Section 2

Money laundering

Introduction

There is no formal definition of 'financial crime'. It includes many kinds of financial fraud, criminal market conduct such as insider trading, the funding of terrorism, and money laundering.

The prevention of the use of financial systems for money laundering purposes has, for many years, been a key objective of most national, European and international communities. In 1989, the Financial Action Task Force on Money Laundering (FATF) was created as an international body dedicated to the fight against criminal money. The FATF has over 30 members including the European Commission and many of the EU member states.

One indication of the scale of the problem is that, in the 12 months from October 2006 to October 2007, the Serious Organised Crime Squad (see Section 2.3.2) received 220,000 suspicious activity reports (SARs).

Because money laundering is such a high profile issue, it forms a separate part of the Unit 2 syllabus, and will be dealt with in some detail in this Section, which will cover the Proceeds of Crime Act 2002 and the money laundering offences; client identification, record keeping and reporting; training requirements; and enforcement.

2.1 Proceeds of Crime Act 2002

The UK's laws and regulations about money laundering were developed in a number of Acts and Amendments over a period of more than 15 years before they were consolidated in the Proceeds of Crime Act 2002. The 2002 Act no longer separates the proceeds of drug-related crimes from others, and deals with the laundering of the proceeds of all forms of crime. In particular, the 2002 Act extends the obligation to report suspicions about the laundering of proceeds of all forms of crime, where previously it had been restricted to those about the proceeds of drug or terrorism offences.

2.1.1 Terrorism Act 2000

The Terrorism Act 2000 defines terrorism as the use of (or threat of) serious violence against a person or serious damage to property or electronic systems, with the purpose of influencing a government, intimidating the public or advancing a political, religious or ideological cause.

The Act specifically mentions as an offence 'the retention or control of terrorist property, by concealment, removal from the jurisdiction, transfer to nominees or on any other way' – in other words, money laundering. 'Terrorist property' is defined as:

- money or other property that is likely to be used for terrorism purposes; or
- proceeds of the commission of acts of terrorism; or
- proceeds of acts carried out for the purposes of terrorism.

2.2 Definitions

Money laundering can be defined as the process of filtering the proceeds of criminal activity through a series of accounts or other financial products in order to give it apparent legitimacy or to make its origins difficult to trace.

The EU's Third Money Laundering Directive (2005) repealed and consolidated two earlier directives. The directive defines money laundering in some detail. It is said to comprise 'the following conduct when committed intentionally:

- the conversion or transfer of property, knowing that such property is derived from criminal activity or from an act of participation in such activity, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such activity to evade the legal consequences of his action;

- the concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to or ownership of property, knowing that such property is derived from criminal activity or from an act of participation in such activity;
- the acquisition, possession or use of property, knowing, at the time of receipt, that such property was derived from criminal activity or from an act of participation in such activity;
- participation in, association to commit, attempts to commit and aiding, abetting, facilitating and counselling the commission of any of the actions mentioned in the foregoing paragraphs'.

Two more important definitions were included, in order to clarify this definition of money laundering:

- *property*: this means assets of every kind, tangible or intangible, movable or immovable, as well as legal documents giving title to such assets;
- *criminal activity*: this means a crime as specified in the Vienna Convention (the United Nations Convention Against Illicit Traffic in Narcotic Drugs) and any other criminal activity designated as such by each member state;

Criminal property is defined as property that consists, directly or indirectly, wholly or in part, a benefit from criminal conduct, where the alleged offender knows or suspects that it constitutes a benefit.

The Directive specifies that money laundering that takes place within the EU will still be treated under EU money laundering rules even when the activities that generated the property to be laundered took place in a non-EU country.

Following the implementation of the Third EU Money Laundering Directive (2005), the FSA decided to change the way in which it regulates authorised firms with regard to Money Laundering. The Money Laundering Sourcebook, which was contained within the Business Standards part of the FSA Handbook, was very prescriptive in its requirements, with little consideration given to the specific nature of a firm's business or type of customer. It was felt that this was in direct contradiction with the FSA's 'principles of good regulation', ie that its resources should be allocated in the most efficient and economic way. It was also felt that many of the FSA's requirements within the Money Laundering Sourcebook were merely a duplication of the legislative requirements contained within the Proceeds of Crime Act (2002) and the Terrorism Act (2000). As a consequence, the Money Laundering Sourcebook was deleted on 31 August 2006 and firms are now given the flexibility to structure their controls and procedures to reflect the specific risks they face, drawing

guidance from the Joint Money Laundering Steering Group's revised guidance notes, which were given Treasury approval on 15 December 2007.

2.3 Money laundering offences

Under the Proceeds of Crime Act 2002 there are three principal money laundering offences:

- *concealing criminal property*: criminal property is property that a person knows, or suspects, to be the proceeds of any criminal activity. It is a criminal offence to conceal, disguise, convert or transfer criminal property – clearly money laundering is included in those definitions;
- arranging: this happens when a person becomes involved in a process that they know or suspect will enable someone else to acquire, retain, use or control criminal property (where that other person also knew or suspected that the property derived from criminal activity);
- *acquiring, using or possessing*: it is a criminal offence for a person to acquire, use or possess any property when that person knows or suspects that the property is the proceeds of criminal activity.

