Agency (NCA) and the Home Office to ensure robust systems are in place to guard against law firms becoming involved in money laundering.³

This report brings together and summarises information from other sources, which are referenced throughout the report, and can be used as a starting point when considering the risk of money laundering.

We will shortly be publishing the following warning notices on money laundering:

- money laundering and terrorist financing
- money laundering and terrorist financing - suspicious activity reports

Below are some good practices around preventing, detecting and reporting money laundering,⁴ some of which are legal obligations. This list is non-exhaustive and law firms must consider all the circumstances of a particular transaction.

You should keep up to date with the latest guidance as the papers referred to in this report are sometimes updated as new information is received.

1. [Frequently Asked Questions relating to money laundering](#), Financial Services Authority (now FCA & PRA), 2013
2. [Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals](#), Financial Action Task Force, 2013
3. [SRA steps up anti-money laundering work](#), Solicitors Regulation Authority, 2014
4. The good practices are non-exhaustive and based on existing guidance. We will update them following the outcomes of our recently announced programme of visits to law firms focusing on anti-money laundering compliance

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Good practices

- Meeting clients in person to verify identity using original ID where possible
- Taking extra steps to verify identity if you cannot meet the client in person
- Only using the client account to hold client funds for a legal transaction, in accordance with rule 14.5 of the SRA Accounts Rules 2011
- Investigating further when clients want to perform large cash transactions
- Investigating further when the source of client money is not clear or comes from a high-risk jurisdiction
- Taking advice if something does not seem right about a client or transaction
- Submitting Suspicious Activity Reports (SARs) that adhere to the best practice set out by the NCA, ensuring they are not vague or inaccurate
- Ensuring your Money Laundering Reporting Officer (MLRO) has sufficient seniority to encourage reporting of suspicious activity
- Ensuring your MLRO knows the criteria as to when to make a SAR
- Ensuring the MLRO can assess the risk of money laundering posed by the firm's work
- Providing up-to-date training to relevant individuals, as part of the role of the MLRO
- Providing training that covers the legislation but focuses on firm policies, behaviours and procedures
- Making all relevant individuals aware there is a list of countries that are high risk for money laundering, and where to find it. ⁵

5. [High-risk and non-cooperative jurisdictions](#), Financial Action Task Force

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Introduction

Money laundering is “the process by which criminal proceeds are sanitised to disguise their illicit origins”.⁶

The Financial Action Taskforce (FATF) highlights that criminals may want to use legal professionals precisely because “they need expert advice to devise complicated schemes to launder vast amounts of money”.⁷

This paper looks at the latest developments in money laundering risk and controls, and includes:

- why we see money laundering as a key risk
- how law firms become involved in money laundering
- what we know about money laundering through law firms in the UK
- how to control the risk of money laundering.

Why we see money laundering as a key risk

Inadequate systems and controls relating to the transfer of money are a key risk due to:

- the large sums of money handled confidentially by legal services firms
- the harm that money laundering causes to the public interest
- the potential for damage to public confidence in legal services
- ongoing cases showing serious failings in firms’ management of this risk
- the increasing number of reports we are receiving relating to this risk
- growing evidence that firms do not recognise the likelihood of this risk affecting them.

6. [Legal Guidance, Proceeds Of Crime Act 2002 Part 7](#) - Money Laundering Offences, Crown Prosecution Service, Updated 15/09/10

7. [Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals](#), Financial Action Task Force, 2013

The Financial Action Task Force is an intergovernmental organisation dedicated to developing and promoting policies to combat money laundering and terrorist financing

