



# UNITED KINGDOM

## FINANCIAL SECTOR ASSESSMENT PROGRAM

June 2016

### ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM (AML/CFT)—TECHNICAL NOTE

This Technical Note on Systemic Risk and Interconnectedness Analysis on the United Kingdom was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed in March 2016.

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# TECHNICAL NOTE

## ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM (AML/CFT)

Prepared By  
**Legal Department**

This Technical Note was prepared in the context of an IMF Financial Sector Assessment Program (FSAP) in the United Kingdom in November 2015 and February 2016 led by Dimitri Demekas. It contains technical analysis and detailed information underpinning the FSAP findings and recommendations. Further information on the FSAP program can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>

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## Glossary

3AMLD	Third EU Anti-Money Laundering Directive
4AMLD	Fourth EU Anti-Money Laundering Directive
AML	Anti-Money Laundering
BIS	Business Innovation and Skills
CD	Crown Dependency
CDD	Customer Due Diligence
CFT	Combating the Financing of Terrorism
CILEx	Chartered Institute of Legal Executives
DNFBP	Designated Non-Financial Businesses and Professions
ECC	Economic Crime Command
EEIG	European Economic Interest Groupings
FATF	Financial Action Task Force
FCA	Financial Conduct Authority
FI	Financial Institution
FIU	Financial Intelligence Unit
FSAP	Financial Sector Assessment Program
FSMA	Financial Services and Markets Act
FT	Financing of Terrorism
FUR	Follow-Up Report
G-8	Group of Eight
HMG	Her Majesty's Government
HMRC	Her Majesty's Revenue and Customs
HMT	Her Majesty's Treasury
ICU	International Corruption Unit
JMLIT	Joint Money Laundering Intelligence Task Force
LEA	Law Enforcement Agency
LP	Limited Partnership
LLP	Limited Liability Partnership
MER	Mutual Evaluation Report
ML	Money Laundering
MLRs	Money Laundering Regulations
MSB	Money Service Business
NCA	National Crime Agency
NPO	Non-Profit Organization
NRA	National Risk Assessment
OECD	Organisation for Economic Cooperation and Development
OT	Overseas Territory
PEP	Politically Exposed Person
POCA	Proceeds of Crime Act
POCU	Proceeds of Corruption Unit
PSC	People with Significant Control

SAMPLP	Systematic AML Program
SAR	Suspicious Activity Report
SBEE	Small Business, Enterprise and Employment Act
SE	Societas Europaea
SFO	Serious Fraud Office
SLP	Scottish Limited Partnership
TAFA	Terrorist Asset-Freezing Act
TCSP	Trust or Company Service Provider
TF	Terrorist Financing
TN	Technical Note
UN	United Nations
UNSCR	United Nations Security Council Resolution
U.K.	United Kingdom
WB	World Bank
WEF	World Economic Forum

## EXECUTIVE SUMMARY

**This Technical Note (TN) sets out the findings and recommendations made in the context of the 2016 Financial Sector Assessment Program (FSAP) for the United Kingdom (U.K.) in the areas of Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT).** It summarizes the findings of a targeted review of the U.K.'s progress in addressing vulnerabilities in the banking sector and in enhancing transparency of legal entities and arrangements. In addition, the TN provides a factual update on the key measures taken by the authorities since the U.K.'s previous assessment against the Financial Action Task Force (FATF) standard in 2006. This is not in any way an evaluation or assessment of the U.K. AML/CFT system: the U.K. is scheduled to undergo an assessment against the FATF standard, which was revised in 2012, in mid-2018, the results of which should be made public.

**Since the 2011 FSAP, steps have been taken to strengthen the AML/CFT regime.** In particular, amendments to the AML/CFT legal framework have been adopted to strengthen asset recovery and enhance the AML/CFT regulations. To address shortcomings in the institutional response to money laundering (ML), the National Crime Agency (NCA) was established in 2013 to lead efforts in combating serious and organized crime, with an Economic Crime Command (ECC) in charge of fighting ML. Steps are currently being taken to reform the suspicious activity report (SAR) regime to ensure higher quality and consistency of reporting on suspicion of ML/TF.

**Although significant progress has been made since the U.K.'s 2007 mutual evaluation against the previous FATF standard, the authorities are now in the process of bringing their AML/CFT framework in line with the prevailing standard, which was revised in 2012.** In particular, the U.K. has recently published its ML/TF National Risk Assessment (NRA) to provide a better understanding of the risks and inform the strategy to combat ML/TF going forward. In addition, the authorities are currently transposing the EU Fourth AML Directive (4AMLD), which will, among other things, extend the application of enhanced due diligence to domestic politically exposed persons (PEPs) and strengthen fit-and-proper requirements for auditors, accountants and legal professionals, and real estate agents.

**The U.K. has recently adopted a comprehensive reform package to enhance entity transparency.** In line with their G8 commitments, the authorities have established a register of people with significant control (PSC), which will come into force in April 2016, and will cover companies, limited liability partnerships (LLPs), and Societas Europaea (SEs). In addition, these reforms abolished bearer shares and the use of corporate directors. Going forward, transposing the 4AMLD will further enhance access to beneficial ownership information with respect to express trusts and other forms of corporate entities, such as Scottish limited partnerships (SLPs) which have legal personality.

**Although these initiatives are welcome and attest to the authorities' commitment to safeguard against misuse of the U.K.'s corporate landscape, further efforts are needed.** In particular, the authorities should consider adopting disclosure requirements for nominee directors,

enhancing the transparency of foreign legal entities and arrangements that conduct business in the U.K., and strengthen the effective implementation of AML/CFT controls in the trust or company service provider (TCSP) sector.

**The banking sector appears to be the channel most vulnerable to ML activity in the U.K.,** owing to its size and complexity, the range of products and services, the transaction volumes, and the sector's interconnectedness with the international financial system.

**The Financial Conduct Authority (FCA) continues to see failings in a number of banks, including in relation to the assessment and management of higher-risk business, although the authorities see the situation as improving.** Many banks, particularly large banks, now appear to recognize AML as an issue requiring senior management attention and a robust message from the top.

**Although the AML/CFT supervisory framework for higher-risk banks appears to be adequate, only time will tell whether it is so across the entire range of banks since the AML/CFT supervisory strategy has only recently been implemented.** As the primary U.K. supervisor charged with combating the abuse of financial services in regulated financial services organizations including banks, the FCA places a high priority on the effectiveness of firms' AML/CFT systems and controls. It has developed a new supervisory strategy to better target its resources and focus on firms that present the highest ML risk, irrespective of their size. At present, however, the backstop on which U.K. authorities depend for ensuring that lower-risk firms are effectively assessing and managing their money laundering risks appears to be limited.

**There have been few instances to-date where fines have been imposed on banks for breaches of their AML obligations relative to the size of the banking sector, and the FCA has only recently begun to apply higher fines allowed under the new penalties regime introduced in 2010.** The FCA applies a risk-based approach to its enforcement case selection. It targets resources strategically to achieve 'credible deterrence' in areas of greatest concern. Since 2012, the FCA has taken formal enforcement action against nine firms and individuals in response to AML failings, with fines totaling approximately GBP 96 million. Furthermore, there are a number of ongoing enforcement investigations. Notwithstanding recent actions, there have been relatively few instances where banks have been fined for breaches of their AML obligations since 2010 when a new penalties regime was introduced, and it is unclear at this time whether it will be applied in a sufficiently dissuasive manner across the entire range of banks. However, the FCA takes the view that financial penalties are not the only means by which it can deter non-compliance. Other tools include, for example, setting a firm and formal remedial plan, restricting certain types of higher-risk business until the weaknesses have been remedied, and seeking formal attestations from senior management that controls have been strengthened. The FCA has indicated that it has taken such measures in the past.

**Table 1. United Kingdom: Main Recommendations for AML/CFT**

<b>Recommendations</b>	<b>Timing*</b>
<b>General</b>	
Adopt an AML/CFT strategy and action plan in line with the findings of the NRA, which would notably address the intelligence gaps identified with respect to “high-end” ML.	Near term
Reform the SARs regime to enhance the quality and consistency of reporting across sectors.	Medium term
Consider reviewing the AML/CFT supervisory model in light of the vulnerabilities identified in the NRA, in particular to address inconsistencies in supervision and enforcement of AML/CFT obligations across regulated sectors.	Medium term
Transpose the 4AMLD, notably by updating the 2007 MLRs.	Medium term
<b>Banking Sector</b>	
Determine over time whether the supervisory attention given to banks in the lowest-risk categories is sufficient to ensure they are effectively assessing and managing their risks.	Medium term
Determine whether more cases should be referred for enforcement as a result of its AML specialist supervision work, in particular, its thematic review of smaller banks’ AML and sanctions controls.	Medium term
<b>Transparency of Legal Persons and Arrangements</b>	
Adopt a risk-based approach to preventing the misuse of legal persons and arrangements as understanding of “high-end” ML deepens and as intelligence gaps are addressed.	Medium term
Consider measures to enhance transparency of foreign legal entities and arrangements.	Medium term
Consider imposing disclosure requirements on nominee directors.	Medium term
Enhance AML/CFT compliance in the TCSP sector.	Medium term
Enhance the transparency of express trusts, notably by transposing the 4AMLD.	Medium term
* “Near term” is within six months; “medium term” is within six to 18 months.	



