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EXECUTIVE SEARCH

Tightening the Net:

The Criminal Finances Act

2017

> "It seems likely that in terms of money laundering going through the UK system every year, it is at least £100 billion."
>
> *Robert Barrington, Executive Director of Transparency International UK, oral evidence to the Home Affairs Committee in May 2016*

Overview

The Criminal Finances Act 2017, passed during the final days of the last Parliament, is expected to come into force by the end of this year. The legislation was hailed by all major political parties and a number of pressure groups and think tanks as an important step forward in the UK's fight against corruption. The need for reform to the UK's anti-money laundering (AML) and tax evasion framework has been widely acknowledged for several years. The debate has included specific events, such as the release of the so called 'Panama Papers' in 2016 and wide spread protests relating to the tax affairs of certain large corporates, as well as a general trend around the world to tighten up the regulatory framework in an effort to combat organised crime and terrorism wherever it resides. The Act includes reforms to the Suspicious Activity Reporting (SARs) regime, introduces Unexplained Wealth Orders (UWOs), and creates new corporate offences in relation to tax evasion.

The need for protections against criminal activity in the financial markets is clear. London's financial institutions, law and accountancy firms, and other advisors are at risk of being targeted by organised criminals attempting to launder the proceeds of crime. The size of our financial markets, combined with our close connections to British Overseas Territories and crown dependencies, and the relative ease of accessing our property market all make the City an attractive place to do legitimate and illegitimate business alike.

Transparency International, a global anti-corruption campaigner, was one of the more prominent forces behind the Act's creation. Its Policy Director, Duncan Hames, welcomed its passage at the end of April, noting though that "any law is only as good as its implementation" . In this series of articles, we seek to answer this point by drawing together opinions from leading practitioners across the business crime sphere as to what implementation may look like in practice and what this could mean for law firms.

Duncan Hames, Director of Policy Transparency International UK, Press Release 27th April 2017

Suspicious Activity Reporting Regime

The Act significantly enhances the SARs regime, giving the National Crime Agency (NCA) additional time to investigate reports and the power to request additional information to aid its investigation. The Act also codifies the sharing of information between regulated institutions, so that different regulated firms advising the same suspicious client may combine their information into a single submission to the NCA.

The need for reform to the AML framework has been discussed for a number of years. This came to a head in the Government's "Action Plan for anti-money laundering and counter-terrorist finance", published in April 2016. The paper acknowledged the British Bankers' Association estimate that its members were collectively spending in excess of £5 Billion annually on core financial crime compliance activities, and that this represented too much emphasis on regulatory compliance and too little on tackling financial crime risk. On the other side of the coin, it has been suggested that the NCA is also overburdened at present – in 2014/15 the agency received more than 380,000 SARs through a dated IT platform designed to handle a fraction of that figure. In part, this is due to evolving AML practices and regulations. There is, however, also a sense that firms may be submitting SARs when they're not strictly necessary in order to cover themselves 'just in case'.

The Government originally considered the removal of the consent regime in favour of an intelligence led approach that placed the emphasis on high risk entities or individuals. This was on the basis that "the volume and speed of financial transactions in the 21st century makes a transaction-focused regime less effective"[2]. Unfortunately for those hoping for significant reform, somewhere between April 2016 and the first draft of the Bill appearing 6 months later, this proposal morphed into Chapter 2 of the Act. Chapter 2 does include a number of updates, but it is hardly the 'radical change' suggested 12 months ago.

"Money laundering is a top priority that's closely policed and punished by the regulators. What firms have to ask themselves is, 'are we really going to take the risk [of not reporting]'? I think regulated firms will continue to be cautious."

Louise Delahunty, White Collar & Regulatory Defence Partner at Cooley

[2] Section 2.7, Action Plan for anti-money laundering and counter-terrorist finance, April 2016

Under the Act, regulated firms submitting a SAR can still request consent from the NCA to proceed with the transaction, such consent giving rise to a statutory defence against the money laundering charge that may otherwise apply. Under the old regime, they were obliged to wait out a 31 day 'moratorium period' if consent was refused (after which they could continue with the transaction if the NCA hadn't taken action). The new law allows the NCA to apply to the High Court to have the moratorium period extended, in 31 day increments, up to a total of 217 days.