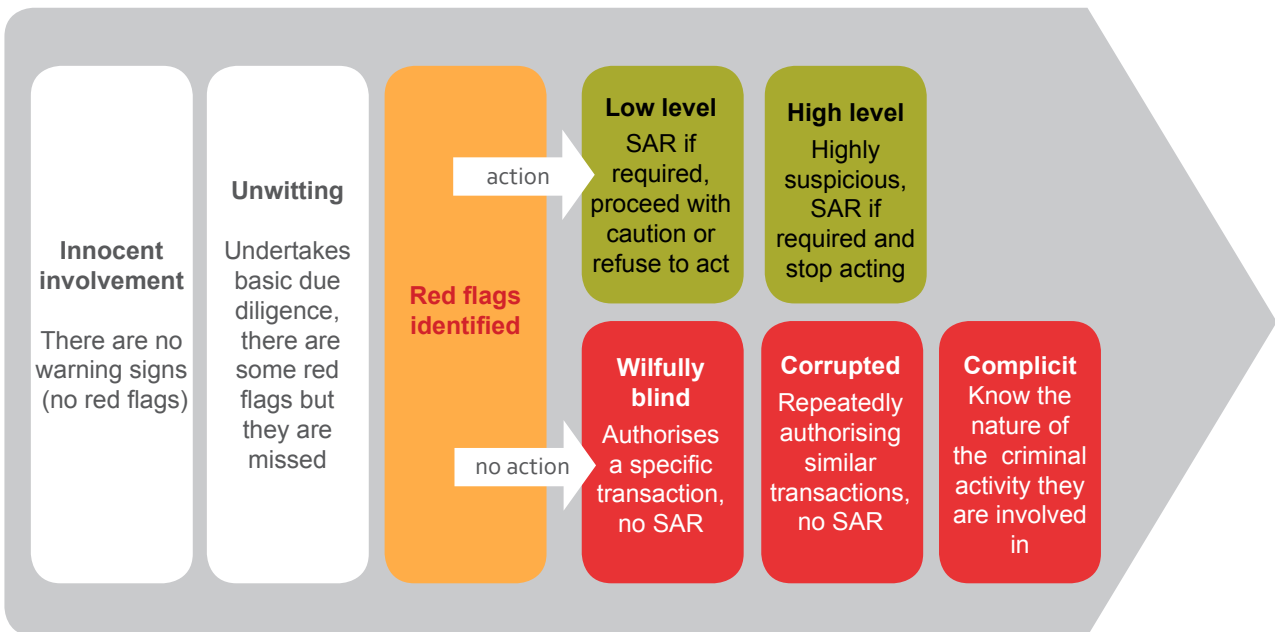
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Money laundering and the role of law firms

The role of the law firm (or individual working in that law firm) in money laundering is primarily that of ‘professional enabler’, rather than direct perpetrator. The law firm provides legitimacy to the funds, rather than obtaining the funds themselves.

The Home Office is in the process of launching a campaign specifically aimed at solicitors and focused on professional enablers, and the National Crime Agency (NCA) is putting together a professional enablers action plan. We are working closely with both agencies.

When a third party attempts to involve law firms in money laundering, the firm’s participation is on a sliding scale between innocent and complicit involvement, as shown in the diagram below.⁸



8. [Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals](#), Financial Action Task Force, 2013

Building up a current picture of money laundering through law firms in England and Wales

How criminals are attempting to launder money through law firms

When many people think of money laundering, they tend to think of large-scale organised crime.

However, the reasons for money laundering, the people involved and the techniques used vary from case to case – there is no single default sign that money laundering is taking place. We have seen attempted money laundering cases ranging from involvement with criminal organisations and deposed regimes, to smaller scale laundering involving local drug dealers.

While the evidence below identifies trends in money laundering, it is important to be aware that new schemes are constantly developing. As authorities become more aware of the latest schemes, criminals develop new approaches to try to evade detection.

Anti-money laundering (AML) training, a well-informed MLRO and regular visits to the FATF, NCA, SRA and Law Society websites are all ways to help keep knowledge of current trends in money laundering up to date.

Types of work attractive to money launderers

FATF have identified the main ways that criminals launder money through law firms:⁹

- misuse of the client account
- property purchases
- creation and management of companies and trusts

- managing client affairs and making introductions
- litigation.

This is useful as a general guide for assessing the risk of specific types of work.

Involvement or exploitation of more than one firm

Large-scale money laundering can involve more than one firm, making it more difficult for regulators and law enforcement agencies to detect. For example, one firm could be making referrals to other firms, which then process the work and inadvertently launder the money. Referrals may help criminals avoid things like identity and background checks, as the referrer firm can claim to have undertaken the checks, even providing evidence such as photocopies of ID.

If a law firm is working as part of a referral network, it is important that due diligence looks at the transaction as a whole, not just the section the firm carries out.

Persuading a law firm to provide a banking facility

This falls under the FATF category of misuse of the client account. Money laundered through law firms does not always involve actual legal transactions, and may instead involve passing the money through the client account to make it look legitimate, when no legal work has been undertaken.

9. [Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals](#), Financial Action Task Force, 2013

Offering banking facilities through a client account is not permitted under the SRA Accounts Rules.¹⁰

We are working on more detailed guidance on improper use of the client account as a banking facility, including case studies, as part of our current focus on money laundering.

