# GETTING TO GRIPS WITH ANTI-MONEY LAUNDERING COMPLIANCE

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It is a fair bet that the main headache for most firms so far this year has been fulfilling the SRA's demands for compliance with the anti-money laundering regime, and the revised Money Laundering Regulations in particular. The chances are that your firm was asked shortly before Christmas to certify to the regulator before the end of January that you had conducted what it would regard as a valid risk assessment. There was then the little matter of ensuring that you had addressed the revised, and highly technical for the most part, regulatory requirements imposed by the Fifth EU AML Directive which took effect on 10 January through the Money Laundering and Terrorist Financing (Amendment) Regulations 2019. Nor is it likely that this will be the end of the SRA's heightened interest in this particular aspect of its responsibilities.

**Why were we asked to certify that we have undertaken a valid risk assessment?**

The SRA is one of the 22 approved legal and accountancy supervisory bodies listed in Schedule 1 of the Money Laundering Regulations 2017 ("MLR 2017"). As such it is accountable to HM Treasury for ensuring that the controls that it imposes on solicitors' practices are effective in ensuring that solicitors in private practice are compliant with the regulations. In pursuance of its responsibilities, the SRA conducted two surveys in 2019. First, in an exercise conducted with 59 firms that were registered as trust and company service providers, it concluded that 26 of them were non-compliant in some way and a failure to have conducted a risk assessment, as required by r.18 MLR 2017, was at least one of their omissions. This led to a larger review of 400 firms and the conclusion was again of concern to the SRA in that 40 of the firms submitted documents that did not constitute a risk assessment at all and a further 43 provided risk assessments that did not address all of the requirements. There then followed the recent SRA mailing to 7,000 firms which probably involved your firm.

**So, what is required for a valid AML risk assessment?**

The issues which must all be addressed by a firm for it to count as a valid process under r.18 of the MLR 2017 are the following, all of which need to be considered in the light of the size and nature of the firm in question:

(i) its customers;
(ii) the countries or geographic areas in which it operates;
(iii) its products or services;
(iv) its transactions; and
(v) its delivery channels (i.e. how it provides its services to its clients)

**How should we conduct or update our risk assessment?**

There are again some specific requirements, but by way of background the risk assessment required of a law firm forms part of a hierarchy of linked risk assessments, starting with the EU Commission, and then a national risk assessment by each of the member states. The UK Government issued its first such risk assessment in 2015 and has since updated this with the current version having been in place since October 2017. At the next level below that, there is then a requirement for each supervisory body (such as the SRA) to issue its sectoral risk assessment. All organisations subject to its jurisdiction have then to produce their own risk assessments under r.18. When doing so firms are required to consider their supervisory body's risk assessment and they must retain a copy of what they produce for inspection if required by that supervisor.

It is also important to bear in mind that although not formally stated as such in the regulations there is then a further level of risk assessment required at matter level. Every time a new matter is commenced consideration should be given to the risk profile of that set of instructions. Experience shows that this a systemic weakness of too many firms' AML controls, in that the all-important customer due diligence (CDD) process is seen to be little more than checking that there is a copy passport or photo driving licence on file, along with some form of official document proving the client's address details. The CDD requirements provide that not only must there be independent evidence of the client's identity but that the lawyer must also understand the "purpose and intended nature" of the matter. Looked at another way, there are two risks posed by the new client: first that they may not be who they claim to be, and secondly, that what they are asking the firm to do is suspicious and quite possibly illegal.

Obtaining copy documents should address the first of these risks but not the second, and nor will asking for additional documentary evidence of who the client is allay any concerns about the nature of the instructions received.

The risk assessment process will also need to address any internal data – from the MLRO's records, file reviews and the like, and an analysis of the breakdown of work types and the risk weighting of the different departments. You should then be ready to go. Bear in mind, however, that the risk assessment is not an end in itself. The purpose of the exercise is then to dictate what will be suitable controls within that firm and in due course it will be necessary to show how the risk assessment shaped the firm's policy.

**What do we need to know about the Fifth EU Directive in force from 10 January 2020?**

For the most part the Fifth Directive, and so the Amendment Regulations, extend the risk principle which runs through the MLR 2017. When forming a business relationship with a company or other such entity, it is now necessary to understand its ownership and control structure. This has long been regarded as best practice in any event and is one of the areas where most firms may well be compliant already.

Unsurprisingly, the issue of beneficial interests receives more attention. A revised r.30(A) provides that, before forming a business relationship with a company or limited liability partnership, a firm will have to obtain proof of registration from Companies House.

There is also a duty to inform the Companies House Registrar of any discrepancies that emerge in relation to "information relating to the beneficial ownership" of the client – and therefore the persons with significant control ("PSC") register. Any such anomalies should be apparent when they arise as firms are already obliged not to rely on the PSC register alone when seeking to establish issues of beneficial ownership under r.28(9).

The other area where there are developments of note is in relation to enhanced due diligence (EDD). There is an apparently minor but potentially significant change of wording here in that, whereas the MLR 2017 required EDD where a transaction was "complex and unusually large", this is now changed to "complex or unusually large". Quite what is required to trigger this requirement must inevitably be judged on a firm by firm basis, rather than on some form of objective basis for the profession as a whole: what amounts to a complex or unusually large transaction for a small commercial department operating in a general high street firm will of course be very different to how it will seem for Slaughter and May. In similar vein, the same need for EDD will arise where is now an unusual pattern of transactions or transactions where there is no apparent purpose (formerly both elements were required rather than either one of them).

The most effective way to address this changed requirement will be to assess what the partners view as being the standard level of transaction for their different work types and so what should be regarded as being complex or unusually large for their firm through being in excess of the norm. This assessment should then be added to its overall risk assessment exercise to which the SRA continues to attach so much importance.

Also, in relation to EDD, there is also more emphasis on dealings with what are regarded as high risk territories, of which there are 16 at present. A revised r.33(3A) also now specifies in greater detail than before what is expected when EDD is required. It has been thought, by the way, that the use of e-verification services would become mandatory under the latest changes but for the time being, at least, there is merely an encouragement to use them instead.

Finally, on this issue, the Government will now be required to produce a list of functions that will count as having politically exposed persons ("PEP") status, which will be helpful. The intention is that there should eventually be one composite list of the roles amounting to PEP status throughout the EU. Whether the UK will be a signatory to that eventual list, and whether it will adopt the future AML directives that are already waiting in the wings, will probably be the main political story that we all follow with interest (or otherwise) as 2020 progresses.

In conjunction with Matthew Moore Director of Infolegal Ltd. For further guidance on this topic, including a range of precedent and training materials, see www.infolegal.co.uk

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