W.I.R.E Debates: Law Commission Proposals on Suspicious Activity Reporting

JULY 15, 2019

An earlier version of this article was published by Thomson Reuters on 8 July 2019.

The UK Law Commission has published a report[1] criticising existing anti-money laundering legislation and providing recommendations to improve the quality of Suspicious Activity Reports (SARs). What should we make of these recommendations, and do they go far enough? **Fred Saugman** and **Lloyd Firth** present their views.

The background

The SAR regime is designed to be one of the UK's chief AML tools, providing intelligence about suspected money laundering to law enforcement agencies and shielding the reporting entities from criminal liability. It operates by way of required disclosures (those operating in the regulated sector are obliged to raise suspicions about potential money laundering, with a failure to do so a criminal offence) and authorised disclosures (individuals who suspect they are dealing with the proceeds of crime can seek consent to complete a transaction by disclosing their suspicions, benefiting from a defence to a principal money laundering charge). The UK Financial Intelligence Unit (UKFIU) – which sits within the National Crime Agency – receives, analyses and distributes SARs.

The primary aim of the Law Commission's report was to address systemic problems in the SAR process to ensure that it is proportionate and efficient. In doing so, it attempts to perform a delicate balancing act between the interests of those who report suspicions, law enforcement agencies and the subjects of SARs (the bank customer whose account is frozen, for example).

In practice, the SAR regime has some significant issues, the biggest of which is the receipt of a large volume of poor-quality SARs by law enforcement agencies which the agencies struggle to analyse and investigate effectively. So-called 'defensive over-reporting' by businesses arises for several reasons, including the low threshold for suspicion, confusion amongst compliance professionals as to the nebulous concept of suspicion, the personal criminal liability of the reporter, and the application of the regime to money laundering arising from any crime, not just serious ones. Not only does this generate a heavy compliance burden for the reporting firm, but it can also cause significant harm to the subjects of SARs, particularly when the proceeds of crime become mixed

with ‘clean funds’ and entire customer bank accounts are frozen, regardless of the value of the suspected criminal property (sometimes only a single transaction).

The report makes 19 recommendations aimed at addressing these issues. Notably, these include the issuance of statutory guidance for business in the regulated sector covering the threshold for suspicion and what constitutes a ‘reasonable excuse’ for not making a SAR, the introduction of a prescribed online format for SARs, and amending the Proceeds of Crime Act 2002 (POCA) to permit the ring-fencing of suspected criminal property in mixed funds.

Fred Saugman: proposals that fall short of a meaningful remedy

Assuming the Commission’s recommendations are followed, reporters will benefit from greater clarity on the circumstances in which an authorised disclosure may be necessary. The quality of reports should be improved by the use of a structured form, which will also be easier and quicker for the NCA to process. However, it is clear the Law Commission has recommended the path of least resistance and has only indirectly addressed the issues it highlighted as the most damaging.

The report notes that around 15% of authorised disclosure SARs did not meet the threshold of suspicion, defined by case law as a possibility that is “more than fanciful”. In its report, the Law Commission considered the merits of raising this bar to one of “reasonable suspicion”. According to the final report, if this measure had been used, only 53.4% of disclosures would have met the threshold in this time period. However, having identified the low threshold for suspicion as a cause of poor-quality reports, and having considered the merits of raising the threshold, the Commission nevertheless recommended retaining the current definition pending a review by the yet to be established Advisory Board.

The report notes that issues with the volume and quality of reports are exacerbated by a lack of clarity over individual reporting obligations. In part, this is the result of a broad definition of “criminal property”, which includes any person’s benefit from any crime whenever it was committed (known as the “all crimes” approach). Having highlighted the “all-crimes” approach as a further major contributor to high volume, poor quality reports, the Commission recommended maintaining this definition, rather than enhancing the seriousness of the types criminal conduct that could be deemed to generate criminal property under POCA.

Finally, according to Commission, the risk of personal liability for reporters promotes defensive over-reporting, partly accounting for the high volume of SARs. Despite recognizing this weakness in the regime, the Commission declined the opportunity to recommend replacing personal liability with a corporate offence.

Although the Law Commission report provides good reasons for these recommendations, its cautious approach may have a limited effect on the problems of high-volume, low-quality reports that it seeks to address.

Lloyd Firth: proposals that are a decent, if long overdue start

That those in the regulated sector, and indeed elsewhere, grappling daily with POCA are still waiting

for statutory guidance to be published on its key definitions some 17 years after it was first enacted is lamentable, but the Law Commission's recommendation for formal guidance to be published is better late than never.

It is true that the Law Commission's data-driven proposals offer evolution, rather than the revolution some had ambitiously hoped for. The Commission's earlier Consultation Paper on the SAR regime was criticised for doing little more than tweaking a regime in supposed dire need of a comprehensive overhaul. Those advocating for an overhaul struggle, however, to articulate what an alternative regime would look like or how it would operate in practice. There is no silver bullet and the Commission's recommendations – pragmatic steps focused on practical reform within the current legislative system – ought to be adopted by the Government.

Many of the Commission's recommendations are commendable. For example, one proposal put forward in the report is that POCA be amended to create an exemption to allow criminal property to be ring-fenced by credit and financial institutions, negating the prevailing orthodoxy that the pooling of legitimate and illicit funds transforms the whole into criminal property. Were it to be adopted, this recommendation would be welcomed by both the subjects of authorised disclosures (who must bear the devastating economic consequences of having their whole accounts frozen) and by the financial institutions who face significant litigation risk for freezing whole client accounts, even for a limited time period.

Though falling outside the remit of the Law Commission's report, the inescapable truth is that if the Government regards AML efforts as a priority then it needs to commit to properly resourcing the UKFIU. In principle there is nothing wrong with the Government's stance that an effective 'public-private-partnership' between law enforcement agencies and the UK's regulated financial sector is the best way to tackle financial crime, with the regulated sector held jointly responsible for combatting money laundering. But if there is to be a successful partnership, both partners must effectively contribute and hold up their end of the bargain. Complying with reporting obligations is expensive. UK Finance estimates that the banking and finance industry is spending at least £5 billion annually on core financial crime compliance. The Government must commit more resources to allow the UKFIU to efficiently analyse and follow up on SARs, both by recruiting and training more analysts and case officers and, critically, by investing in burgeoning AI technologies well suited to the data-laden SARs environment.

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[1] Anti-money laundering: the SARs regime. The Law Commission, published 18 June 2019.

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