## INTRODUCTION<sup>1</sup>

1. **This Technical Note (TN) provides a targeted review of the U.K. Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) system in the context of the 2016 Financial Sector Assessment Program (FSAP) for the U.K.**<sup>2</sup> It builds upon a previous TN that accompanied the U.K. 2011 FSAP.<sup>3</sup> This review is not, in any way, an assessment or evaluation of the U.K. AML/CFT system. A comprehensive assessment against the current FATF standard will be available in 2018 (i.e., after the completion of this FSAP) when the FATF is expected to conclude its mutual evaluation of the U.K. AML/CFT system.
2. **Staff’s review focused mainly on the U.K.’s progress in addressing vulnerabilities in the banking sector and in enhancing transparency of legal entities and arrangements.** In light of the size and interconnectedness of the U.K.’s banking sector, the TN examines the main steps taken by the Financial Conduct Authority (FCA) to address vulnerabilities in banks’ mitigation of their ML risks. In addition, the TN also considers recent reforms adopted by the authorities to enhance transparency of legal persons and arrangements in light of the deficiencies identified at the U.K.’s last mutual evaluation in 2007. This TN also provides a factual update on the main steps taken by the authorities to strengthen their AML/CFT regime since their previous assessment.
3. **Staff analysis was based on a range of materials and benefited from discussions with the authorities.** Staff reviewed available information, including information submitted by the U.K. to the FATF on progress since 2007, and answers provided by the authorities to a questionnaire submitted ahead of the FSAP.

## PROGRESS SINCE THE LAST ASSESSMENT

### A. Compliance with International Standards

4. **In its last FATF mutual evaluation, the U.K. was found to have a comprehensive AML/CFT framework, although some shortcomings were identified.** The U.K. was last assessed

<sup>1</sup> This note was prepared by Richard Lalonde and Yasmin Almeida, Legal Department, IMF.

<sup>2</sup> Under FSAP policy, every FSAP should incorporate timely and accurate input on AML/CFT issues. Where possible, this input should be based on a comprehensive AML/CFT assessment conducted against the prevailing standard. In instances where a comprehensive assessment against the prevailing standard is not available at the time of the FSAP, (as is the case with the U.K.) staff may derive key findings on the basis of other sources of information, including already available information or information obtained in the context of the FSAP. See the Acting Chair’s Summing Up—Review of the Fund’s Strategy on Anti-Money Laundering and Combating the Financing of Terrorism—Executive Board Meeting 14/22, March 12, 2014 (<http://www.imf.org/external/np/sec/pr/2014/pr14167.htm>).

<sup>3</sup> United Kingdom: Technical Note on Anti-Money Laundering/ Combating the Financing of Terrorism, IMF Country Report No. 11/231, July 2011. Available at: <http://www.imf.org/external/pubs/ft/scr/2011/cr11231.pdf>

against the FATF standard<sup>4</sup> in November/December 2006 and a Mutual Evaluation Report (MER) was adopted in June 2007.<sup>5</sup> The assessment found that the AML/CFT legal framework and criminalization of the ML and TF offenses were comprehensive, the authorities had adequate powers to freeze, seize and confiscate proceeds of crime and terrorist-related assets, and the U.K. Financial Intelligence Unit (FIU) was effective. Shortcomings were identified with respect to certain customer due diligence (CDD) requirements, which did not require the identification of beneficial owners of accounts, and with respect to supervision of the real estate and company service providers sectors; although these were expected to be addressed with the implementation of the Third EU Anti-Money Laundering Directive (3AMLD) later in 2007.<sup>6</sup>

**5. Moreover, the 2007 MER identified shortcomings in financial sector supervision and enforcement, and with respect to the transparency of legal persons and arrangements:**

- **Supervision and compliance enforcement:** Although the assessors found the supervisory framework for larger firms to be adequate, they concluded that it was not so for certain smaller firms, including small banks. The assessors also found the number of enforcement actions to be low relative to the size of the financial sector.
- **Transparency of legal persons and arrangements:** While investigative powers were deemed generally sound, no adequate measures were in place at the time of the assessment to ensure timely access by competent authorities to adequate and accurate information on beneficial ownership and control of legal persons and arrangements. In addition, the MER also highlighted the risks posed by bearer shares, which were found not to be adequately mitigated.

**6. The U.K. made significant progress in addressing shortcomings with respect to CDD obligations and, as a result, was removed from the FATF's regular follow-up process in October 2009.** The U.K. was placed in the FATF's regular follow-up process following the adoption of the 2007 MER in light of the important deficiencies identified with respect to CDD. As reported in the last Follow-Up Report (FUR),<sup>7</sup> the adoption of the Money Laundering Regulations (MLRs) in 2007, implementing in part the 3AMLD, addressed a number of shortcomings, including nearly all of the deficiencies relating to CDD. Notwithstanding, other deficiencies remained, notably those identified with respect to the transparency of legal persons and arrangements.

<sup>4</sup> At the time, the prevailing FATF standard was the Forty Recommendations 2003 and the Nine Special Recommendations on Terrorist Financing 2001, and the prevailing methodology was the AML/CFT Methodology 2004, as updated in June 2006.

<sup>5</sup> FATF: "Third Mutual Evaluation Report Anti-Money Laundering and Combating the Financing of Terrorism – The United Kingdom of Great Britain and Northern Ireland"—June 29, 2007.

<sup>6</sup> Directive 2005/60/EC of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing.

<sup>7</sup> FATF: "Mutual Evaluation Fourth Follow-Up Report Anti-Money Laundering and Combating the Financing of Terrorism – United Kingdom"—October 16, 2009.

**7. The U.K.'s 2011 FSAP provides a comprehensive overview of the U.K.'s AML/CFT framework as assessed in 2007 and the steps taken by the authorities to address the shortcomings identified as reported in the FURs.<sup>8</sup>**

**8. The U.K. has yet to be assessed against the prevailing FATF standard, which was revised in 2012.** The FATF standard and methodology have been revised in 2012 and 2013, respectively, placing a greater emphasis on a risk-based approach to AML/CFT and on assessing the effectiveness of the AML/CFT regime. In addition, the revised standard includes tax crimes as predicate offenses to ML and extended the application of enhanced due-diligence obligations required for foreign politically exposed persons (PEPs) to also cover domestic PEPs, in cases of a higher-risk business relationship. The U.K. is tentatively scheduled to undergo an assessment against the prevailing standard in March/April 2018.

## **B. Bringing the AML/CFT Framework in Line with the Revised Standard<sup>9</sup>**

### **National Risk Assessment**

**9. In line with the 2012 FATF standard, the U.K. has recently conducted an ML/TF national risk assessment (NRA), the results of which were published in October 2015.** The revised standard introduces a new requirement that countries identify, assess, and understand the ML/TF risks they face and adopt mitigating measures commensurate with those risks. The objectives of an NRA are to provide a better understanding of the ML/TF risks and to inform the allocation of resources to mitigate those risks. The U.K. NRA was conducted by HM Treasury and the Home Office in consultation with law enforcement agencies, the U.K. FIU, supervisors, and private sector representatives. The exercise took stock of the collective knowledge of the ML/TF risks faced by the U.K., identified intelligence gaps, and considered the effectiveness of the current AML/CFT regime in addressing these risks.

**10. The NRA identified fraud and tax offenses as the main proceed-generating crimes in the U.K.** The tax gap related to tax crimes and evasion in 2012/13 was estimated at almost GBP 10 billion.<sup>10</sup> Narcotics trafficking also generates high levels of illicit proceeds, with a market value estimated at approximately GBP 4 billion per year. More broadly, HM Government estimates that serious and organized crime have an annual social and economic cost of GBP 24 billion, including drug-related offenses and fraud perpetrated by organized criminal groups.<sup>11</sup>

<sup>8</sup> IMF: Financial Sector Assessment Program Update – United Kingdom: “Anti-Money Laundering/Combating the Financing of Terrorism – Technical Note”—July 2011 (IMF Country Report No. 11/231)

<sup>9</sup> Steps taken to enhance AML/CFT compliance in the banking sector and transparency of legal persons and arrangements are considered in greater detail in sections III and IV.

<sup>10</sup> HMRC: “Measuring Tax Gaps 2014 Edition,” October 2014—where criminal attacks against the tax system accounted for £5.4 billion and tax evasion accounted for £4.1 billion.

