



Legal Sector Briefing

# Money Laundering Regulations 2007

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## Law firms targeted in fight against terrorism

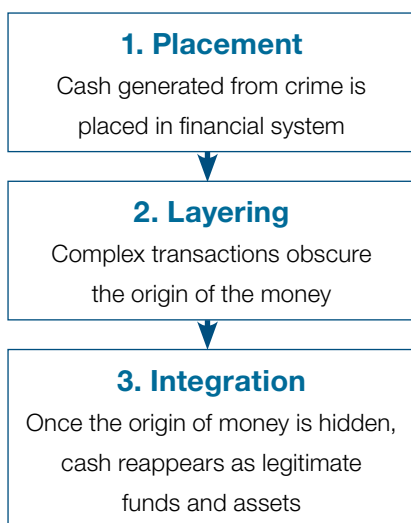
Since the introduction of the Money Laundering Regulations 2007 last December, law firms are now required to adopt rigorous customer screening and due diligence standards. As senior partners and MLROs get to grips with the enhanced compliance measures expected of them, this briefing document sets out the essential background on the new regulations and offers practical guidance to law firms faced with implementing anti-money laundering processes.

## What is money laundering?

Money laundering is the process of creating the appearance that large amounts of money obtained from serious crimes, such as drug trafficking or terrorist activity, originated from a legitimate source.

## How is money laundered?

There are three principle stages involved in the process of money laundering:



## How much money laundering goes on?

Calculating the extent of money laundering is extremely difficult due to the secret nature of the markets involved. A number of approximations can be used in order to measure the scale of the problem. The Financial Services Authority estimates that £25 billion in cash is laundered through British financial institutions every year. HM Treasury estimates that £15 billion is lost annually to organised crime in the UK. Looking at the problem from an international perspective, KPMG estimates that \$590 billion - \$1.5 trillion in funds is laundered annually. This equates to 2-5 percent of global GDP.

## Why is fighting money laundering important?

Drug dealers, people traffickers, burglars, fraudsters, robbers, illegal arms dealers and smugglers are among those who use the financial system to launder money. When one makes money laundering more difficult, one makes it more difficult to live a life of crime. That can only be a benefit to society.

Source: FSA

## Origin of the Money Laundering Regulations 2007

The Money Laundering Regulations 2007 are the result of a series of legislative and other measures implemented over a number of years:

### Timeline

<b>15th December 2007</b>	<b>Money Laundering Regulations 2007</b> Implements the EU Third Money Laundering Directive into UK law and repeals and replaces the Money Laundering Regulations 2003. Related measures also update the Proceeds of Crime Act 2002
<b>Sept 2007</b>	<b>Law Society Anti-Money Laundering Practice Note published</b> Represents core industry guidance for the UK legal sector
<b>2006</b>	<b>Terrorism Act 2006</b> Amends the Terrorism Act 2000 and contains a number of measures designed to ensure that the police, intelligence agencies and courts have all the tools they require to tackle terrorism and bring perpetrators to justice
<b>2005</b>	<b>EU Third Money Laundering Directive (2005/60/EC)</b> Amends the Second Money Laundering Directive including the implementation of the Financial Action Task Force (FATF) Recommendations on tackling money laundering and terrorist financing across the EU
<b>2005</b>	<b>Financial Action Task Force (FATF) 40 Recommendations published</b> Provide a complete set of counter-measures against money laundering covering the criminal justice system and law enforcement, the financial system and its regulation, and international co-operation
<b>2004</b>	<b>Money Laundering Regulations 2003</b> Implements the EU Second Money Laundering Directive into UK law
<b>2003</b>	<b>Proceeds of Crime Act 2002</b> Applies to the seizure of criminal assets together with the funding of crime and terrorism through money laundering. Places obligation on financial institutions to monitor transactions and to report suspicious activities, failure to report can result in imprisonment.
<b>2001</b>	<b>EU Second Money Laundering Directive (2001/97/EC)</b> Amends First Money Laundering Directive to tackle wider financial crime and expands scope to include non-financial activities and professions (for example: lawyers, notaries, accountants, estate agents, high value dealers and casinos) and wider financial crime
<b>1991</b>	<b>EU First Money Laundering Directive (91/308/EEC)</b> Introduced to prevent the financial system from being used for money laundering to combat drug trafficking. Focuses on anti-money laundering measures within the financial services sector

## Overview of the Money Laundering Regulations 2007

The Money Laundering Regulations require firms to put preventative measures in place. They require firms to ensure that they know their customers (including conducting customer identification and verification and undertaking ongoing monitoring where applicable), to keep records of identity and to train their staff on the requirements of the Regulations.

