All change for UK money laundering regulation? - Impact for the private equity industry

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A number of very significant changes are being made to the UK anti-money laundering regime.

Of particular interest to the private equity industry will be the proposed new criminal offence of failure to prevent the facilitation of tax evasion, a strict liability offence which will require consideration by way of risk assessment and will need to be addressed when formulating policies and procedures. Here, we summarise the changes and consider the potential impact on businesses in the regulated sector. Companies should track the progress of the Criminal Finances Bill so that they can make their views heard and are ready to implement the changes.

The Criminal Finances Bill

The UK government has published its new Criminal Finances Bill, which forms part of the Action Plan for anti-money laundering ("AML") and counter-terrorist finance ("CTF"). The Bill has been through the initial committee stage and will now be considered at the Report Stage and Third Reading. There is broad all-party support for the Bill, and while we do not expect its provisions to be watered down, it may change during the legislative process. This note tells you what you need to know about the current version of the Bill.

The new Bill is a major change to the UK's AML landscape, but the radical proposal to remove the consent regime from the Proceeds of Crime Act 2002 ("POCA") has been dropped. The option of introducing a U.S.-style power to designate entities as being of "primary money laundering concern" is also not being pursued.

New criminal offences for corporates

The Bill introduces two new corporate offences of failure to prevent facilitation of tax evasion. A corporate body or partnership (a "corporate entity") is guilty of the offence if an associated person commits a tax evasion facilitation offence (e.g. becoming knowingly concerned in the fraudulent evasion of tax). A person will be "associated" with a corporate entity if he/she is an employee or an agent of the corporate entity or is performing services for the corporate entity (in each case, provided the person is acting in the relevant capacity, e.g. as an employee). There is no requirement for the corporate entity to have benefited from the conduct.

The first offence targets facilitation of UK tax evasion. The second offence targets facilitation of foreign tax evasion and can be committed if a corporate entity (a) is incorporated in the UK; or (b) conducts business wholly or partly in the UK; or (c) any part of the facilitation activity takes place in the UK.

The new offences are strict liability offences. As with the corporate offence of failure to prevent bribery in the Bribery Act 2010 (section 7), the express focus is on tackling financial crime through corporate governance. The Government's aim is to hold corporate entities to account for the actions of their employees, and to prevent situations where lax compliance cultures tacitly encourage individual employees to commit criminal offences. It is therefore a defence to both offences for the corporate entity to prove that it has in place reasonable procedures to prevent the commission of tax evasion facilitation offences. Unlike the bribery offence, it is also a defence to argue that it is unreasonable for the corporate entity to have such procedures in place.

HM Revenue and Customs has published draft guidance on what corporate entities will need to do to rely on the available defences. In line with the existing guidance on the Bribery Act 2010, the six guiding principles are risk assessment, proportionality of risk-based prevention procedures, top level commitment, due diligence, communication (including training), and monitoring and review. Notes to the Bill clarify that reasonable procedures do not mean fail-proof procedures, so corporate entities can adopt a risk-based approach. HMRC is committed to working with industry bodies to produce sector-specific guidance.

One of the challenges arising out of the new offences for both law enforcement and companies seeking to comply is their extra-territorial nature: to what extent will action by the UK authorities overlap with action taken by regulators in other countries? The cross-border nature of the offences may complicate any enforcement efforts.

The new offences will also place an additional burden on corporate entities because they will need to assess whether they need to put new procedures in place to ensure that employees and other associates do not facilitate tax evasion, and document the steps which they have taken to implement and enforce their procedures.

There was a Labour Party proposal to expand the Bill to introduce the much-talked about offence of failing to prevent economic crime (i.e. fraud and money laundering). However, the Government is opposed to introducing this new offence through the Bill because there has not been much public consultation on an offence of failing to prevent economic crime – but a consultation has been promised for May 2017.

Amendments have been proposed to the Bill, including extending the new offences to cover companies incorporated in a British Overseas Territory or Crown Dependency. At present, these amendments look unlikely to be agreed.