<sup>11</sup> Home Office: “Understanding Organised Crime: Estimating the scale and understanding the social and economic costs”, 2013.

**11. While there is a better understanding of cash-based ML, significant intelligence gaps were found with respect to “high-end” ML through the financial and professional services sectors.** The NRA highlighted major fraud and serious corruption, notably overseas corruption, as significant sources of “high-end” ML. Corruption, in particular, is believed to result in billions of pounds worth of suspected proceeds laundered through the country each year. Law enforcement has traditionally focused on tackling cash-based ML and drug trafficking, resulting in a better understanding of ML vulnerabilities arising from cash collection networks, international controllers, and money service businesses (MSBs). In contrast, more is needed to address the intelligence gaps in “high-end” ML, where the proceeds are held in bank accounts, real estate and other investments, and to understand the vulnerabilities in the financial and professional services sectors.

**12. The NRA also identified vulnerabilities in the AML/CFT regime, in particular stemming from inconsistencies in supervision.** The U.K.’s role as a global financial center makes it an attractive destination to launder the proceeds of crime. Banks, and the accounting and legal professions, were found to be exposed to higher overall ML risks. In this context, effective and consistent supervision across these sectors is a central part of safeguarding against illicit financial flows. The U.K.’s current supervisory regime comprises 27 supervisors, which include both public sector organizations and professional bodies. While the NRA did not find evidence that the use of professional bodies as supervisors undermines the effectiveness of supervision, their role as both industry representatives and supervisors may give rise to potential conflicts of interest. In addition, the large number of supervisors could undermine the consistent application of AML/CFT controls and “fit-and-proper” requirements across regulated sectors, creating an incentive for regulatory arbitrage. While greater outreach between law enforcement and supervisors, and among supervisors themselves, is essential in addressing these vulnerabilities, the supervisory model as a whole could also be revisited.

**13. TF was found to pose a significant threat to national security and combating TF is part of the U.K.’s “CONTEST” counter-terrorism strategy since 2011.**<sup>12</sup> With the aim of detecting, investigating and disrupting terrorist threats, countering TF in the U.K. focuses on reducing terrorist fundraising, both domestically and overseas, and restricting the movement of TF-related funds into and out of the country. The sectors most vulnerable to TF were found to be the MSB sector, due to the low number of TF-related suspicious activity reports (SARs)<sup>13</sup> and the ability of terrorists and terrorist financiers to circumvent the €1,000 reporting threshold, and cash couriers. Other sectors, such as the non-profit organization (NPO) and the banking sectors, are also considered to be exposed to TF risks, although to a lesser extent (medium-high and medium TF risks, respectively). The U.K. has had 17 convictions for TF-related offenses between September 2001 and June 2014, although this does not necessarily reflect all instances in which TF-related activities have been

<sup>12</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/97995/strategy-contest.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/97995/strategy-contest.pdf)

<sup>13</sup> Only 16 SARs under the Terrorism act 2000 were received from the MSB sector between October 1, 2001 and September 31, 2013 (Source: NRA).

disrupted as law enforcement agencies (LEAs) have other tools at their disposal to combat terrorist threats.

**14. The findings of the NRA will inform the government’s strategy to combat ML/TF going forward.** While some elements of the U.K.’s AML/CFT strategy can be found in the Serious and Organized Crime Strategy (2013) and on the Anti-Corruption Plan (2014), going forward the authorities are committed to developing an AML Action Plan, which will build on these strategies and on the findings of the NRA. Specifically, the AML Action Plan will look to address the intelligence gaps identified, notably with respect to “high-end” ML; align the U.K.’s law enforcement response with the ML/TF risks; reform the SARs regime and enhance the U.K. FIU’s capacity; improve the consistency of supervision and information exchange between supervisors, law enforcement and the private sector; and improve the understanding of ML/TF risks across the regulated sectors. In addition, with respect to intelligence gaps, the National Crime Agency (NCA) adopted a strategy and action plan in December 2014 to tackle the specific threat of “high-end” ML.<sup>14</sup>

#### **Legislative framework<sup>15</sup>**

**15. Since the 2011 FSAP Update, several amendments to the AML/CFT legislative and regulatory framework have been adopted, and going forward, the authorities will transpose the Fourth EU AML Directive (4AMLD) by June 2017 to bring the framework in line with the 2012 FATF standard.**

**16. The Serious Crime Act 2015 substantially amended the asset recovery regime under the Proceeds of Crime Act (POCA) 2002.** In particular, these amendments intended to strengthen asset recovery, notably by making it easier to obtain freezing orders and extending POCA’s financial investigative powers to trace assets once confiscation orders have been made. POCA’s civil recovery regime was also enhanced by amendments introduced in the Crime and Courts Act 2013, especially with respect to recovering criminal property overseas. In addition, other provisions of the Serious Crime Act introduced a new “participation” offense and provided immunity from civil liability for making an SAR in good faith.

**17. The 2007 MLRs were amended in 2012 and 2015 to enhance the AML/CFT regulatory regime.** The amendments introduced a modest package of reforms. In particular, these amendments extended the definition of real estate agents to include those selling U.K. properties outside the U.K., enhanced the “fit-and-proper” requirements for MSBs and trusts and company service providers (TCSPs), and enabled law enforcement to impose fines upon failure to comply with a notice compelling information. In addition, the amendments also introduced information-sharing powers among supervisory authorities, subject to certain conditions, although further progress is needed in this area, as highlighted by the NRA. Finally, the most recent amendments, adopted in

<sup>14</sup> NCA: “High End Money Laundering – Strategy and Action Plan”, December 2014.

<sup>15</sup> The Small Business, Enterprise and Employment Act is discussed in Section IV on transparency of legal persons and arrangements.

2015, designated the Chartered Institute of Legal Executives (CILEx) as the supervisor for legal executives.<sup>16</sup>

**18. Since the 2007 mutual evaluation, the U.K. has also replaced the Terrorism (UN Measures) Order 2006 with the Terrorist Asset-Freezing Act (Tafa) 2010.** Tafa is the current implementing legislation for the United Nations Security Council Resolution (UNSCR) 1373 and successor resolutions.

**19. Going forward, the U.K. intends to transpose the 4AMLD<sup>17</sup> by June 2017.** The 4AMLD adopted in May 2015 intends to bring the EU legal framework in line with the revised FATF standard, while taking into account the European Commission's review of the implementation of the 3AMLD. The changes introduced in the 4AMLD include (i) measures to enhance the transparency of legal persons and arrangements, notably through central registers of beneficial ownership information (see Section IV); (ii) extending the application of enhanced CDD to domestic PEPs; and (iii) reducing the threshold for requiring CDD for high value dealers' transactions from €15,000 to €10,000. The U.K. expects to incorporate most of these changes by updating the 2007 MLRs. In addition, the accompanying Fund Transfer Regulation<sup>18</sup> will come into force in the U.K. in June 2017, which should improve the traceability of transfers of funds.

### Enhancing effectiveness

**20. While the NRA found that the law enforcement response to ML has been weak, reflecting in part a lower priority given to ML, the U.K. has taken a number of measures to address this.** One such measure was the establishment of the NCA in October 2013 to lead the efforts in combating serious and organized crime in the U.K. The Economic Crime Command (ECC) within the NCA is in charge of combating ML and hosts both the U.K. FIU, responsible for the receipt, analysis and dissemination of financial intelligence, and the Proceeds of Crime Centre, responsible for accreditation and monitoring of financial investigations in England, Wales, and Northern Ireland. In addition, the recent establishment of an International Corruption Unit (ICU) in May 2015 should enhance intelligence and law enforcement response in the area of overseas bribery and corruption.

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<sup>16</sup> Chartered legal executives are lawyers that have qualified by following one of the routes to qualification prescribed by the CILEx. They are subject to AML/CFT obligations to the extent that they fall within the scope of "independent legal professionals" under the 2007 MLRs.