The Proceeds of Crime Act 2002 and the Terrorism Act 2000 provide the criminal offences of money laundering and terrorist financing and impose obligations on firms and individuals to report suspicions of money laundering or terrorist financing.

Source: HM Treasury

## Which sectors are affected?

The following sectors need to comply with the Money Laundering Regulations:

- Credit institutions
- Financial institutions
- Auditors, insolvency practitioners, external accountants and tax advisers
- **Independent legal professionals**
- Trust or company service providers
- Estate agents
- High value dealers
- Casinos

## Core obligations of the Money Laundering Regulations 2007

### Adopt a risk-based approach to customer due diligence

This principle has been in existence for some time and is essentially a management tool that allows firms to apply greater levels of customer due diligence to those individuals and corporate entities deemed a higher risk to the business.

### Extended customer due diligence requirements

The above measures focus on a more detailed definition of customer due diligence:

- Identifying the customer and verifying the customer's identity
- Identifying, where applicable, the beneficial owner and taking risk-based and adequate measures to verify his identity
- Obtaining information on the purpose and intended nature of the business relationship
- Conducting ongoing monitoring of the business relationship

There are also measures outlined that emphasise the need to conduct either Simplified Customer Due Diligence or Enhanced Customer Due Diligence depending on the level of screening required, as determined by a firm's risk-based approach.

### Perform checks for Politically Exposed Persons (PEPs)

PEPs are broadly defined as "individuals who are or have been entrusted with prominent public functions" and their "immediate family members". For example: heads of state, government ministers, members of the judiciary, members of the boards of central banks, ambassadors etc. Essentially, as PEPs are deemed open to influence or corruption, they are considered a higher business risk and must be identified where appropriate.

Conducting due diligence on politically exposed persons or 'PEP checks' has been considered best practice for some time, however the new Money Laundering Regulations 2007 set this procedure in law for the first time.

### Reliance on third parties

Another measure to appear in the Money Laundering Regulations 2007 is the ability for a regulated entity to rely on customer due diligence carried out by another regulated entity. In theory, this measure would enable firms to reduce the amount of due diligence carried out on their clients, however it is emphasised that final responsibility still remains with the original firm and cannot be transferred to the third-party, so in reality how much this measure will be applied by firms is debatable.

### Training

There is also a regulatory obligation to ensure that all relevant employees receive training on changes in anti-money laundering procedures.

## LexisNexis' top ten tips

- 1)** Assess the level of risk posed by the clients you work with. Examples of risk assessment criteria often include:
  - Jurisdiction of origin
  - Industry sector
  - Political prominence of individual
  - Reputational profile of entity
  - Your previous knowledge of client
- 2)** Assess the level of risk posed by the type of work you undertake. Examples of risk assessment criteria often include:
  - Face-to-face or remote customer engagement
  - Nature of transaction being conducted
  - Level and method of financing
- 3)** Tap into both informal and formal peer group networks to benchmark your risk-based approach against those of other firms with a similar business profile. Create a policy document setting out your firm's approach to risk. Share this document via your intranet or company handbook.
- 4)** Put in place a workflow process (paper or online) guiding your staff through the customer due diligence process. Set out:
  - The minimum level of checking to be conducted before any client is accepted
  - The red flags that indicate a higher level of risk and the further checks that are then required
  - The acceptable point at which to stop checking
- 5)** Add anti-money laundering training to your induction process for appropriate members of staff. Two levels of briefing aimed at partners and administrators will often suffice. Cover:
  - The individual's obligation to conduct anti-money laundering checks
  - Where to go for guidance if staff have a money laundering concern
- 6)** Set up a process to update staff on anti-money laundering changes. This could be an annual e-mail or a face-to-face briefing with refresher training, dependent on the level of risk you have identified.
- 7)** Enforce an effective process to record all checks carried out. A comprehensive audit trail is essential to demonstrate compliance. Even nil results must be dated and filed.
- 8)** Remember that the verification process does not end when a client is accepted. Set up an ongoing monitoring routine to highlight any changes in the status of individuals within your customer base.
- 9)** Consider the benefits of electronic identity verification and customer due diligence tools to reduce the paper trail, minimise the compliance burden on clients, speed business take-on and maintain your competitive edge.
- 10)** Look at how you can add value to your firm by identifying new business opportunities when due diligence uncovers more detailed profiles of your clients.

## Focus on the legal sector

The Money Laundering Regulations' focus on the legal sector relates to specific activities undertaken by law firms and solicitors that are deemed at most risk from money laundering and wider financial crime:

“ ‘Independent legal professional’ means a firm or sole practitioner who by way of business provides legal or notarial services to other persons, when participating in financial or real property transactions concerning –

- a) the buying and selling of real property or business entities;
- b) the managing of client money, securities or other assets;
- c) the opening or management of bank, savings or securities accounts;
- d) the organisation of contributions necessary for the creation, operation or management of companies; or
- e) the creation, operation or management of trusts, companies or similar structures, and, for this purpose, a person participates in a transaction by assisting in the planning or execution of the transaction or otherwise acting for or on behalf of a client in the transaction.”