On its face, this increase seems alarming for firms trying to balance their AML obligations against the demands of their clients and commercial objectives. Even under the old regime, the prevailing opinion of the business community was that a 31 day period was too long and incompatible with their business objectives as it caused transactions to fall through[3]. It is of course understandable that law enforcement would want more time to investigate suspicious activity and there are instances where this is not possible within 31 days[4] . However, a reading of Hansard for the sessions in which this was debated doesn't offer much evidence of the private sectors' concerns being considered or any justification for why specifically 7 months was chosen as the limit, as opposed to 6 or 12 months.

"Where terrorist financing is concerned this would almost certainly justify the extensions, but the vast majority of SARs – maybe 95% of those that I've dealt with – are technical offences such as breaches of the Environmental Protection Act or IP rights. Not to minimise the need to comply with these rules, but they're not on the same level as terrorism and serious crime."

White Collar Crime Partner, Elite US Law Firm

In practice, how often will assets really be frozen for the full 7 months? A number of practitioners highlighted that the NCA is already overstretched and, as one put it, "will be reluctant to expend more resources than they do already by applying for extensions more often than is strictly necessary". It is also worth noting that the extensions are not automatic. Each one will require the High Court to be satisfied that the NCA is conducting its investigations expeditiously and is genuinely in need of the time. This is a saving grace in the minds of many, with several practitioners anticipating an increase in work from financial institutions challenging the NCA's applications.

Additionally, and somewhat counterintuitively, the fact that a 31 day moratorium was already a problem for regulated firms is seen by some as a reason not to worry too much about the additional time introduced by the Act. As Denton's Head of Business Crime & Investigations, Daren Allen, remarked, "the real issue is the 31 day period – if the customer is going to start pushing then it is going to happen during this window anyway".

There is then the issue of 'tipping off', another gripe that the private sector had with the old legislation given the restrictions that were placed on what they were able to say to customers whose property was frozen as a result of a SAR. This remains a concern under the new rules. Although the majority of issues may still arise in the first 31 days, with the additional time comes an additional risk to firms seeking to maintain client relationships while remaining compliant. For the majority of practitioners, this was viewed as more of an inconvenience than a genuine problem. Under the old regime, the NCA was able to assist in these situations and there is a widely held expectation that this support will continue. There is, however, a question mark as to whether additional guidance or a relaxing of the tipping off offence may be forthcoming in relation to transactions subject to the full 7 month moratorium.

[3] Annex B, Action Plan for anti-money laundering and counter-terrorist finance, April 2016