<sup>17</sup> Directive (EU) 2015/849 of the European Parliament and of the Council of May 20, 2015, on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No. 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC – Official Journal of the European Union (L 141/73)

<sup>18</sup> Regulation (EU) 2015/847 of the European Parliament and of the council of May 20, 2015 on information accompanying transfers of funds and repealing Regulation (EC) No. 1781/2006 – Official Journal of the European Union (L 141/1)

**21. Reforming the SARs regime is identified as an area of priority in the NRA in light of deficiencies identified in the quality of reporting across a number of regulated sectors.**

A breakdown of SARs by regulated sectors shows inconsistent reporting, with the designated non-financial businesses and professions (DNFBPs)<sup>19</sup> significantly underrepresented. DNFBPs account for only 2.8 percent of all SARs submitted to the FIU in 2014, compared with 82 percent submitted by the banking sector alone. While the number of SARs submitted to the FIU has increased approximately 12 percent from 2013 to 2014, reaching 354,186 SARs in total, the focus should be on improving quality over quantity of reports.<sup>20</sup> In addition, shortcomings were identified with respect to “consent requests” under the Proceeds of Crime Act SARs regime. Businesses can request consent from the FIU to proceed with an activity/transaction raising significant ML concerns, which can form the basis of a defense against an ML charge. The FIU can refuse consent to allow law enforcement to take action. A recent Transparency International (TI) report highlights the potential for abuse by gaming the system, including through defensive reporting and offloading of due diligence requirements to the FIU.<sup>21</sup> The authorities have launched a Call for Information in February 2015 on how to enhance the SARs regime and should adopt measures to enhance the quality and consistency of reporting across regulated sectors.<sup>22</sup>

**22. Different initiatives have been pursued to enhance information exchange and cooperation between the regulators, law enforcement, and the financial sector.**

Among these initiatives is the Serious and Organised Crime Financial Sector Forum. It meets on a quarterly basis to facilitate practical collaboration between law enforcement, regulators, and the financial sector to disrupt serious and organized crime and facilitate asset recovery. Other similar initiatives include the Joint Money Laundering Intelligence Taskforce (JMLIT), set up in February 2015 as a 12-month pilot project. The task force provided a forum for law enforcement, regulators, and the financial sector to exchange information and intelligence on the current and emerging ML and economic crime threats faced by the financial sector and on how to detect, prevent, and disrupt these crimes.

## C. Conclusions and Recommendations

**23. The authorities have taken significant measures to enhance the AML/CFT legislative and regulatory framework since the U.K.’s 2007 mutual evaluation, and steps are being taken to bring the AML/CFT regime in line with the revised FATF standard.** Continuing to implement these initiatives will strengthen the AML/CFT regime going forward. In particular, the authorities should:

<sup>19</sup> Specifically, the accountants and tax advisers, independent legal professionals, trust or company service providers, real estate agents, high value dealers, and casinos.

<sup>20</sup> NCA: “Suspicious Activity Reports (SARs) Annual Report 2014”, December 11, 2014

<sup>21</sup> TI U.K.: “Don’t Look, Won’t Find: Weaknesses in the Supervision of the UK’s Anti-Money Laundering Rules,” November 2015

<sup>22</sup> Home Office: “Suspicious Activity Reports regime: call for information,” February 25, 2015

- **Adopt an AML/CFT strategy and action plan in line with the findings of the NRA.** The publication of the NRA in October 2015 was a welcome initiative to enhance the understanding of the ML/TF risks faced by the U.K. Addressing the intelligence gaps identified with respect to “high-end” ML will be key to developing a risk-based AML/CFT strategy going forward.
- **Reform the SARs regime to enhance the quality and consistency of reporting across regulated sectors.** Drawing from the NRA findings and the February 2015 Call for Information, the authorities should adopt measures to enhance the quality and consistency of reporting.
- **Transpose the 4AMLD, notably by updating the 2007 MLRs.**
- **Consider reviewing the AML/CFT supervisory model in light of the vulnerabilities identified in the NRA.** In particular, inconsistencies in supervision and enforcement of AML/CFT obligations across regulated sectors—FIs and DNFBPs—should be addressed, and a risk-based approach should be effectively implemented by each supervisor. In this context, the current AML/CFT supervisory regime, which comprises 27 supervisors including both public sector organizations and professional bodies, could be revisited.

## AML/CFT MEASURES IN THE BANKING SECTOR

### A. ML/TF Vulnerabilities in the Banking Sector

**24. The banking sector appears to be the channel most vulnerable to ML activity in the U.K. owing to its size and complexity, the range of products and services, the transaction volumes, and the sector’s interconnectedness with the international financial system.** The U.K. was the highest-ranked country in terms of both interconnectedness and composite rank in the IMF assessment of strategically important financial sectors.<sup>23</sup> It has the largest banking sector on a residency basis and relative to GDP, standing at around 450 percent in 2013 compared to 100 percent in 1975. Foreign banks constitute around half of the U.K. banking sector assets on a residency basis. Nearly a fifth of global banking activity is booked in the U.K.

**25. According to the U.K.’s NRA, although the true scale and origin of criminal proceeds placed in or moved through the U.K. is an intelligence gap, it is believed to be considerable.** Some non-governmental organizations estimate that between GBP 2,357 billion is laundered within and through the U.K. each year. The NCA assesses that hundreds of billions of U.S. dollars of criminal money almost certainly continue to be laundered through U.K. banks, including their subsidiaries, each year.<sup>24</sup>

<sup>23</sup> <http://www.imf.org/external/np/pp/eng/2013/111513.pdf>

<sup>24</sup> National Crime Agency, “National Strategic Assessment of Serious and Organised Crime 2015,” June 2015. <http://www.nationalcrimeagency.gov.uk/publications/560-national-strategic-assessment-of-serious-and-organised-crime-2015/file>.



**26. In the course of its assessments, thematic reviews and general casework undertaken since 2012, the FCA continues to see failings in a number of banks, including in relation to the assessment and management of higher-risk business.** The most common deficiencies in banks include:<sup>25</sup>

- Inadequate governance and oversight of ML risk;
- Inadequate risk assessment processes to identify high-risk customers, poor management of high-risk customers and those who are Politically Exposed Persons (PEPs), particularly in relation to establishing the source of wealth and source of funds for PEPs;
- Inadequate due diligence on correspondent banks;
- Inadequate or poorly calibrated AML/sanctions-related IT systems;
- Weaknesses in handling of alerts relating to sanctions and/or transaction monitoring; and
- Poor judgments or questionable decisions leading the firm to take on unacceptable ML risk.

Alongside these vulnerabilities, the authorities see developments beginning to emerge of which firms need to be mindful (e.g., mobile payments and virtual currencies).<sup>26</sup>

**27. According to the NRA, banks believe more work is required on understanding and developing AML/CFT risk assessments.** This is confirmed by findings from thematic supervisory work by the FCA, where the FCA found the quality of banks' client risk assessments to be weak. Many of the banks deemed to have weak risk assessments were also found to have little to no understanding of the vulnerabilities in their products, services, and distribution lines.

**28. Although the FCA's supervisory inspections continue to find weaknesses in financial firms' AML controls, the authorities deem that the situation is improving.** According to the authorities, some banks still have a substantial amount of work to do, and, in some cases, this will require significant investment, for example, to replace—or bring together—legacy systems. Consequently, many firms now have major remedial plans in place. For some of the larger firms, these will take several years to implement and there is often significant execution risk.

**29. Many banks, particularly large banks, now appear to recognize AML as an issue requiring senior management attention and a robust message from the top.** According to the authorities, private banks and wealth management firms are generally performing better on AML issues than retail and wholesale banks. Some firms with more effective AML/CFT controls have

<sup>25</sup> Financial Conduct Authority, "Anti-money Laundering Annual Report 2013/14". <https://www.fca.org.uk/your-fca/documents/corporate/anti-money-laundering-annual-report-13-14>

<sup>26</sup> <https://www.fca.org.uk/your-fca/documents/corporate/anti-money-laundering-annual-report-13-14>, p.12.

conducted gap analyses against its Financial Crime Guidance and other relevant sources of information, such as the Joint Money Laundering Steering Group's guidance.

## B. Risk-Based Supervision of the Banking Sector

**30. The FCA is the primary U.K. supervisor charged with combating the abuse of financial services in regulated financial services organizations including banks.** The Financial Services and Markets Act 2000 (FSMA) sets one of the FCA's operational objectives as protecting and enhancing the integrity of the U.K. financial system, which includes not allowing it to be used for financial crime.

**31. The effectiveness of firms' AML/CFT systems and controls remains a high priority for the FCA.** Since 2012, the FCA (and its predecessor, the Financial Services Authority) has strengthened its regulatory process in its efforts to improve compliance across banks. Specific actions include improving its understanding of the financial risk in firms; seeking to change behaviors in banks through its enforcement and supervisory early intervention work; enhancing its supervision (including more intrusive and risk-based supervision for both large and small firms); further thematic work into higher-risk situations; growing its specialist financial crime expertise; and better outreach and information sharing.

**32. The FCA has the authority needed to supervise compliance with its rules and enforce breaches; and to supervise all authorized firms that are subject to the U.K.'s 2007 MLRs.** The FCA estimates that some 15,000 firms are subject to the MLRs, of which 900 are deposit-taking institutions.

**33. The FCA conducts AML/CFT supervision on a risk basis.** In 2012, the FCA introduced the Systematic AML Program (SAMPLP), which provides for "deep dive" comprehensive testing of financial crime systems and controls across 14 major retail and investment banks operating in the U.K. The program operates on a four-year, rolling cycle. SAMLP on-site work in a bank lasts around three months and is intensive, involving detailed testing and extensive interviewing of key staff responsible for the bank's business and for implementing AML processes and controls. In addition to visiting U.K.-based operations, the FCA visits selected operations of U.K.-incorporated banks outside the EEA, where they are required to operate U.K.-equivalent AML standards. Institutions in the next band are subject to regular on-site visits on a two-year cycle. These visits last two–four days.

