

# Tough on money laundering...and on the EU: UK authorities chart their course on AML policy

The trend of tough enforcement by UK anti-money laundering ("AML") authorities has continued in recent weeks. The Financial Services Authority ("FSA") has taken further action and the Office of Fair Trading ("OFT") has imposed its first significant fine for breaches of the Money Laundering Regulations 2007 ("MLR"). The UK's commitment to tough deterrence has also been underlined by HM Treasury's ("HMT's") review of MLR, which has resulted in the retention of criminal sanctions for breaches and the bolstering of accompanying regulatory powers. At the same time, the UK response to EU proposals shows that it is resistant to delegating responsibility for developing policy to EU institutions.

## UK: Changes to the Money Laundering Regulations 2007

When MLR came into effect in December 2007, HMT committed to reviewing how they were operating in practice two years later. Following that review, undertaken during 2009 and 2010, and the subsequent consultation process undertaken in 2011, HMT has now announced changes to be made to MLR, which amend and update rather than overhaul the existing provisions. These changes are intended to take effect on 1 October 2012.

Details of changes to be made and areas where MLR will remain unaltered are set out below.

### What will change?

Of the changes made to MLR, the most important can be placed into three main categories.

- 1. Simplification of reliance provisions** - HMT has broadened the range of third parties upon whose due diligence regulated businesses may rely (under regulation 17(2)(b)(ii) of MLR).  
At present, regulated businesses may rely upon due diligence conducted by third parties supervised by any of the bodies in Part 1 of Schedule 3 to MLR (i.e. bodies which were, at the time when MLR was drafted, well

established in terms of AML supervision and/or well known to HMT, such as the Law Society and the Bar Council). Reliance cannot currently be placed on due diligence conducted by third parties supervised by any of the bodies listed in Part 2 (i.e. those which were not, which mainly consist of smaller representative bodies of various types of tax and accountancy professionals).  
HMT has now done away with the distinction as it has concluded that all the bodies currently included in Schedule 3 are now sufficiently well versed in AML supervision for third parties to rely upon the due diligence conducted by the organisations which they supervise.

## 2. Penalties for failure to comply with information requirements

– HMT has given supervisory bodies the power to cancel businesses' registration or impose a civil penalty for failures by those businesses or individuals connected with them to provide information (under regulation 37 of MLR).

This addresses inconsistency between the tools available to different supervisory authorities under MLR. Most businesses supervised by the Financial Services Authority ("FSA") for the purposes of MLR will also be authorised firms under the Financial Services and Markets Act 2000 ("FSMA").

As such, in addition to its powers under regulation 37, it can require the production of information using its powers under Part XI of FSMA. Failure to comply with those requirements is a criminal offence and/or may be treated as contempt of court under section 177 of FSMA. In practice, such a failure would also be likely to amount to a breach of Principle 11 of its Principles for Businesses, which would enable it to take regulatory action against the firm concerned.

Although, as noted below, the Office of Fair Trading ("OFT") has recently asserted itself, enforcement activity in respect of breaches of MLR has, in recent years been led by the FSA. This disparity may have been partially attributable to a perception held by it (which is borne out by its response to HMT's consultation) and the other principal supervisory authority, HM Revenue & Customs ("HMRC") that they have not been able to

buttress their powers to require information from businesses supervised by them under regulation 37 of MLR with other, stronger, complementary powers to the same extent as the FSA has.

## 3. Gateways for information sharing between supervisory authorities

– HMT has also sought to even out inconsistencies between the levels of information available to supervisory authorities by establishing a new information gateway through which they may exchange information relating to their enforcement responsibilities under MLR.

Other minor amendments have also been made to the scope of MLR and to its provisions relating to money service businesses.

Consideration of some proposals, namely the refinement of the definition of "beneficial ownership" and the treatment of appointed representatives (i.e. whether regulated businesses may rely upon due diligence conducted by their appointed representatives) has been postponed until there is greater clarity as to how the Third Money Laundering Directive will be amended.

## What will not change?

The main headline arising from HMT's announcement is that organisations and individuals may still (at least in theory) be held criminally liable for breaches of MLR.

HMT, in the review conducted in 2009 and 2010, raised the question of whether the threat of criminal sanctions for breaches of MLR may be disproportionate and may have the effect of encouraging businesses to become unduly risk-averse. These

sanctions have never been used in any publicised case pursued by supervisory authorities, which have favoured the use of civil penalties (under regulation 42 of MLR), and in the case of the FSA, the imposition of financial and other penalties for breaches of provisions of its Handbook.

However, HMT has now decided that criminal sanctions should remain. Concluding that they are still required as a deterrent to non-compliance, it refers, for example, to the thematic review produced by the FSA in 2010 as evidence that the existence of criminal sanctions "have not perverted the risk-based approach by encouraging over-compliance".

HMT had also considered the possibility of strengthening supervisory authorities' powers to require businesses to take particular actions in relation to improve their AML compliance. It has decided though that, since criminal sanctions are to remain, it is not necessary to provide supervisors with additional powers. This decision broadly reflected the outcomes of the consultation exercise, where respondents referred to the already significant powers held by the FSA in particular which, as outlined below, it has increasingly used to take tough action in respect of AML breaches by firms for which it is responsible.