These definitions lead to a number of practical procedures designed to ensure that persons working in the financial services industry do not become 'involved' in money laundering. The rules require that all authorised firms must:

- establish accountabilities and procedures to prevent money laundering;
- educate their staff about potential problems;
- obtain satisfactory evidence of identity for individual transactions (or a series of linked transactions) over €15,000 – the sterling equivalent is set each year and is around £10,000 (special limits apply for life assurance policies – see Section 2.4);
- report suspicious circumstances;
- refrain from alerting persons being investigated;
- appoint a Money Laundering Reporting Officer. This post is a controlled function (see Section 1.7.1), and must be filled by a person of 'appropriate seniority';
- give regular training to staff about what is expected of them under the money laundering rules, including the consequences for the firm and for themselves if they fail to comply;

- take reasonable steps to ensure that procedures are up to date and reflect any findings contained in periodic reports on money laundering matters issued by the government or by the Financial Action Task Force;
- requisition a report at least once in each calendar year from the Money Laundering Reporting Officer. This report must assess the firm's compliance with the sourcebook, indicate how Financial Action Task Force findings have been used during the year and provide information about reports of suspected money laundering incidents submitted by staff during the year;
- take appropriate action to strengthen its procedures and controls to remedy any deficiencies identified by the report.

Contravention of any of the money laundering rules is a criminal offence.

When assessing a firm's compliance with its money laundering requirements, the FSA will take into account the extent to which the firm has followed:

- the Joint Money Laundering Steering Group's guidance notes for the financial sector. These describe the steps that firms should take to verify the identity of their customers and to confirm the source of their customer's funds. The Joint Money Laundering Steering Group is made up of the leading UK trade associations in the financial services Industry. Its aim is to promote good practice in countering money laundering and to give practical assistance in interpreting the UK money laundering regulations. This is primarily achieved by the publication of guidance notes;
- the publications of the Financial Action Task Force, which highlight any known developments in money laundering and any deficiencies in the money laundering rules of other jurisdictions;
- the FSA's own guidance on financial exclusion (see Section 2.4.1).

Two areas of particular concern to financial advisers are failure to disclose and tipping off.

2.3.1 The Financial Action Task Force

The Financial Action Task Force (FATF) was established in 1989 to coordinate the international fight against money laundering, and its main office is in Paris. It currently has 33 full members: these are countries and international bodies, including the European Commission (and many EU member states), the United States, and other countries in North and South America, Eastern Europe and the Far East. Similar bodies around the world also operate as Associate members of the FATF or have observer status with the FATF.

The FATF also maintains a list of 'non-cooperative countries and territories', which it considers do not have adequate anti-money laundering measures.

The work of the FATF falls into three main areas:

- setting appropriate standards for national anti-money laundering programmes; these are set out in a list of 40 'Recommendations' incorporating minimum standards for the measures that countries should have in place within their own criminal justice and regulatory systems;
- evaluating the extent to which individual countries have implemented these standards;
- identifying trends in money laundering methods.

It describes itself as an 'inter-governmental policy-making body', and points out that it does not itself become involved in law enforcement. That is the responsibility of local authorities in individual countries, such as the Serious Organised Crime Agency (SOCA) in the UK.

2.3.2 Serious Organised Crime Agency (SOCA)

SOCA is a public body sponsored by but operationally independent of the Home Office. It is an intelligence-led agency with law enforcement powers and a responsibility to reduce the impact of serious organised crime on people and communities; this includes responsibility for pursuing and recovering the proceeds of crime. Three of its major priorities relate to drug trafficking, immigration crime and money laundering.

2.3.3 Failure to disclose

All suspicions of money laundering *must* be reported to the authorities. The Proceeds of Crime Act 2002 introduced the requirement for a person to disclose information about money laundering if he has *reasonable grounds* for knowing or suspecting that someone is engaged in money laundering. The FSA will determine this on the basis of whether a reasonable professional should have known – so the importance of good quality appropriate training of staff is obvious.

2.3.4 Tipping off

It is also an offence to disclose to – or tip off – a person who is suspected of money laundering that an investigation is being, or may be, carried out.

2.4 Client identification

One of the most important elements in the financial service industry's action against money laundering is the process of confirming the identity of customers.

Evidence of identification is required in the following cases:

- when entering into a new business relationship (particularly when opening a new account, investment or policy);
- in the case of new customers (and any existing customers whose identity has not been verified previously), when the value of a transaction exceeds €15,000, whether as a single transaction or as a series of linked transactions. For life assurance policies the limits are €1,000 for annual premiums and €2,500 for single premiums.