**34. In 2014, the FCA developed a new supervisory strategy to ensure it targets its resource more effectively and focuses on firms that present the highest ML risk, irrespective of their size.** All regulated firms are grouped into risk bands to reflect the overall ML/TF risk they present. Risk bandings consider a number of factors, such as, but not limited to, the nature of a firm's business, jurisdiction of the firms' controller, sector and customer base. The highest-risk firms are subject to either an extensive SAMLP assessment or a regular visit program.

**35. Firms in lower-risk categories are monitored by a combination of risk alerts, event-driven reactive supervision and thematic sector-wide reviews.** For firms in the lower-risk categories—which constitute the majority of firms but only represent 1–5 percent of the market share by volume—the FCA relies on periodic thematic reviews, and event-driven casework relating to suspected or crystallized ML risks. In addition to this, the FCA undertakes desk-based AML reviews. The FCA uses the results from its supervisory work to inform its overall assessment of firm risk, which in turn helps it position its resources most effectively.

**36. The FCA’s AML/CFT thematic work covers a broad range of higher financial crime risk situations.** The FCA’s sample size for thematic work is generally around 20–30 firms, selected to be broadly representative of the sector, product, or theme. A firm visit, depending on the size of the firm, will last from two to four days and will involve a combination of staff interviews and file reviews. Since 2012, the FCA has carried out thematic reviews into: *Banks’ controls of financial crime risks in trade finance* (2013),<sup>27</sup> *AML and ABC systems and controls: asset management and platform firms* (2013),<sup>28</sup> and *How smaller banks manage AML and Sanctions risks* (2014).<sup>29</sup> Examples of the good and poor practices identified during these reviews are incorporated in the FCA’s *Financial Crime: a guide for firms*.

**37. In addition to its regular inspection and thematic supervisory work, the FCA undertakes casework in response to apparent crystallized risk in individual firms.** Sources of information include self-reporting by firms, whistleblowers, intelligence from law enforcement and public domain information, such as press reports.

**38. In total, the FCA has carried out approximately 230 on-site AML review visits to banks since August 2012, which includes 17 visits to overseas foreign branches, subsidiaries, and central service centers.** During this period, it also undertook a further 186 desk-based AML reviews.

**39. Although the AML/CFT supervisory framework for higher-risk banks appears to be adequate, only time will tell whether it is so across the entire range of banks since the AML/CFT supervisory strategy has only recently been implemented.** Banks in the lower-risk categories are not subject to regular testing and instead are monitored based on information gathered through intelligence from law enforcement agencies, self-reporting by firms, complaints, whistleblowers, press reports, or through thematic reviews. Given that the FCA’s thematic reviews have identified significant problems with compliance and the appropriateness of internal controls in smaller firms, a question remains whether sufficient testing is done to ensure that all banks, and not solely those viewed currently as being in the highest-risk categories, have developed and implemented appropriate policies, procedures, controls, and training. At present, the backstop on

<sup>27</sup> <https://www.fca.org.uk/static/documents/thematic-reviews/tr-13-03.pdf>.

<sup>28</sup> <https://www.fca.org.uk/static/documents/thematic-reviews/tr13-09.pdf>.

<sup>29</sup> <http://www.fca.org.uk/news/tr14-16-how-small-banks-manage-money-laundering-and-sanctions-risk>.

which U.K. authorities depend for ensuring that lower-risk firms are effectively managing their ML risks appears to be limited.

## C. Penalties Regime

### 40. The FCA has sufficient powers to enforce banks' compliance with AML/CFT requirements.

Under the FSMA, the FCA may vary or cancel the bank's permissions to carry on regulated activities in various circumstances, including where the bank is failing, or is likely to fail, to satisfy threshold conditions (i.e., principles that set out minimum requirements for a firm's organization and structure), or where such variation is desirable in order to advance one or more of the FCA's operational objectives. Under FSMA, the FCA can furthermore issue private censures and impose unlimited financial penalties, and pursue criminal sanctions.

41. **The FCA also applies a risk-based approach to its enforcement case selection.** It targets resources strategically to achieve 'credible deterrence' in areas of greatest concern. By this, the FCA seeks the best means to change the behavior of those who are the subject of its actions and deter noncompliance by others. A new penalties regime was introduced in 2010. Since 2012, the FCA has taken formal enforcement action against nine firms and individuals in response to AML failings, with fines totaling approximately GBP 96 million (USD 140 million).<sup>30</sup> Furthermore, there are a number of ongoing enforcement investigations.

42. **Relative to the size of the banking sector, there have been few instances where fines have been imposed on banks for breaches of their AML obligations.** In January 2014, the FCA imposed a fine of GBP 7.6 million on a global bank for failings relating to its AML policies and procedures over corporate customers connected to PEPs. This was the first AML case that the FCA had brought that focused on commercial banking activity, and the first instance of the application of a higher fine allowed under the new penalties regime introduced in 2010. More recently, in November 2015, the FCA imposed a fine of GBP 72.1 million on a global bank for failure to adhere to a higher level of due skill, care and diligence regarding customers that are PEPs. The FCA has indicated that it is considering whether more cases should be referred for enforcement as a result of its AML specialist supervision work, in particular, its thematic review of smaller banks' AML and sanctions controls.<sup>31</sup> Moreover, even though the recent application of the new penalty regime to banks is a welcome development, only time will tell whether it will be applied in a sufficiently dissuasive manner across the entire range of banks. However, the FCA takes the view that financial penalties are not the only means by which it can deter non-compliance. Other tools include, for example, setting a firm and formal remedial plan, restricting certain types of higher-risk business until the weaknesses have been remedied, and seeking formal attestations from senior management

<sup>30</sup> The total includes a fine of GBP 72.1 million imposed on a global bank in 2015 for serious failure to manage ML risk, and one of GBP 7.6 million imposed on another global bank in 2014 for failings relating to its AML policies and procedures over corporate customers connected to politically exposed persons—the first AML case that the FCA had brought that focused on commercial banking activity, and the first instance of the application of a higher fine allowed under the new penalty regime introduced in 2010.

<sup>31</sup> <https://www.fca.org.uk/your-fca/documents/corporate/anti-money-laundering-annual-report-13-14>, p.10.

that controls have been strengthened. The FCA has indicated that it has taken such measures in the past.

## D. Conclusions and Recommendations

**43. The AML/CFT supervisory framework for higher-risk banks appears to be adequate, however only time will tell whether it is so across the entire range of banks since the AML/CFT supervisory strategy has only recently been implemented.** The FCA has developed a new supervisory strategy to better focus on firms that present the highest ML risk, irrespective of their size, but the backstop on which it depends for ensuring that lower risk firms are effectively assessing and managing their ML risks appears to be limited.

**44. There have been few instances where fines have been imposed on banks for breaches of their AML obligations since the introduction of the new penalties regime in 2010.** It is unclear whether it will be applied in a sufficiently dissuasive manner across the entire range of banks. However, the FCA takes the view that financial penalties are not the only means by which it can deter non-compliance, and other means have been used to pursue that objective.

**45. Going forward, the authorities should:**

- **Determine whether the supervisory attention given to banks in the lowest-risk categories is sufficient to ensure they are effectively assessing and managing their risks;** and
- **Determine whether more cases should be referred for enforcement,** particularly given the results of the FCA's thematic review of smaller banks' AML and sanctions controls.

# TRANSPARENCY OF LEGAL PERSONS AND ARRANGEMENTS

## A. U.K. Corporate Landscape

**46. The most common types of legal persons and arrangements in the U.K. are companies, partnerships, and trusts.** While other forms of legal entities exist in the U.K.,<sup>32</sup> the most common are companies and partnerships. Under the Companies Act (2006), companies can be public or private, and limited or unlimited.<sup>33</sup> Partnerships with legal personality include Scottish partnerships, Scottish limited partnerships (SLPs) and limited liability partnerships (LLPs), whereas partnerships without legal personality include traditional partnerships and limited partnerships (LPs).<sup>34</sup> The most common form of legal arrangement in the U.K. is the common law trust.

**47. The U.K. has seen an increase in the number of companies, LPs, and LLPs over the past few years. As of November 2015, the number of companies and LLPs registered with Companies House amount to over 3.6 million and 59,000, respectively.**<sup>35</sup> This represents an increase of almost 30 percent for companies and around 18 percent for LLPs since November 2011. However, the highest percentage increase has been observed with respect to LPs, which increased by over 72 percent since 2010/11, reaching 32,398 in 2014/15. In particular, SLPs have more than doubled in the same time-period (*Figure 1*). While there are no statistics for the number of express trusts formed in the U.K., conservative estimates suggest that their number is between 1.5 to 2 million.<sup>36</sup>

<sup>32</sup> Other forms of legal entities include Friendly Societies, Building Societies, and Industrial and Provident Societies (IPS). In addition, transnational companies include Societas Europaea (SE), European Economic Interest Grouping (EEIG), Open-Ended Investment Company (OEIC), and Societas Cooperativa Europa (SCE).