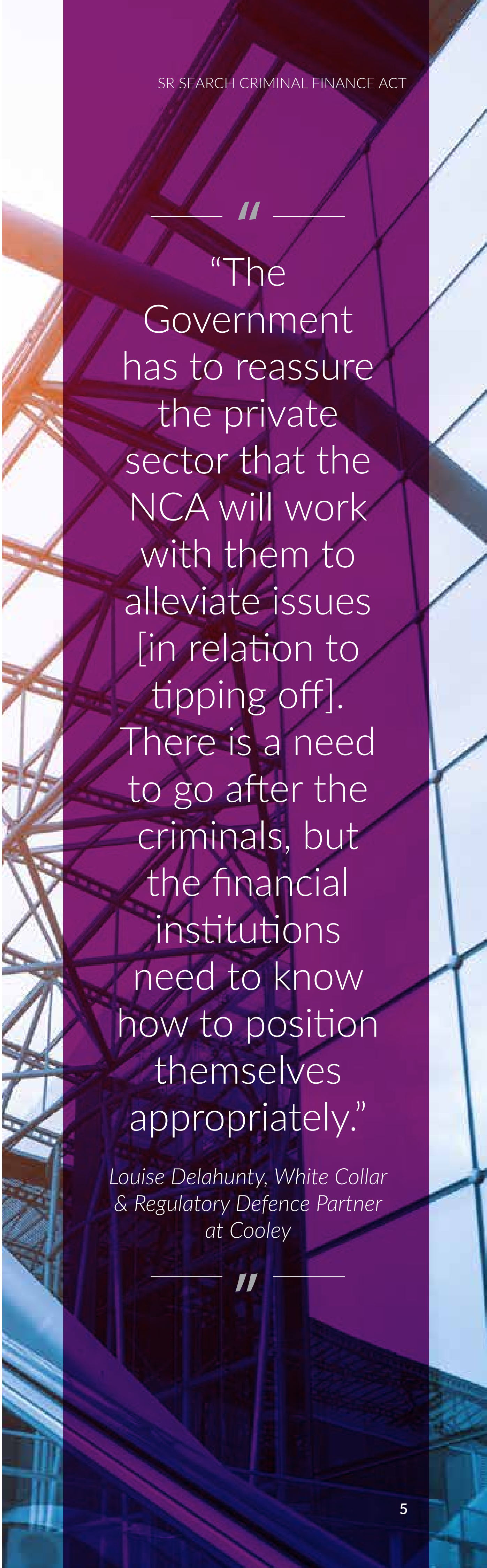
[4] Donald Toon, Director of the NCA's Economic Crime Command, oral evidence to the Home Affairs Committee in May 2016

The majority of practitioners do not appear to expect that a more onerous moratorium period will make reporting firms more selective when submitting SARs. This leaves the issue of the huge volume of information for the NCA to deal with. In an attempt to bring this down, or at least to streamline the process, section 11 of the Act codifies the mechanism for information sharing between reporting firms with the creation of shared SARs. As a concept, this is nothing new. The Joint Money Laundering Intelligence Taskforce (JMLIT) has, since its formation in 2016, made a significant contribution to the more 'intelligence led' approach to AML that the Government sought originally. There is a widely held belief that section 11 is the natural product of this success.

While it is generally accepted that information sharing is a good and sensible approach, we spoke to some who are concerned that firms may be overly cautious of acting on the provision, at least at first. The hypothesis goes that, although JMLIT has been successful, firms that have not been part of the taskforce may be less inclined to expose themselves to perceived risks of information sharing. The various conditions attached to the process will be useful for firms that feel this way and a number of partners predict that they will be called upon to advise on the more subjective conditions contained in section 11 in order to support the decision to go it alone.

"[Firms] may be reluctant to share information where there are costs or potential liabilities. The fourth condition in particular [which requires the discloser to be satisfied that the disclosure may assist in the NCA's determination] may be open to challenge. Because of the way section 11 is worded, firms may just submit their own SAR rather than collaborating."

Daren Allen, Head of Business Crime & Investigations, Dentons



"The Government has to reassure the private sector that the NCA will work with them to alleviate issues [in relation to tipping off]. There is a need to go after the criminals, but the financial institutions need to know how to position themselves appropriately."

Louise Delahunty, White Collar & Regulatory Defence Partner at Cooley

Unexplained Wealth Orders

Unexplained Wealth Orders (UWOs) are perhaps the most radical introduction in the Act, given the impact that they could have on Law Enforcement's ability to investigate and recover criminal property. At present, the courts require some evidence of wrongdoing before allowing enforcement authorities to investigate the source of an individual's wealth. The Act eliminates this requirement in certain circumstances by effectively creating a presumption of wrongdoing and shifting the burden onto the individual, requiring them to rebut this and demonstrate a legitimate source for their property or otherwise face recovery proceedings.