Clients may offer law firms financial incentives to use their accounts in this way. Criminals may also encourage or dupe law firms into making the misuse of the client account look as if it is related to legal work through sham matters that are then cancelled.

The weak points criminals are exploiting to launder money through law firms

There is evidence that the legal sector has particular vulnerabilities that criminals seek to exploit in order to launder money.¹¹

Failure to conduct appropriate identity checks

Verifying identity is a money laundering check every firm must undertake, and failing to provide valid ID documents is one of the key money laundering red flags for any law firm.¹² When speaking to 100 randomly-selected conveyancing firms in 2012, we found that one in four had experienced attempted money laundering or fraud, the majority of which they identified through attempts to avoid or cheat identity checks.¹³

Due diligence around identity includes not only validating the identity of an individual, but also checking relevant background issues, including whether the individual could be classed as a politically exposed person requiring enhanced checks.

If a criminal identifies that a firm has lax identity checks or is prepared to forgo identity checks, they may target the firm for money laundering.¹⁴

Failure to conduct due diligence on source of funds and beneficial owner

We have seen firms where transactions have taken place involving money connected to organised crime, but the firm has failed to undertake due diligence regarding the true origin of the funds or the true beneficial owner of the transaction.

This often relates to inadequate due diligence around the true source of funds, and in some circumstances whether the individuals or businesses approaching the firm are politically-exposed persons (PEPs) or have connections to organised crime. These types of people will often not approach a firm directly, but launder money through an intermediary business or contact. It is therefore important to identify the true beneficiary of the transaction.

Checks to determine source of funds include, but are not limited to, requesting bank statements and undertaking background checks.

10. [SRA Accounts Rules 2011, Rule 14.5](#), Solicitors Regulation Authority, 2014

11. [Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals](#), Financial Action Task Force, 2013

12. [Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals](#), Financial Action Task Force, 2013

13. [Conveyancing thematic study: Full report](#), Solicitors Regulation Authority, 2013

14. [Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals](#), Financial Action Task Force, 2013

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Infiltration of law firms

We have seen cases over the last few years where criminals have targeted law firms to launder money by placing someone at the firm. Failing to undertake the appropriate level of vetting relevant to the role, when employing staff, may make a firm more vulnerable to infiltration and exploitation by criminals. Ways that criminals infiltrate firms include:

- identity theft – criminals impersonate a regulated person to obtain a job at a firm
- falsification of credentials – criminals claim to have qualifications or experience for a legal role which are wholly or partly falsified
- targeting solicitors for partnership, merger or acquisition – to allow for the creation of a regulated firm through which to launder money
- short term managers – individuals who take manager positions but only stay for a very short time
- targeting of certain roles – an example could be a criminal contact applying for positions which involve assessing conveyancing case files but do not require admittance.



The scale of money laundering through law firms in England and Wales

It is always going to be difficult to estimate the true scale of money laundering through law firms, as we cannot know how much goes undetected. However, evidence suggests it is a significant risk.



Between £23 billion and £57 billion

Estimated amount of money laundered in the UK in 2013



316,527

UK total Suspicious Activity Reports
October 2012-September 2013

38,000

Increase in UK Suspicious Activity Reports
between 2011/12 and 2012/13

3935

UK total Suspicious Activity Reports made by the
legal sector 2012/13



68

Reports to SRA of law firms perpetrating/facilitating
money laundering in 2013

74

Reports to SRA of law firms breaching money
laundering regulations in 2013

Recent cases

Recent cases of solicitors convicted of money laundering include:

- a solicitor who was convicted for her role in laundering money from a multi-million pound conveyancing fraud, involving identity theft and forged documents, in which she had knowingly taken part in an attempt to keep her business afloat
- a solicitor who was running a sham marriage immigration fraud, and laundering the proceeds.

Increased money laundering through property transactions

We are aware that the current growth of the UK economy, particularly the current strength of the housing market, may lead to increased use of property transactions to launder the proceeds of crime.

Property transactions are particularly attractive to money launderers as they can legitimise a large amount of money in one go. Money tied up in property can also be a way for people who have had their bank accounts frozen to preserve access to funds.

As conveyancing work grows, there may be pressure to reduce due diligence activities to handle the volume of work they receive.

In order to manage this risk, firms seeing their property work increasing should ensure that they uphold standards of due diligence.