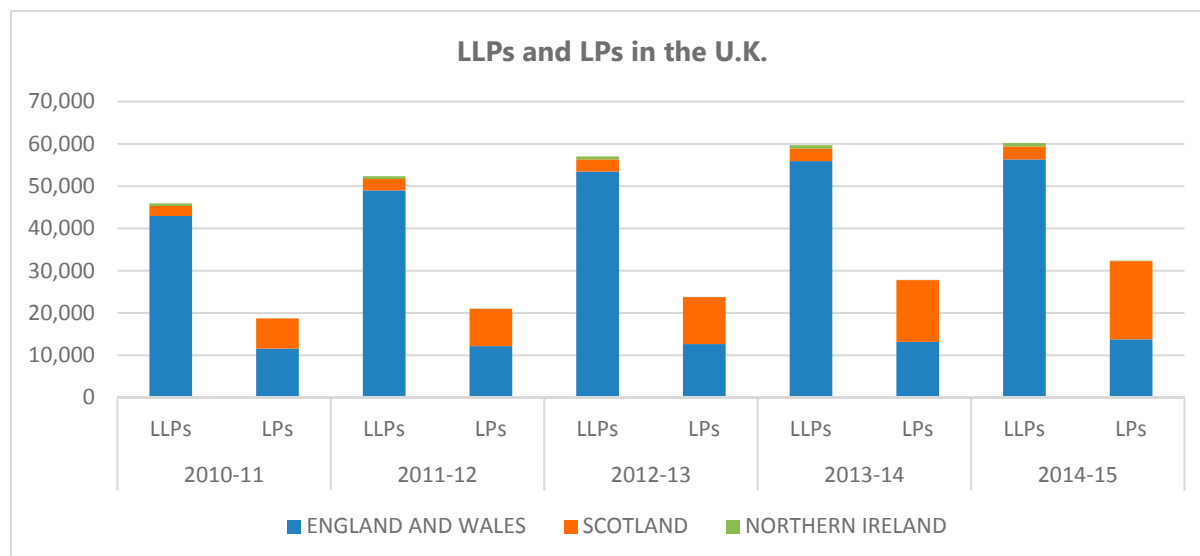
<sup>33</sup> More specifically, Companies Act (2006) companies include private company limited by shares, private company limited by guarantee, private unlimited company, and public limited company (Part I, sections 3 and 4). Among the private companies, limited companies far outnumber unlimited companies (Source: Companies House). Non-Companies Act (2006) companies also exist and are those formed by Act of Parliament, or by Royal Charter.

<sup>34</sup> The scope of liability varies depending on the type of partnership.

<sup>35</sup> Companies House – Incorporated companies in the United Kingdom November 2015.

<sup>36</sup> Source: U.K. ML/TF NRA.

**Figure 1. United Kingdom: LLPs and LPs Registered with the Companies House between 2010 and 2015**



Source: Companies House – Company Register Activities in the United Kingdom 2014/2015 MS Excel Spreadsheet.

## B. ML Risks Involving the Misuse of Legal Persons and Arrangements

**48. Criminals are known to misuse legal persons and arrangements for the purpose of laundering illicit proceeds.** Legal persons and arrangements can facilitate the movement of large sums of money without attracting the same level of attention or suspicion as a natural person. In addition, complex corporate structures can obfuscate the identity of the ultimate beneficial owner or purpose of the transaction, hindering the detection, investigation and prosecution of illicit activity. The misuse of corporate vehicles has been well documented, notably by the Organisation for Economic Co-operation and Development (OECD),<sup>37</sup> the World Economic Forum (WEF),<sup>38</sup> and the World Bank (WB).<sup>39</sup>

**49. The U.K. NRA highlighted ML risks involving the misuse of legal persons and arrangements.** In the U.K., most investigations into ML conducted by HMRC and the Serious Fraud Office (SFO) involve the misuse of corporate structures.<sup>40</sup> Corporate structures identified in the NRA as particularly vulnerable include “shell” companies, “off the shelf” companies and “dormant” companies, with case examples also illustrating the misuse of offshore companies and trusts. In addition, some forms of partnerships, such as LPs and SLPs, are deemed less transparent due to

<sup>37</sup> OECD: “Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes”, 2001.

<sup>38</sup> WEF – Global Agenda Council on Organized Crime: “Organised Crime Enablers”, July 2012.

<sup>39</sup> WB: “The Puppet Masters: How the Corrupt Use Legal Structures to Hide Stolen Assets and What to Do About It”, October 2011.

<sup>40</sup> Source: UK ML/TF NRA.

lighter reporting obligations and as they are shielded from investigation under the 1985 Companies Act.<sup>41</sup> The NRA also recognized the risk posed by bearer shares, as the owner of a bearer share did not have to be entered into the company's register of members.

**50. Bearer shares, nominee directors, and corporate directors can be exploited to conceal corporate ownership and control and, as such, are exposed to ML risk.** Bearer shares are negotiable instruments, the ownership of which passes with the bearer share certificate. As such, individuals holding bearer shares do not appear on the shareholder register of a company, providing a higher degree of anonymity and making these arrangements attractive for ML. A corporate director is a legal person and a nominee director is a non-executive director who acts on behalf of another natural or legal person who effectively exercises control.<sup>42</sup> These arrangements can be exploited to conceal the identity of the individual who ultimately exercises control over the corporate entity as the register of directors only provides information on the corporate or nominee director.

**51. Legal persons and arrangements often play a key role in facilitating "high-end" ML.** "High-end" ML typically refers to the laundering of proceeds of large-scale fraud and serious corruption through the financial, real estate, and professional services sectors. In particular, a recent TI report on beneficial ownership of U.K. property<sup>43</sup> found that over 75 percent of properties in the U.K. under investigation by the Metropolitan Police's Proceeds of Corruption Unit (POCU) are owned through a company incorporated in a "secrecy jurisdiction."<sup>44</sup> The report also finds that among the companies that hold properties under POCU investigation, 79 percent are incorporated in a Crown Dependency (CD) or Overseas Territory (OT).<sup>45</sup> There are currently intelligence gaps with respect to "high-end" ML, which the NCA is committed to addressing.<sup>46</sup> While in the past, law enforcement has focused on combating cash-based ML, the NRA recognizes that more needs to be done to understand the threat posed by "high-end" ML and the role played by professional enablers in facilitating these activities.

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<sup>41</sup> In particular, SLPs have recently received increased attention due to allegations that this legal entity type was used in a complex ML scheme involving the US\$1 billion bank fraud in Moldova. (e.g., BBC: "Scam sparks Scots fraud haven fears", June 19, 2015; BBC: "The billion-dollar ex-council flat", October 7, 2015).

<sup>42</sup> There is no legal definition of "nominee" director, and they are also referred to as "front" directors.

<sup>43</sup> Transparency International UK: "Corruption on Your Doorstep – How Corrupt Capital is Used to Buy Property in the UK", February 2015.

<sup>44</sup> The term used in the TI report is borrowed from Richard Murphy's "Defining the Secrecy World: Rethinking the language of 'offshore'" ([www.financialsecrecyindex.com](http://www.financialsecrecyindex.com)), February 16, 2015.

<sup>45</sup> Specifically, 49 percent in Jersey, 15 percent in the Isle of Man, 10 percent in the BVI and 5 percent in Gibraltar.

<sup>46</sup> UK ML/TF NRA and NCA: "High End Money Laundering: Strategy and Action Plan", December 2014.



## C. Transparency of Legal Persons and Arrangements: Overview of the Current Framework

### 52. To mitigate the risks aforementioned, law enforcement relies on different sources of information to establish beneficial ownership and control of legal persons and arrangements.

In particular, these include information (i) maintained in the central register of companies, Companies House; (ii) filed with tax authorities, Her Majesty's Revenue and Customs (HMRC); (iii) obtained through regulated entities subject to AML/CFT obligations, financial institutions and DNFBPs; and (iv) kept with the legal person or arrangement itself.

### 53. The main source of legal ownership and control information for legal entities is

**Companies House.** Companies House is an executive of the Department of Business, Innovation and Skills. It is responsible for incorporating and dissolving limited companies, registering information provided under legal requirements, and making such information publicly available. The corporate entities that are required to register with Companies House include limited companies, LPs, LLPs, overseas companies with some degree of physical presence in the U.K.,<sup>47</sup> European economic interest groupings (EEIGs), and Societas Europaea (SEs). Although Companies House comprises the company registrars for England and Wales, Northern Ireland and Scotland, companies registered in Jersey, Guernsey and the Isle of Man (who as CD are not part of the U.K.) are excluded from the U.K. Companies Register.