Just as the strength and size of the City's financial markets make it an attractive place to do business, the resilience of our property market, relatively low levels of political risk, and strength of the rule of law make London an ideal place to invest one's wealth. While the vast majority of such investments are legitimate, there is evidence to suggest that a small but significant minority are the proceeds of crime and foreign corruption. One partner at an international firm in London summed up the views of many of his peers when he said, "there's a belief that a lot of property in London is derived from corruption[5]. This needs to change, both in reality and perception." For the majority of those we spoke to, the aim of introducing UWOs is relatively clear: to reduce the UK's attraction to criminals and negate the perception of London as a magnet for illicit wealth from all over the world.

According to analysis by Transparency International UK, real estate transactions totalling in excess of £180 Million have been investigated for suspected corruption between 2004 and 2015. However, reflecting the difficulties in investigating suspicious property transactions, this is believed to be only the tip of the iceberg. It is hoped that UWOs will allow the authorities to make more of an impact on this area. Transparency International's research team has compiled a list of properties with a total value of £4.2 Billion that represent 'low-hanging fruit' for the NCA to go after once the Act is implemented. As Neil Swift of Peters & Peters commented, "when we start to see the use of Unexplained Wealth Orders, they're going to have a potentially huge impact on those that have parked assets here in London."

There are still questions about UWOs which will only be answered by further guidance from the Government or, more likely, as the first generation of the Orders go through the courts. Some of these are about how UWOs will interact with other aspects of the legal system, such as diplomatic / sovereign immunity of foreign officials. Others relate to the level of scrutiny to be applied by the High Court when issuing the orders. This lack of clarity is somewhat concerning given that the instrument reverses the burden of proof which, while not revolutionary of itself, is taken further under the Act than in previous legislation.

[5] "Faulty Towers: Understanding the impact of overseas corruption on the London property market", Transparency International UK, March 2017

> "Unexplained Wealth Orders are a way to make the civil recovery regime more effective. If you look at the rest of POCA, there are other provisions in there – for example the lifestyle provisions – that transfer the burden of proof. This is really just an extension of that."
>
> *Neil Swift, Business Crime Partner, Peters & Peters*

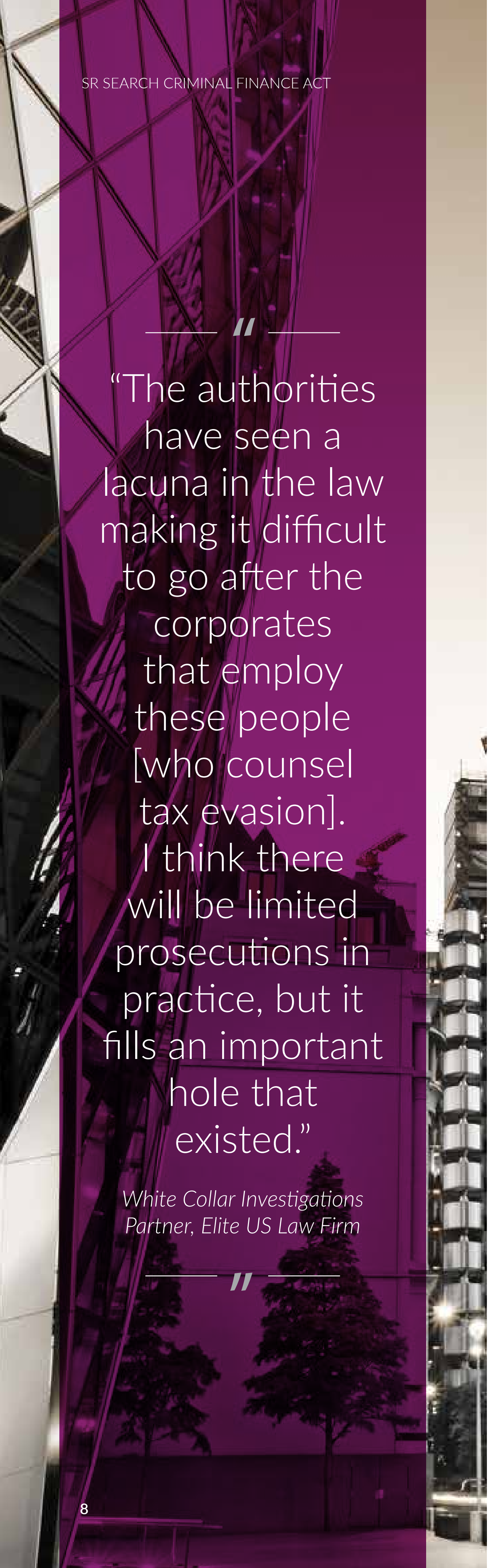
Overall, UWOs have the potential to be a significant step forward in the fight against corruption and have largely been welcomed by corporate crime practitioners and law enforcement officers alike. One US firm partner observed that her "contacts in law enforcement [at the NCA and SFO] are more excited about Unexplained Wealth Orders than I've seen them about anything else for a long time." However, there is some question over how often they will be used in practice, given that the Home Office predicted that they will only be used in around 20 cases per year[6]. It is a mark then of this uncertainty that they have so far garnered little opinion beyond speculation amongst the majority of informed practitioners.