Controlling the risk

Law firm legal requirements

This is not solely a regulatory issue. Regulated law firms are required by law, under the Money Laundering Regulations 2007, the Proceeds of Crime Act 2002 and the Terrorism Act 2000, to:

- ✓ have a nominated money laundering reporting officer (MLRO)
- ✓ report suspicious activity that they think may indicate money laundering both internally and to the MLRO and externally to the NCA
- ✓ have a system clearly setting out the requirements for making a disclosure of suspicious activity under the Proceeds of Crime Act 2002 and the Terrorism Act 2000
- ✓ undertake customer due diligence to verify identity of clients, source of funds, beneficial owners and the nature of business transactions
- ✓ keep records of customer due diligence undertaken
- ✓ ensure staff are properly trained.¹⁵

Controls

To help control this risk, there are a number of papers on how to detect and report potential

money laundering. These include our forthcoming warning notices, and publications from the Law Society, FATF and NCA.¹⁶ A summary of this guidance follows, and for more details consideration should be given to reading the source material.

Identifying the risk

A focus of most anti-money laundering guidance is what are known as 'red flags'; the warning signs that money laundering could be taking place. FATF identified 42 red flags for law firms in its 2013 report *Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals*. These red flags focus on due diligence around clients, source of funds, choice of lawyer and the nature of the retainer.¹⁷ These are echoed in Law Society guidance in the form of 'know your client' procedures.¹⁸

Acting once a risk has been identified

Once a law firm has identified a red flag, they need to decide what further action to take, in line with their legal and regulatory obligations. This includes, but is not limited to:

- requesting additional information from the client or other sources
- cross-checking different types of information
- making a SAR
- refusing to deal with the client.

15. [The Money Laundering Regulations 2007](#), HM Treasury, 2007, [Terrorism Act 2000 and Proceeds of Crime Act 2002 \(Amendment\) Regulations 2007](#), Home Office, 2007. Please note this is a simplified overview. For more detailed information about legal obligations of law firms, consult the Law Society's [Anti-money laundering practice note](#)

16. [Anti-money laundering practice note](#), Law Society, 2013, [SRA Guidance on Fraud and Dishonesty](#), SRA, 2013, [Reporting and how to report](#), SRA, 2013,

17. [Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals](#), Financial Action Task Force, 2013

18. [Anti-money laundering practice note](#), Law Society, 2013

Making a SAR

A regulated law firm is required to submit a SAR to the NCA if they know or suspect, or have reason to know or suspect, that another person or individual is engaged in money laundering, and the information has come to them in the course of their business.

The NCA specify what a SAR should contain in order for them to make a decision about whether to allow the transaction to proceed. The diagram below is our summary of this information.¹⁹



The NCA has commented on the poor quality of consent SARs made by the legal sector, and has recently announced that they will be rejecting any consent SARs that do not contain the information they require.

As a result, we will be issuing a warning notice

providing guidance and outlining our expectations on the quality of SARs.²¹

Ultimately, making an accurate SAR should ensure the NCA has the appropriate information required to make a decision about whether you should proceed with the transaction.

19. [Closure of cases requesting consent](#), National Crime Agency, 2014. A consent SAR is an application to the NCA for consent to continue with a transaction that you believe is suspicious.

20. This is best practice as presented in the United Kingdom Financial Intelligence Unit Guidance – [Submitting A Suspicious Activity Report \(SAR\) within the Regulated Sector](#), National Crime Agency, 2014

21. SRA Warning notice: Money Laundering and Terrorist Financing- Suspicious Activity Reports, Solicitors Regulation Authority, 2014 - not yet published


Case studies: identifying and reporting the risk of money laundering


The following case studies are based on real events, and show instances where law firms have effectively identified the risk of money laundering and taken appropriate action. Names and some details have been changed to preserve anonymity.

Case Study 1

Client asks whether to accept cash payment for property

The following case is based on real events and illustrates how transactions involving long-standing clients can still pose a risk.

Mrs A was a sole practitioner acting on behalf of a seller in a property transaction. The seller was a regular client who had been instructing Mrs A on property matters for more than 20 years, and he called to ask her if he was able to accept £50,000 cash as part-payment for a house. 

The client explained that the buyer had made an offer of £150,000: this included £100,000 that he had in savings, but he had also won a large sum of money on a horse race and so was able to pay £50,000 in cash. Mrs A advised her client not to accept this payment, as she knew that cash payment was a key money laundering red flag. She also told her client that it contravened regulations for the cash payment to be held in her client account. The client did not continue with the sale and Mrs A made a SAR. 