### 54. The top three legal entity types registered with Companies House are private limited companies, LLPs, and LPs (which include SLPs).

Together they account for 99 percent of the legal entity types registered with Companies House, with private limited companies accounting for over 96 percent alone.<sup>48</sup> These three entity types are subject to varying registration and disclosure requirements, making different levels of ownership and control information available both directly in Companies House or indirectly through inspection of information kept with the legal entity itself. Failure to comply with registration and disclosure requirements amounts to an offense under the relevant acts.

### 55. All Companies Act companies must submit information on their directors and members upon registration with Companies House and must comply with disclosure requirements.

Registration of companies must include, in addition to the articles of association and a registered office, information on the directors and, depending on the type of company, information on the initial shareholders or guarantors at the time of incorporation—hereafter referred to as the members.<sup>49</sup> Every company must keep a register of its directors and members available for inspection. Any changes must be recorded in the registers within 14 days, and in the

<sup>47</sup> Companies Act 2006, Part 34 – companies incorporated outside the U.K. that have registered a U.K. establishment(s).

<sup>48</sup> Companies House: “Statistical release – Companies Register Activities 2014/15”, August 2015.

<sup>49</sup> Companies Act 2006: Sections 9–12.

case of changes to the register of directors, the company must notify Companies House. In addition, companies are also required to file an update of its registered shareholders and the number of shares they hold on an annual basis<sup>50</sup> in the form of annual returns and now through a confirmation statement.<sup>51</sup>

**56. Although LLPs and LPs must also be registered with Companies House, partnerships are generally subject to lesser scrutiny than companies.** To register as an LLP or an LP, the names of each of the members of the partnership must be provided—in the case of an LP, this includes both the names of each general partner, as well as the names and amount of capital contributed by each limited partner; and in the case of LLPs, addresses must also be provided. Companies House must also be notified of any membership changes of a LLP or LP within 14 days.<sup>52</sup> While LLPs are required to file annual returns to Companies House<sup>53</sup> similarly to companies, LPs are not subject to annual disclosure obligations. Traditional partnerships under the Partnership Act are not registered with the Companies House, although they may need to register with HMRC.

**57. In contrast to information on legal ownership and control, access to adequate, timely and accurate beneficial ownership information was found to be lacking by the U.K.'s mutual evaluation.** While the registration and disclosure regimes with the Companies House account for legal ownership of companies and certain legal entities, notably through the registers of directors, partners and shareholders, the lack of requirement to hold or disclose beneficial ownership information was identified as a vulnerability in the 2006 assessment. Where beneficial ownership information could not be obtained through regulated entities under AML/CFT obligations, law enforcement's efforts to tackle ML and asset recovery were hindered.

**58. There is no central register for express trusts, although they may be required to register with HMRC for tax purposes.** To the extent that the trust, through its assets, settlor or trustee(s), incurs domestic tax liability, information on the trust will have to be filed with HMRC. By registering with the HMRC and submitting tax returns, information on the beneficiaries of the trust should be available. In addition, trustees are under a common law obligation to have information on the purpose, assets, and beneficiaries of the trust. Notwithstanding, the 2006 U.K. assessment found that the measures in place were lacking to ensure timely and adequate access to accurate and up-to-date information on beneficial ownership and control of trusts.

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<sup>50</sup> U.K.-traded companies need only provide the names and addresses of persons holding more than 5 percent of shares.

<sup>51</sup> Small Business, Enterprise and Employment Act 2015, section 92, replaces Part 24 of the Companies Act 2006 (annual return).

<sup>52</sup> Limited Liability Partnerships Act 2000: sections 2 and 8; Limited Partnership Act 1907: Sections 8 and 9.

<sup>53</sup> 2009 LLP Regulations, Part 8.

## D. Enhancing the Transparency of Legal Persons and Arrangements: G-8 Commitments, 2015 Legislative Reforms and 4AMLD

**59. As part of the 2013 U.K. G-8 Presidency, the authorities have committed to improving the transparency of companies and legal arrangements.** For this purpose, the U.K. adopted an Action Plan in July 2013 setting out concrete steps to prevent the misuse of companies and legal arrangements.<sup>54</sup> These steps include requiring companies and trustees of express trusts to obtain and hold adequate, accurate, and current beneficial ownership information and ensuring that competent authorities have access to this information—in the context of companies, through the establishment of a central registry. In addition, the U.K. has also committed to reviewing corporate transparency, including the use of bearer shares and nominee directors. These commitments have since been reaffirmed by the Prime Minister in his 2015 Singapore speech on tackling corruption,<sup>55</sup> where he called for a “new era of corporate transparency in Britain.”

**60. In 2015, the U.K. introduced a comprehensive reform package to enhance entity transparency in the form of the Small Business, Enterprise and Employment Act (SBEE Act).** Among the key reforms, and in line with the U.K.’s 2013 G-8 commitments, the SBEE Act establishes a register of people with significant control (PSC) and abolishes bearer shares. In addition, other measures include prohibiting the appointment of corporate directors subject to some exceptions,<sup>56</sup> simplifying filing requirements by replacing the obligation to file an annual return with a confirmation statement and strengthening the fit-and-proper requirements for directors by ensuring that individuals are disqualified for certain convictions abroad.<sup>57</sup> While the authorities reviewed the use of nominee directors, after consultation<sup>58</sup> no disclosure requirements were introduced to enhance the transparency of these arrangements.

**61. The SBEE Act establishes a PSC register to enhance transparency of beneficial ownership and control of companies.**<sup>59</sup> As such, companies will be required to start holding a register of PSCs as of April 6, 2016, and file this information with Companies House from June 30,

<sup>54</sup> <https://www.gov.uk/government/publications/uk-action-plan-to-prevent-misuse-of-companies-and-legal-arrangements>.

<sup>55</sup> Prime Minister Cameron’s Speech in Singapore on Tackling Corruption – July 2015.

<sup>56</sup> Previously, companies were required to have at least one director who is a natural person – Companies Act 2006: Section 155.

<sup>57</sup> SBEE Act: sections 84, 81 and 85, respectively.

<sup>58</sup> Department for Business Innovation and Skills: “Transparency and Trust: Enhancing the Transparency of UK Company Ownership and Increasing Trust in the UK Business” – Discussion Paper, July 2013, and Government Response, April 2014.

<sup>59</sup> Companies subject to Chapter 5 of the FCA’s Disclosure Rules and Transparency Rules sourcebook are exempt from PSC register requirements under the SBEE Act and, after consultation, the authorities also intend to exclude from the PSC register U.K.-registered companies listed on a regulated market in a European Economic Area (EEA) state and those listed on certain markets in Japan, the U.S., Switzerland, and Israel.

2016. The scope of the PSC regime will also include LLPs and SEs.<sup>60</sup> Significant control over a company is defined under the SBEE Act as meeting one (or more) of the following five conditions: holding, directly or indirectly, more than 25 percent of shares, or voting rights; holding the right, directly or indirectly, to appoint or remove a majority of the board of directors; having the right to exercise, or actually exercise, significant influence over the company; or having significant control over a trust or firm. Although the PSC is by definition a natural person, legal persons can be entered in the PSC register where it is found to be relevant and registrable under the SBEE Act—i.e., where the legal entity keeps its own PSC register<sup>61</sup> and is the first relevant legal entity in the ownership chain.

**62. While the PSC register is a welcome development, some changes may need to be made to transpose the 4AMLD.** LLPs and SEs will be subject to the same obligations as companies with respect to PSC, with modifications on the definition of “significant control” for LLPs to reflect their specific features. Notwithstanding, the scope of the PSC register will still fall short of the scope required under the 4AMLD, which calls for a central register of all corporate and legal entities. In this context, the U.K. will also need to include SLPs under the scope of the PSC register, as these have separate legal personality. In addition, while corporate entities are expected to file their PSC information together with their confirmation statement—which replaces the annual returns<sup>62</sup>—the 4AMLD requires that the information held in the central register is current.

**63. Abolishing bearer shares enhances transparency of corporate ownership and addresses concerns identified by the U.K. 2007 mutual evaluation.** Although the authorities reported at the time of the assessment that the issue and use of bearer shares in the U.K. was rare, the provisions of the SBEE Act abolishing these types of shares will undoubtedly enhance transparency of corporate ownership. No bearer shares may be issued effective May 2015, and existing bearer shares must be surrendered by February 2016.<sup>63</sup>

**64. Imposing disclosure requirements for nominee directors would enhance transparency of corporate control.** As part of the U.K.’s G8 commitments, the authorities reviewed the use of nominee directors and considered different options to enhance the transparency of these arrangements. After consultation,<sup>64</sup> the authorities opted for measures enhancing communication on directors’ obligations, promoting early intervention preceding potential misconduct, and tightening

<sup>60</sup> Department for Business Innovation and Skills: “The Register of People with Significant Control: Scope, nature and extent of control, fees, the protection regime and warning and restrictions notices”, June 2015.

