

Traps for the unwary



It's easy to trip up with the new money laundering regulations. Find out how to stay on the right side of the law. **Simon Paget-Brown** and **James Hilsdon**

Accountants are constantly bombarded with severe warnings concerning any failure to comply with the Money Laundering Regulations 2007 (MLRO 2007). The theory of these warnings is simple enough, but when applied in practice by a busy accountancy firm, it is all too easy to find yourself in breach of the law. As with any breach, the individuals may find themselves, without the benefit of the firm's insurance policy, defending their personal as well as their firm's reputation. The individual accountant could also end up with a prison sentence with the resultant criminal record.

Identity verification

For example, Mr Smith is a partner in a firm which has acted for Mr Jones, a small property developer for the last three years. Mr Smith knew that he had to identify and verify Mr Jones' identity *'on the basis of documents, data or information obtained from a reliable and independent source'* as per Regulation 5 of MLRO to ensure compliance with the same.

However, Mr Smith did not personally copy the original of Mr Jones' passport, driving licence and home utility bill as evidence of Mr Jones' identity. Mr Smith fell into the trap of accepting ready made copies of Mr Jones' identification

documentation, which were not therefore obtained *'from a reliable and independent source'*. Even if Mr Smith had relied upon certified copies of the same, provided by, for example, an auditor, insolvency practitioner, external accountant, tax adviser or independent legal professional, this would not be sufficient. Mr Smith would also have had to obtain the consent of the party who had certified the documentation, for him to rely upon it, for the purposes of identity verification (see Regulation 17(2)(b) of MLRO). Mr Jones may, at a later date, turn out to be not Mr Jones at all, but someone far more sinister.

Timing of verification

Mr Smith knew that these identity checks should be undertaken *'before the establishment of a business relationship or the carrying out of an occasional transaction'*, as per Regulation 9 of MLRO 2007. Mr Smith sought to rely upon Regulation 9(3) of MLRO 2007, which enabled him to undertake the verification process *'during the establishment of a business relationship if (a) this is necessary not to interrupt the normal conduct of business; and (b) there is little risk of money laundering or terrorist financing occurring, providing that the verification is completed as soon as practicable after contact is first established'*. Mr Smith acted before the identity verification procedure had

been completed, perhaps as Mr Jones said that the work was urgent. The risk that Mr Smith ran was that the transaction could be speedily completed without the identity and verification checks having been completed, leaving him open to having worked for a money laundering/terrorist organisation and potentially be charged as a co-conspirator.

Ongoing monitoring

Mr Smith knew that he *'must conduct ongoing monitoring of a business relationship'*, pursuant to Regulation 8 MLRO 2007, which meant *'(a) scrutiny of transactions throughout the course of the relationship (including where necessary source of funds to ensure that the transactions are consistent with the relevant person's knowledge of the customer, his business and risk profile; and (b) keeping the documents, data or information obtained for the purpose of applying customer due diligence measures up-to-date'*.

Mr Smith sought to confine his duty to monitor the 'business relationship' narrowly, not seeking to put Mr Jones' business affairs into a wider context. Mr Smith did not consider, say, whether it was normal for Mr Jones, as a young man, or for that matter as a man with a declared income of, say, £45,000 per year, to be developing houses in the region of £700,000. Mr Smith had forgotten that s328(1) of the Proceeds of Crime Act 2002 (POCA), states that a person commits a money laundering offence *'...if he enters into or becomes concerned in an arrangement which he knows or suspects facilitates (by whatever means) the acquisition, retention, use or control of criminal property by or on behalf of another person'*.

Mr Smith, in preparing the tax returns for Mr Jones, continually sought to apply the capital gain exemption for the sales of Mr Jones's principal private residences, notwithstanding the fact that Mr Jones was buying and selling property as a business, ie, he was making a trading profit, rather than a capital gain, so this exemption should not have applied. Mr Smith was aware that Mr Jones was not living and had never lived in the properties that he was developing as he always addressed his correspondence to Mr Jones at another address, where he believed Mr Jones resided. Mr Jones, with Mr Smith's knowledge, was committing tax evasion, a money laundering offence, pursuant to s327 of POCA.

Use of a corporation

Even if Mr Smith had advised Mr Jones that his property development business should be undertaken via a corporate vehicle so as to pay less tax, and he had assured himself as to source of funds and who the directors and shareholders were of the development company (via original documentation), his obligations do not end there. Mr Smith should also, as part of his ongoing monitoring duties, ensure that he was aware of any changes in the corporate structure of the newly formed company. Mr Jones may have thought that if he was able to obtain funds from fellow investors (who could be money launderers), he might be able to scale up his operations.

However, Mr Smith is under an obligation to identify the

beneficial owner which, if a body corporate, includes any *'body other than a company whose securities are listed on a regulated market, ultimately owns or controls (whether through direct or indirect ownership or control, including through bearer share holdings) more than 25% of the shares or voting rights in the body'*, pursuant to Regulation 6(6) MLRO 2007.

Again, Mr Smith's duty to monitor means that Mr Smith would need to ensure that he was aware of any changes in the shareholding of Mr Jones's property company. This investigation should be carried out via electronic searches, just in case Mr Jones seeks to hide any shareholding changes of over 25% from Mr Smith.

Offshore company

In the event that Mr Jones sought to run his property development business from offshore, there are further considerations that Mr Smith would need to take into account. Mr Smith would need to satisfy himself that the offshore structure did not amount to tax evasion. It may well be harder to identify the beneficial owners as well as their sources of funding.

Penalties

Mr Smith and his firm might have to take a great deal of time seeking to convince the Crown that they neither knew nor had any suspicions about any money laundering activities and that this ignorance was not the result of negligence or wilful blindness on their part.

This exercise, often in the public domain and without insurance cover, can be very expensive indeed and can lead to imprisonment.

Pursuant to s330 of POCA, the penalty, for failing to disclose knowledge, suspicion or reasonable grounds for suspicion of money laundering, is up to six months' imprisonment or a fine, or both. Further, if Mr Smith was the nominated officer to report suspicious activity for his firm and did not act upon any internal suspicious activity reports, pursuant to s331 of POCA, the penalty on indictment is up to five years' imprisonment or a fine, or both.

Conclusion

All professionals are aware of the law or should be aware. The law does not allow for ignorance. Notwithstanding the law, the prudent running of a business requires the individual to follow the procedure set out in the MLRO regulations and the statutes, as well as any guidance issued by their professional body.

Professionals are often too reliant upon the initial money laundering checks that they have undertaken, not complying with their obligations to continually monitor the situation.

A comprehensive and ongoing identification and verification procedure for clients/shareholders/source of funds is a must for anyone seeking to do business. A refusal to properly resource this exercise and to review a client's transactions for so-called 'red-flag' behaviour, eg, tax evasion, unusual or improbable business purpose, can lead to a prison term and professional ruin.

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