Some months later, the individual who had tried to purchase the property was convicted of drug related crimes, and it emerged he had been trying to launder proceeds through the purchase of property.

Mrs A was called as a witness in proceedings to help secure the conviction.

The red flags in this case were that the buyer wanted to pay a large sum in cash, and that the source of the funds was unusual.

Case Study 2

Suspicious payments identified in bank statement review

The following case is based on real events and illustrates how appropriate checks on source of funds can uncover inconsistencies that indicate criminal activity.

Firm B was acting for a client in a flat purchase. To check source of funds, they had requested six months bank statements as part of their 'know your client' procedures. When Mr C, an associate at Firm B, checked the statements, he noticed that the client had no money coming into his account at all for two months, and then regular very large deposits coming in the following months. The large deposits were from a company, XYZ Biz. Mr C could not find any details of XYZ Biz when he did an internet search. The client had not previously mentioned XYZ Biz and had given no indication that there would be anything irregular in the statements.



Mr C reported the irregularity to Firm B's MLRO, who examined the bank statements himself and subsequently made a suspicious activity report, detailing the payments and the lack of information available on XYZ Biz.

Soon after the report, the police contacted Firm B requesting the client's file.

It later emerged that the client had bought a number of properties as premises in which to grow cannabis. XYZ Biz was a shadow company set up by the client to try to disguise the proceeds of his criminal activity as payment for legitimate work.

The red flags in this case were the size of the payments, the successive payments over a short period, that the business was not mentioned by the client previously, and that there were no details of the business on the internet.

Training

Training staff on the regulations and their responsibilities in preventing money laundering and terrorist financing is a key part of the role of MLRO, and is required under regulations 20 and 21 of the Money Laundering Regulations 2007. The Law Society has produced a practice note which includes information to consider when training staff.²²

In summary, anti-money laundering training should include:

- how to recognise and deal with transactions and other activities related to money laundering
- the law relating to money laundering

Regulation 20 sets out the requirement to have policies and procedures in place, prescribes what they must relate to and requires that they are communicated to staff.²³

Firms should provide training in a way that is appropriate to the staff member's role. Training on topics such as ID verification and identification of source of funds will only be effective if they cover both the law and the firm's processes.

We have recently changed our approach to continuing competence, deciding to remove the requirement for a certain number of hours of CPD and allowing firms to arrange appropriate training at their own discretion. Anti-money laundering

training and the policies that underpin it, remain a legal requirement as noted above, and firms should consider this as part of their continuing competence planning.

Scenario-based training, using stories or case studies such as the ones included in this report, is recommended by the Law Society and can help staff understand the types of decisions or dilemmas they may face.²⁴

Potential future requirements

The proposed *Fourth Anti-Money Laundering Directive*²⁵ for the European Union describes how law firms are targeted for money laundering due to their handling of high value transactions, and the legitimacy they can bring to criminal enterprise.

In this directive, the EU has proposed tighter anti-money laundering controls. The Fourth Directive is currently making its passage through the European Parliament. Guidance on any major changes that result will be issued once it is adopted.

22. 3.9: Communication and training, [Anti-money laundering practice note](#), Law Society, 2013; Part 3, Regulation 20 and 21 [The Money Laundering Regulations 2007](#), HM Treasury, 2007

23. Part 3, Regulation 20 and 21 [The Money Laundering Regulations 2007](#), HM Treasury, 2007

24. [Help! I'm a New MLRO: training your staff](#), Law Society, 2012

25. [Financial Action Task Force Fourth Anti-Money Laundering Directive](#), Financial Action Task Force,

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Further information

Legislation

[The Money Laundering Regulations 2007](#)

[Terrorism Act 2000 and Proceeds of Crime Act 2002 \(Amendment\) Regulations 2007](#)

SRA

[Reporting and how to report](#)

[SRA Guidance on Fraud and Dishonesty](#)

Law Society

[Anti-money laundering practice note](#)

[AML toolkit](#)

[AML pages](#)

National Crime Agency

[UK Financial Intelligence Unit](#)

[Suspicious Activity Reports](#)

[Closure of cases requiring consent: latest guidance on consent SARs](#)

International documents

[Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals –](#)

Financial Action Task Force report about what makes law firms across the world susceptible to money laundering, including international case studies

[High-risk and non-cooperative jurisdictions –](#) an up-to-date list of jurisdictions FATF consider high risk for money laundering

[EU Fourth Anti-Money Laundering Directive](#)