<sup>61</sup> A legal entity is also “relevant” for the purposes of the PSC register if it is a company exempt from PSC register requirements – see footnote 58.

<sup>62</sup> The confirmation statement replaces the annual returns under the SBEE Act’s “check and confirm” process. In addition, a statement of initial PSC will also be required upon incorporation.

<sup>63</sup> Nine months from May 26, 2015 – SBEE Act: Schedule 4, section 1(2).

<sup>64</sup> Department for Business Innovation and Skills: “Transparency and Trust: Enhancing the Transparency of UK Company Ownership and Increasing Trust in the UK Business” – Discussion Paper, July 2013, and Government Response, April 2014.

enforcement of directors' statutory duties. While these measures should assist in addressing unwitting and "irresponsible" (nominee and shadow) director misconduct,<sup>65</sup> it is unclear to what extent they would prevent the willful misuse of nominee director arrangements for ML purposes. In this context, additional measures should be considered to mitigate the ML risks posed by the use of nominee directors. Specifically, the authorities are encouraged to revisit the possibility of establishing a register of nominee directors and those on whose behalf they operate,<sup>66</sup> notably with respect to TCSPs that act as nominee directors.<sup>67</sup>

**65. While recent reforms have focused on legal persons, transposing the 4AMLD will require steps to be taken to enhance the transparency of express trusts.**<sup>68</sup> The 4AMLD introduces a number of requirements to improve the transparency of express trusts. In particular, it requires trustees to obtain and hold adequate, accurate, and up-to-date information on beneficial ownership, including on the identity of the beneficiaries of the trust and on any natural person who exercises effective control. In addition, the new directive requires trustees to disclose their status and provide information on the beneficial ownership of the trust when engaging with regulated entities subject to AML/CFT obligations. Finally, the 4AMLD also requires that countries set up an accurate and up-to-date central register of beneficial ownership of express trusts where these give rise to tax liability. As with other provisions of the 4AMLD, the authorities have until June 2017 to transpose these measures.

## E. Strengthening Compliance of Trust or Company Service Providers (TCSPs)

**66. TCSPs have an important role to play in preventing the misuse of legal persons and arrangements.** Although companies may be incorporated directly with the Companies House, about three quarters of overall new companies in 2012/13 were incorporated through a third party.<sup>69</sup> In addition to incorporations, services provided by TCSPs also include acting as a director, partner, or nominee shareholder to a company or partnership and providing a registered office for the corporate entity.<sup>70</sup> As such, these services are exposed to risks and can be exploited, wittingly or

<sup>65</sup> The SBEE Act extends the application of directors' general duties to shadow directors – section 89.

<sup>66</sup> The FATF standard calls for countries to take measures to prevent the misuse of nominee directors (Rec.24), and provides as examples of such measures imposing disclosure requirements to identify the person on whose behalf the nominee director is acting, or imposing a licensing regime for nominee directors (Rec.24: Interpretative Notes).

<sup>67</sup> As noted in the NRA, law enforcement investigations have found TCSPs acting as nominee directors of several corporate entities.

<sup>68</sup> 4AMLD, Art. 31.

<sup>69</sup> Source: UK ML/TF NRA.

<sup>70</sup> 2007 MLRs, section 3(10): "Trust or company service provider" means a firm or sole practitioner who by way of business provides any of the following services to other persons—(a) forming companies or other legal persons; (b) acting, or arranging for another person to act—(i) as a director or secretary of a company; (ii) as a partner of a partnership; or (iii) in a similar position in relation to other legal persons; (c) providing a registered office, business address, correspondence or administrative address or other related services for a company, partnership or any other

unwittingly, to facilitate ML, and notably “high-end” ML. In particular, in the context of several investigations, law enforcement has identified TCSPs acting as nominee directors for a number of limited companies.

**67. TCSPs fall within the regulated sectors subject to the 2007 MLRs.** As such, they are required to conduct CDD, keep records, and report suspicious activity to the FIU. In particular, in conducting CDD, TCSPs are expected to identify and verify their customer’s identity, as well as the identity of the beneficial owner where different from the customer. Where the customer is a legal person or arrangement, the TCSP must take adequate measures to understand its ownership and control structure. These measures must be applied when establishing a business relationship, carrying out an occasional transaction (amounting to €15,000 or more), where an ML/TF suspicion arises, or where there is doubt as to the veracity of the information provided. In addition, as a regulated sector, TCSPs must comply with fit-and-proper requirements, as specified in the regulations.<sup>71</sup>

**68. Supervision of TCSPs is fragmented, resulting in inconsistent monitoring and enforcement of AML/CFT obligations.** Due to the diverse nature of the services provided by TCSPs, other regulated entities can also provide these types of services, including lawyers, accountants, and financial service providers. Each of these sectors fall within the purview of one or more supervisors,<sup>72</sup> with the default supervisor for TCSPs being HMRC. One of the consequences of this fragmented supervision is that, at the time of the NRA, the total number of registered TCSPs operating in the U.K. was unknown. In this context, ensuring consistent compliance with AML/CFT obligations and enforcing fit-and-proper requirements across TCSPs can prove challenging.

**69. The number of SARs received from TCSPs and related sectors do not reflect the risks identified in the NRA.** Among the U.K.’s ML risk assessment of the regulated sectors, both the structural and overall risks of accountancy and legal service providers were rated as high, while the structural and overall risk of TCSPs was rated as medium. In contrast, the SARs reported by these sectors represent less than 3 percent of all SARs received between October 2013 and September 2014, with the TCSP sector showing the lowest reporting rate of the three, representing 0.05 percent of the total (or 177 SARs).<sup>73</sup> While the specific scale of misuse of TCSP could not be

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legal person or arrangement; (d) acting, or arranging for another person to act, as—(i) a trustee of an express trust or similar legal arrangement; or (ii) a nominee shareholder for a person other than a company whose securities are listed on a regulated market, when providing such services.”

<sup>71</sup> 2007 ML Regulations, section 28.

<sup>72</sup> The main supervisory bodies for sectors that provide TCSP services include the FCA, the Association of Chartered Certified Accountants, the Institute of Chartered Accountants of England and Wales, the Institute of Chartered Accounts of Scotland, the Institute of Chartered Accountants in Ireland, the Association of Accounting Technicians, Chartered Institute of Management Accountants, Chartered Institute of Taxation, International Association of Bookkeepers, Institute of Financial Accountants, Institute of Certified Bookkeepers, Law Society (source: <https://www.gov.uk/guidance/money-laundering-regulations-trust-or-company-service-provider-registration>).

<sup>73</sup> National Crime Agency: “Suspicious Activity Reports (SARs) Annual Report 2014”, July 28, 2015.

ascertained in the NRA due to intelligence gaps, the lack of adequate AML/CFT controls contributes to the risks in the sector.

## F. Conclusions and Recommendations

**70. The U.K.'s G-8 commitments and recent legislative reforms to enhance entity transparency are welcome, while additional steps should be taken to enhance availability of beneficial ownership and control information across a broader range of legal entities and arrangements.** Since the 2007 mutual evaluation of the U.K., the authorities have adopted significant reforms to enhance transparency of legal persons, notably by establishing the PSC register, and abolishing bearer shares and corporate directors. Going forward, the authorities should consider:

- **Adopting a risk-based approach to preventing the misuse of legal persons and arrangements** as understanding of “high-end” ML deepens and as intelligence gaps are addressed. In particular, further understanding the ML risks posed by different types of legal persons and arrangements, including foreign legal person and arrangements, could also inform actions going forward.
- **Considering measures to enhance transparency of foreign legal entities and arrangements.** In last year’s Singapore speech on tackling corruption, the PM referred to enhancing transparency of foreign companies investing in the U.K. As a first step, the authorities could consider bringing foreign companies required to register with the Companies House within the scope of the PSC register.
- **Imposing disclosure requirements on nominee directors,** either through a central register or a licensing regime. In particular, disclosure requirements should be imposed on TCSPs that act as nominee directors.
- **Enhancing AML/CFT compliance of the TCSP sector.** Strengthening compliance with AML/CFT controls in the TCSP sector should enhance the availability and quality of beneficial ownership information that can be accessed by law enforcement. In addition, enforcing adequate fit-and-proper requirements should safeguard the sector against criminals.
- **Enhancing the transparency of express trusts, notably by transposing the 4AMLD.** In particular, competent authorities should have access to adequate, timely and accurate information on the beneficial ownership and control of express trusts. Effectively implementing the requirements on express trusts of the 4AMLD will help in this regard.