The Corporate Offences

The previous two articles in this series have looked at issues that will, in the main, affect law firms' clients. Part 3 of the Act, on the other hand, hits a little closer to home given that it introduces two new offences for corporations and partnerships, namely, failing to prevent the facilitation of both UK and foreign tax evasion. Modelled on section 7 of the Bribery Act, these are strict liability offences with a built-in statutory defence of the organisation having 'adequate procedures' in place to prevent facilitation. The offences were first proposed 2 years ago against a backdrop of growing public pressure to close loopholes in the tax system and go after those perceived as not paying their 'fair share'. It has been suggested by a number of people that the legislation is more about perception than fighting crime, however it raises important issues for those offering advisory services in the City and beyond.

When Parliament debated the offences in Autumn 2016 it was noted by a number of MPs that tax evasion is not as big an issue for the UK as others dealt with in the Act. Nonetheless, as with bribery pre-2010, there has been a difficulty in prosecuting firms due to the problems of proving a 'directing mind'. Consequently, it has been all too easy for firms to paint wrongdoers as rogue employees acting without the knowledge of their superiors. The strict liability nature of the new offences removes this hurdle.

[6] Section E, Home Office Impact Assessment: Criminal Finances Bill – Unexplained Wealth Orders, January 2017



> "The authorities have seen a lacuna in the law making it difficult to go after the corporates that employ these people [who counsel tax evasion]. I think there will be limited prosecutions in practice, but it fills an important hole that existed."
>
> *White Collar Investigations Partner, Elite US Law Firm*

Of some concern to many law firm partners is how the new offences will impact their own firms in their dealings with clients and counterparts. Several individuals stated that they would be shocked if any large law firm was actively advising clients to evade taxes, however the worry arises from the fact that liability under the Act extends to the actions of agents and other service providers. There was general agreement amongst the people we spoke to that this aspect of the offence posed the greatest challenge, specifically as it relates to overseas offices and third-party advisors.

> "Due to the way the corporate offence is drafted, it can give rise to liability for actions of which a law firm has limited visibility and control. This will clearly affect our relationships as a profession with other actors including barristers, tax consultants, and foreign counsel."
>
> *Elizabeth Robertson, Government Enforcement & White Collar Crime Partner, Skadden*

It is thought to be relatively easy to institute policies and procedures in a London office. However as companies grow into ever larger global networks the challenge of instituting uniform policies becomes ever more difficult. "The real difficulty will be for firms that have branches in London," says Dentons Partner Daren Allen, "they may need to ensure that they implement adequate procedures across the entire organisation." This is less of an issue for firms that retain some form of centralised control, but presents more of a challenge for those that have expanded through local associations rather than acquisitions or organic growth.