Evidence of identification must be obtained in every case where there is suspicion of money laundering. If there is suspicion that the applicant may not be acting on his own behalf, reasonable measures must be taken to identify the person on whose behalf the applicant is acting.

If a client is introduced to the firm by a financial intermediary or other authorised firm, it is permissible to accept the written assurance of the intermediary that he has obtained sufficient evidence of identity. This is clearly important to, for instance, financial advisers and mortgage advisers. Many will use a standard format for giving the required confirmation, such as that developed by the Association of Independent Financial Advisers.

The definition of what constitutes satisfactory evidence of identity is rather vague – it requires that it should be reasonably capable of establishing that the applicant is the person that he claims to be, to the satisfaction of the person who obtains the evidence. Acceptable forms of identification include:

- current passport;
- national identity card with photograph;
- driving licence with photograph;

- entry on electoral roll;
- recent utility bill or council tax bill.

2.4.1 Financial exclusion

The FSA offers guidance on financial exclusion. This guidance helps firms to ensure that, where people cannot reasonably be expected to produce detailed evidence of identity, they are not denied access to appropriate financial services. The FSA cites the example of a person who does not have a passport or driving licence, and whose name does not appear on utility bills. In such circumstances, the FSA considers that a firm may accept, as evidence of the customer's identification, a letter or statement from a person in a position of responsibility (such as a solicitor, doctor or minister of religion) who knows the client.

2.5 Record-keeping requirements

Institutions must keep appropriate records for use as evidence in any investigation into money laundering. This means that:

- evidence of identification must be retained until at least five years *after* the relationship with the customer has ended;
- supporting evidence of transactions (in the form of originals or copies admissible in court proceedings) must be retained until at least five years *after* the transaction was executed.

2.6 Reporting procedures

Each firm must appoint a *Money Laundering Reporting Officer (MLRO),* a person of 'appropriate seniority' who will co-ordinate all the firm's anti-money laundering activities.

All members of staff must make a report to the MLRO if they know or suspect that a client is engaged in money laundering. The MLRO will then determine whether to report this to the Serious Organised Crime Agency (SOCA), using known information about the financial circumstances of the client and the nature of the business being transacted.

At least once in each calendar year senior management of the firm must requisition a report from the Money Laundering Reporting Officer. This report must:

- assess the firm's compliance with the Joint Money Laundering Screening Group guidance notes (revised guidance, December 2007); and
- indicate how Financial Action Task Force findings have been used during the year; and
- provide information about reports of suspected money laundering incidents submitted by staff during the year.

A firm's senior management must consider this report and must take any action necessary to solve any problems identified.

2.7 Training requirements

Firms are required to:

- take appropriate measures to make employees aware of money laundering procedures and legislation;
- provide training in the recognition and handling of money laundering transactions.

In particular, staff should be made aware of the following aspects:

- the law relating to money laundering;
- the firm's procedures and staff individual responsibilities;
- the identity of the firm's Money Laundering Reporting Officer and what his responsibilities are;
- how any breach of money laundering rules can impact on the firm and on themselves, ie the consequences of committing what may be a criminal act.

Training should be given on a regular basis throughout the time that the individual handles transactions that could lead to money laundering.

2.8 Enforcement

The FSA can discipline firms and individuals for breaches of its money laundering rules, as described in Section 1.6. It also has the power to prosecute anyone who breaks the Money Laundering Regulations 2003 established under UK law to give effect to the EU money laundering directives.

The penalties are severe. Anyone convicted of concealing, arranging or acquiring (see Section 2.3) could be sentenced to up to 14 years imprisonment or an unlimited fine, or both. The offence of failing to disclose or of tipping off carries a prison sentence of up to five years or an unlimited fine, or both.

Test your knowledge and understanding with these questions

Take a break before using these questions to assess your learning across Section 2. Review the text if necessary.

Answers can be found at the end of this unit.

1. Transferring criminally obtained money through different accounts is not the only action treated as money laundering. What other activities are also defined as money laundering?

2. What is the name of the international body that co-ordinates the fight against money laundering?

3. What is the transaction level above which firms must obtain evidence of identity of the client?

4. How often must a Money Laundering Reporting Officer provide a report to his firm's senior management?

5. What is 'tipping off'?

6. How long must evidence of identification be retained for anti-money laundering purposes?

7. If a Money Laundering Reporting Officer suspects a case of attempted money laundering, to whom must this be reported?

8. Which types of financial services employees must be given training about money laundering?

Answers

1. Concealing the true nature or source of property that you know to result from criminal activity; acquiring or using property that you know to result from criminal activity; aiding or abetting any other type of money laundering activity.
2. The Financial Action Task Force (FATF).
3. €15,000.
4. At least once every calendar year.
5. Disclosing to a person who is suspected of money laundering that they are under investigation.
6. Five years after the relationship with the client has ended.
7. The Serious Organised Crime Agency (SOCA).
8. Anyone who handles transactions that could involve money laundering.