Changes to the consent regime

The POCA consent regime has been controversial from its inception. In a nutshell, the primary money laundering offences in POCA are drawn very widely and cover, for example, becoming concerned in an arrangement which you know or suspect facilitates (by any means) the acquisition, retention, use or control of criminal property by another person. "Criminal property" is very widely defined, and can be generated through almost any type of criminal conduct, including administrative offences.

The difficulty that businesses in the regulated sector face is that they may have reason to suspect money laundering (and so run the risk of committing a primary money laundering offence), but they may not have sufficient grounds to refuse to carry out a transaction or to close an account. The consent regime was developed to deal with this situation: the firm submits a suspicious activity report ("SAR") to the National Crime Agency ("NCA") and requests consent to continue its participation in the transaction. The NCA then has seven working days to grant or refuse consent; the firm cannot proceed with the transaction until it obtains consent. If the NCA refuses consent, a 31 day moratorium period begins and gives the NCA the opportunity to take action against the suspected criminal. If the moratorium period expires without the NCA obtaining a court order to restrict the transaction, the transaction can proceed.

The current consent regime is an unsatisfactory process on both sides. From the regulated sector's perspective, the consent regime slows down transactions and creates disputes with customers because the customer cannot be told about the SAR. There is no de minimis threshold, so all suspected money laundering must be reported, regardless of the amount or the nature of the underlying offence. On the other hand, the NCA receives numerous SARs of limited value and is only given a short window in which to take action against the suspects or try to freeze the funds where a serious crime has occurred. The 31 day moratorium period does not give the NCA enough time to gather evidence, particularly in cross-border cases. In April, the government consulted on the possible removal of the consent regime, although it was never entirely clear what shape the new regime would take. These plans have now been dropped in favour of two strands of reform:

- a. The Bill gives the court the power to extend the moratorium period if the NCA needs further time to investigate. The court can grant extensions of up to 31 days; multiple extensions can be granted, up to a total of 186 days (from the expiry of the original 31 day moratorium period). The Bill also gives the NCA new powers to obtain further information from SAR reporters.
- b. A SARs reform programme of practical improvements (which do not require legislative change, so they are not part of the Bill). The improvements include better guidance on reporting for the regulated sector, better information-sharing and IT and operational enhancements. Improved guidance on when a SAR needs to be filed should assist both the regulated sector and the NCA by reducing the number of low value SARs to enable the NCA to focus on higher risk cases.

The Bill also contains new provisions on information-sharing in the regulated sector. This change is being made because the regulated sector is concerned that sharing information about SARs could amount to "tipping off", which is an offence under POCA. The new provisions enable parties in the regulated sector to share information without running the risk of "tipping off", provided certain conditions are met. The primary drawback is that a party can only rely on the new provisions if the NCA has asked it to share the information with the other party, or if the other party has asked it to share information. The new provisions do not deal with a scenario where a bank wants to share information with another party in the regulated sector on a proactive basis. The party requesting the information is also required to make a notification report to the NCA stating that a disclosure request has been made. This new administrative step may discourage the regulated sector from sharing information and/or delay information-sharing.

New enforcement powers

The Bill also creates new powers in the fight against serious crime:

- a. Unexplained wealth orders require a person to explain his/her interest in specified assets and how he/she obtained the assets, together with a linked power to seize the assets. The orders can only be used if the court considers that there are reasonable grounds to suspect that a person could not have obtained specified assets from their legitimate income, and if the person is linked to serious crime or is a politically exposed person.
- b. A new power is included in the Bill to allow suspected criminal funds held in bank accounts to be seized and forfeited quickly.
- c. Finally, an additional new power has been added to allow the seizure and forfeiture of precious metals, precious stones, watches, artistic works, stamps and vouchers which were obtained through criminal conduct or were intended to be used in criminal conduct (e.g. for money laundering).

For more, or to discuss how you might improve your policies and procedures to future proof your firm please get in touch.

Contacts

Louise Lamb

Partner

Lourdes Catrain

Partner

Ed Harris

Partner

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