A similar concern surrounds the involvement of third party advisors to transactions. In the past, clients may have instructed an international law firm to manage their transaction, with the firm acting as the primary advisor while 'sub-contracting' certain specialist aspects of the deal out to tax consultants or local counsel. There is a feeling that this may now change, as firms seek to insulate themselves against any suggestion of wrongdoing over which they have little-to-no control. One partner commented privately that he expects to see far more 'arms-length' relationships with some third parties going forwards and it is easy to see why. As Skadden's Elizabeth Robertson says, "the consequences for a law firm of even being named in an investigation into the corporate offence would be significant from a reputational and regulatory point of view. It could mean the end of the firm."

There is a single defence for firms under the Act: that they have 'adequate procedures' in place. However, there is currently little guidance as to what these procedures would have to look like in order to satisfy the courts. Although the offences are modelled on section 7 of the Bribery Act, this is of little help. Louise Delahunty, a Partner at Cooley told us, "Under section 7 of the Bribery Act we've seen a number of Deferred Prosecution Agreements [DPAs] and a guilty plea, so there's no jurisprudence on what constitutes 'adequate procedures' or how the defence would work in practice."

DPAs, originally a US import, are a useful tool for resolving investigations but one that precludes the production of helpful judicial opinions. Their use in relation to Bribery Act investigations also gives rise to uncertainty around how DPAs in respect of corporate offences may impact the possibility of a fair trial for the individual alleged to have committed the underlying offence. In a country that prides itself on the rule of law, particularly in a piece of legislation that strengthens the potential to enforce it, it will be interesting to see how this plays out in practice.

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"In the context of corporate bribery cases, the consequences of resolution by Deferred Prosecution Agreement on the subsequent trial of individual defendants have yet to be seen. The same considerations will apply to the use of DPAs for the new offence of failing to prevent tax evasion. There will doubtless be concerns about whether individuals who are prosecuted following a widely publicised DPA based on their conduct are capable of having a fair trial."

Neil Swift, Business Crime Partner, Peters & Peters

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There have been some suggestions that guidance on these issues may be forthcoming from the Government before the Act comes into force. Regardless of whether this materialises, "like the Bribery Act, it will generate a lot of work for those positioned to advise firms on how to approach it", says Neil Swift, "de-risking across all sectors seems likely as people will be looking at this very closely." A large number of partners are of the view that the courts will not accept a simple 'cut & paste' of anti-bribery policies, but instead will look for evidence of training, procedures, and genuine efforts towards culture change where necessary. Given that law firms' clients will be looking to them for guidance on these issues over the coming months, several partners have said that they're starting to get their own houses in order now.

Conclusions

Overall, the prevailing opinion amongst those who spoke to us for these articles is that the Act is a positive step towards fighting corruption in the UK. Although contained in a single piece of legislation, the issues we've discussed are framed as separate and discrete. One can imagine how UWOs may be used to advance an NCA investigation into a SAR, however this does not appear to be the Orders' primary purpose. As such, it is generally predicted that organisations will look at these matters in parallel rather than in tandem.

What draws all three aspects of the Act together is their secondary purpose. While the language focuses on compliance and the potential sanctions for a lack thereof, the longer term aim of the legislation is to encourage and foster an improved culture in the sector. During debates on the Act there was a suggestion that, as a result of the Bribery Act, people as far away as Africa and South East Asia no longer attempt to bribe British companies. There is also anecdotal evidence to suggest that this Act is already having a similar effect: One US firm partner told us of a manufacturing client that had already made enquiries as to whether they should implement policies around invoicing to avoid being caught by the corporate offences.

London's financial services sector is the envy of cities across the world and is one of our country's greatest exports. For too long it has been targeted by those seeking to take advantage of its success for nefarious purposes. There are those who have argued, in Parliament, in the press, and privately to us, that the new rules will simply push work to jurisdictions with lighter regulations. They may be right. However, the rule of law has been a cornerstone of London's growth as a global city and is one of the reasons that huge numbers of legitimate businesses choose to transact here every day. The strengthening of this will encourage others to do so in the years to come. In the immediate future though, it will present new challenges and increased business opportunities for law firm partners across the sector. At a time when political events have been chipping away at certainty and confidence, the consistency of work that flows from this may be a refreshing change of pace.

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