Other areas where HMT, having consulted on suggestions arising from the review in 2009 and 2010, has decided not to change the status quo include the introduction of a general *de minimis* exclusion of businesses with turnover of less than €15,000 (excluding VAT) from MLR's requirements. HMT, agreeing with most parties who responded to the consultation exercise, has recognised

that there is not a positive correlation between money laundering risk and the size of institutions, and that there would be significant practical difficulties with the administration of such a threshold.

## EU: Revisions to the Third Money Laundering Directive ("3MLD")

The above amendments have been made against the backdrop of the ongoing process of reforms being made to the European legislative framework upon which MLR is based.

Following the revised recommendations published by the Financial Action Task Force ("FATF") in February 2012 (see [Clifford Chance briefing](#)), the European Commission has consulted on revisions to be made to the 3MLD and is working towards publishing a finalised legislative proposal by the end of 2012.

The European Commission ("EC"), in its report to the European Parliament and the European Council published in April 2012, has proposed to implement the FATF revised recommendations and other changes by increasing the levels of harmonisation between the AML and counter terrorism financing measures employed by member states. Specific measures proposed by the EC aimed at implementing this increasingly federal model include pan-European risk assessments and EU wide lists of documents detailing acceptable documents for the purposes of customer due diligence.

The UK government's response, submitted by HMT, opposes this approach. Whilst it supports some of the proposed refinements to some of the terminology used in 3MLD, such as that mentioned above in relation to "beneficial ownership" and appointed representatives, it argues strongly against measures proposed by the EC aimed at greater harmonisation. It argues that powers should remain within member states and that, in particular, member states must retain flexibility to apply the risk based approach in a manner appropriate to the risks and types of business which are most prevalent in their respective jurisdictions.

The extent to which any revisions, when eventually implemented in the form of the fourth Money Laundering Directive, require further amendments to be made to MLR (or for MLR to be replaced) will become clearer as the EU legislative process progresses.

## Recent UK enforcement action

Throughout the review and legislative processes which have been ongoing at domestic and European level in recent years, the FSA in particular has been adopting an increasingly tough approach to enforcement of AML compliance. Significant enforcement cases resulting in substantial financial penalties have been successfully pursued against institutions ranging from UK branch offices of overseas banks to large UK based institutions, and associated individuals, for a wide range of AML related breaches.

The FSA has recently concluded the third enforcement case to flow from its

thematic review into banks' management of high money-laundering risk situations, whose findings were released by the FSA in June 2011. The FSA imposed a civil penalty of £294,000 on Turkish Bank (UK) Limited ("TBUK") for breaches of MLR arising from failures, in relation to correspondent banking relationships with respondents in Northern Cyprus and Turkey, to establish and maintain appropriate and risk-sensitive AML policies and procedures, to carry out adequate due diligence and ongoing monitoring of customers acting as respondent banks or to maintain adequate records. On this occasion, the FSA did not take regulatory action against any individuals. However, as noted in the Decision Notice issued to TBUK, individuals' bonus payments were withheld in connection with the breaches, reinforcing the trend of individuals being held personally culpable for failings by firms (see, for example, [Clifford Chance briefing](#)).

This most recent action taken by the FSA demonstrates both the breadth of its regulatory remit and the flexibility of its enforcement approach. In this case, as in some previous cases arising from thematic reviews on AML issues, it chose to take action as a supervisory authority under MLR.

However, in other cases, it has used its wider powers under FSMA to impose financial penalties and prohibition orders for AML related breaches of its Principles for Businesses and Statements of Principle and Code of Practice for Approved Persons ("APER").

As the proposed transition towards the handover of responsibility for consumer credit to the FSA's successor body, the Financial Conduct Authority ("FCA") continues,

the OFT has, in an enforcement decision announced last week (which may yet be subject to appeal), followed the approach taken by the FSA on breaches of MLR. Using its powers under MLR in conjunction with those under the Consumer Credit Act 1974, it has imposed a civil penalty of £544,505 on payday lender MCO Capital Limited, and has revoked its consumer credit licence for failings including inadequate verification of the identities of loan applicants.

Having not used the criminal sanctions provided for by MLR and now preserved by HMT in any publicised case to date, it is unlikely that supervisory authorities will rush to do so. The refinements made to MLR to bolster the powers of supervisory authorities to impose civil penalties set out above may in time lead to continued increases in the levels of enforcement activity. Reforms to 3MLD which, when concluded, will begin a new cycle of review and amendment of MLR, may necessitate greater levels of collaboration between authorities across Europe in future.

What is clear in the meantime though

is that taking action for breaches of MLR remains high on the financial crime agendas of UK supervisory authorities. Senior figures at the FSA have, in recent public statements, reaffirmed its (and the FCA's) commitment to using its powers, both under FSMA and MLR, proactively and robustly in support of its credible deterrence agenda. The OFT's most recent action indicates that it is prepared to take a similarly robust approach. As such, AML compliance

should remain a particular priority for businesses operating in the financial services sector.

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