Essentially, this covers services like conveyancing, company formations, estates & trusts and financial services. Some firms may also undertake activities similar to auditors and accountants like insolvency work which are also covered by the Regulations.

## The Law Society Anti-Money Laundering / Counter Terrorist Financing Practice Note

The Law Society updated its industry guidance on money laundering and published a detailed Practice Note in September 2007. This industry guidance represents essential advice for the UK legal sector and provides a useful interpretation of key obligations.

### Electronic Verification

The updated Law Society guidance states for the first time the acceptable use of electronic verification:

“Verification can be completed on the basis of documents, data and information which come from a reliable and independent source... ..including: conducting electronic verification”

The Law Society recommends firms consider the following details when choosing an electronic verification service provider:

- Has proof of registration with the Information Commissioner’s Office to store personal data
- Can link an applicant to both current and previous circumstances using a range of positive information sources
- Accesses negative information sources, such as databases on identity fraud and deceased persons
- Accesses a wide range of ‘alert’ data sources
- Has transparent processes enabling you to know what checks are carried out, the results of the checks, and how much certainty they give on the identity of the subject
- Allows you to capture and store the information used to verify an identity

When using electronic verification, you are not required to obtain consent from your client, but they must be informed that this check will take place.

## AML risk assessment within the legal sector

Each firm must develop their own risk-based policy. However there are some broad guidelines within the Law Society Anti-Money Laundering / Counter Terrorist Financing Practice Note indicating types of business that may affect the risk of money laundering or terrorist financing:

### Client demographic

Your client demographic can affect the risk of money laundering or terrorist financing.

Factors which may vary the risk level include whether you:

- Have a high turnover of clients or a stable existing client base
- Act for politically exposed persons (PEPs)
- Act for clients without meeting them
- Practice in locations with high levels of acquisitive crime or for clients who have convictions for acquisitive crimes, which increases the likelihood the client may possess criminal property
- Act for clients affiliated to countries with high levels of corruption or where terrorist organisations operate
- Act for entities that have a complex ownership structure
- Are easily able to obtain details of beneficial owners of your client or not

### Services and areas of law

Some services and areas of law could provide opportunities to facilitate money laundering or terrorist financing. For example:

- Complicated financial or property transactions
- Providing assistance in setting up trusts or company structures, which could be used to obscure ownership of property
- Payments that are made to or received from third parties
- Payments made by cash
- Transactions with a cross-border element

Source: Law Society Anti-Money Laundering / Counter Terrorist Financing Practice Note

## Do the Money Laundering Regulations 2007 apply to litigation services?

Bowman v Fels [2005] EWCA Civ 226

Regarding the Regulations and litigation services, a precedent was set by the Bowman v Fels case where the judgment imposed important limitations on the reporting requirements under the Proceeds of Crime Act (POCA) for solicitors.

Effectively the litigation process had stalled in this case after one of the party's legal advisers reported the other side to NCIS (National Criminal Intelligence Service – now the Serious Organised Crime Agency (SOCA)) for suspicion of money laundering under the requirements of POCA. This meant the case was delayed while the legal adviser awaited consent from NCIS to continue with the case.

The Law Society intervened in the case to clarify the impact of POCA on the work of solicitors. The Bar Council and NCIS also intervened. Although the case had been settled, the Court of Appeal wanted to give a judgment as it was aware that the orderly conduct of litigation was being affected by POCA, and this was a matter of importance not only for courts and lawyers, but also for the public. However, this does not mean that providing litigation services carries no risks as firms should remain alert to false claims etc.

Source: Law Society

## Legal market supervision

The Money Laundering Regulations 2007 list the principle industry bodies responsible for supervising the UK legal sector:

- Council for Licensed Conveyancers
- Faculty of Advocates
- Law Society of England and Wales  
(The Solicitors Regulation Authority is the independent regulatory body of the Law Society of England and Wales)
- Law Society of Scotland
- Law Society of Northern Ireland
- General Council of the Bar
- General Council of the Bar of Northern Ireland

## Further advice on money laundering

The Law Society's Practice Advice Service can guide you through the practice notes on anti-money laundering.

The service can be reached on 0870 606 2522 or e-mail [practiceadvice@lawsociety.org.uk](mailto:practiceadvice@lawsociety.org.uk).

The helpline is open 09:00 to 17:00, Monday to Friday

Practice Advice Service:

[www.lawsociety.org.uk/practiceadvice](http://www.lawsociety.org.uk/practiceadvice)

Practice notes:

[www.lawsociety.org.uk/practicenotes](http://www.lawsociety.org.uk/practicenotes)

## Further Information

The following useful links provide further information and guidance

### Law Society

AML page

<http://www.lawsociety.org.uk/newsandevents/news/majorcampaigns/view=newsarticle.law?CAMPAIGNSID=217590>

### Law Society

AML and CTF practice note (UK legal sector guidance)

<http://www.lawsociety.org.uk/productsandservices/practicenotes/aml.page>

### Law Society

Gatekeeper AML Bulletin

<http://www.lawsociety.org.uk/newsandevents/news/view=newsarticle.law?NEWSID=297076#gatekeeper>

### HM Treasury

Money Laundering Regulations 2007 page including the full text of the legislation and supporting documents

[http://www.hm-treasury.gov.uk/consultations\\_and\\_legislation/money\\_laundering\\_directive/consult\\_moneylaundering\\_2007.cfm](http://www.hm-treasury.gov.uk/consultations_and_legislation/money_laundering_directive/consult_moneylaundering_2007.cfm)

### HM Treasury

Financial Crime and Sanctions page includes commentary, consultation documents and legislation

[http://www.hm-treasury.gov.uk/Documents/Financial\\_Services/money/fin\\_money\\_index.cfm](http://www.hm-treasury.gov.uk/Documents/Financial_Services/money/fin_money_index.cfm)

## Financial Services Authority

Money laundering page

[http://www.fsa.gov.uk/Pages/About/What/financial\\_crime/money\\_laundering/index.shtml](http://www.fsa.gov.uk/Pages/About/What/financial_crime/money_laundering/index.shtml)

## Glossary of Terms

### AML

Anti-money laundering

### CDD

Customer due diligence

### CTF

Counter-terrorist financing

### EDD

Enhanced due diligence

### EU Third Directive

EU Third Money Laundering Directive

### FATF

Financial Action Task-Force

### FSA

Financial Services Authority

### HMRC

Her Majesty's Revenue and Customs

### IDV

Identity verification

### JMLSG

Joint Money Laundering Steering Group

### KYC

Know your customer

### MLR

Money Laundering Regulations 2007

### MLRO

Money Laundering Reporting Officer

### OFAC

Office of Foreign Assets Control

### PEPs

Politically exposed persons

### POCA

Proceeds of Crime Act 2002

### SARs

Suspicious activity reports

### SOCA

Serious Organised Crime Agency

### SRA

Solicitors Regulation Authority

### STRs

Suspicious transaction reports

## About LexisNexis Risk & Compliance

LexisNexis offers comprehensive solutions to meet your client screening and ongoing monitoring needs. Combining unrivalled content with the latest technology, our anti-money laundering tools enable you to **safeguard your reputation, reduce financial risk** and **add value to your business**.

### KYC ID

Streamline your identity verification processes with our **KYC ID** application. Designed to **reduce the time** and **effort** needed to undertake due diligence checks and **improve your new client acceptance process**, **KYC ID** is the only risk and compliance tool that gives you the ability to:

- **Verify the identity of your clients instantly online**, saving time and inconvenience chasing and storing paper documents
- Conduct checks on your clients' potential money laundering risk across three key areas – individual, director or company, **all from one place**
- Screen your clients against a **comprehensive database** including Politically Exposed Persons (PEP) lists, company financial reports, sanction lists and individual ID verification sources (including passports, utility bills and DVLA data)
- Uncover **negative press coverage** about your clients by searching our extensive UK and Irish news archive, enabling you to minimise risk by accessing the premium content that does not appear on the web

**Small, medium and large law firms use KYC ID to mitigate risk every day.**

### KYC

Developed for firms doing business globally, **KYC** offers all of the above plus the broadest international dataset:

- Over 90 databases of **global public and private company reports** and directories, including 120 million D&B company records, enabling you to **identify beneficial owners in European, US and emerging markets**
- Comprehensive English and non-English news coverage from **15,000 international news sources** giving you the best resources for conducting enhanced due diligence and **minimising risk to reputation**
- Detailed **biographies of high net worth individuals**, political figures and company directors

**Top tier banks already deploy LexisNexis KYC and mitigate risk every day.**

### Contact LexisNexis

For further information on how our international anti-money laundering solutions can help you add value to your organisation, please speak to your account manager or contact LexisNexis directly on:

Online: **[www.lexisnexis.co.uk](http://www.lexisnexis.co.uk)**

E-mail: **[risk@lexisnexis.co.uk](mailto:risk@lexisnexis.co.uk)**

Tel: **020 7400 2984**

Lines are open from 9am to 5pm Monday to Friday



Let us focus on the risks,  
so you can focus on doing business.

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