Law Society of Scotland

Consultation Response

HMT Consultation:
Improving the effectiveness of the Money Laundering Regulations

4 June 2024

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Introduction

The Law Society of Scotland is the professional body for over 13,000 Scottish solicitors.

We are a regulator that sets and enforces standards for the solicitor profession which helps people in need and supports business in Scotland, the UK and overseas. We support solicitors and drive change to ensure Scotland has a strong, successful, and diverse legal profession. We represent our members and wider society when speaking out on human rights and the rule of law. We also seek to influence changes to legislation and the operation of our justice system as part of our work towards a fairer and more just society.

This response is submitted on behalf of the Regulatory Committee of the Law Society of Scotland. The Regulatory Committee (the committee) is a committee of the Council of the Law Society but exercises the Law Society's regulatory functions independently of the Council, as set out in Section 3F of the Solicitors (Scotland) Act 1980. The committee's core purpose is to ensure that the regulatory functions are exercised independently, properly, and with a view to achieving public confidence and protection.

The committee welcome the opportunity to consider and responds to His Majesty's Treasury consultation: *Improving the effectiveness of the Money Laundering Regulations.*[1] In preparing this response the committee has been kindly assisted by members of the Society's Anti Money Laundering sub-committee and colleagues within the Society's AML compliance team.

We have the following comments and observations to put forward for consideration in response to the consultation questions.

Questions and responses

Chapter 1: Making customer due diligence more proportionate and effective

Customer Due Diligence - Due diligence triggers for non-financial firms

Q1 Are the customer due diligence triggers in regulation 27 sufficiently clear?

No, we do not believe the triggers in r.27 are sufficiently clear in the context of the legal profession, as the definition of "business relationship" does not help ascertain whether certain legal activities fall under the scope of a "business relationship" or "occasional transactions".

The definition as set out in r.4 may be considered vague and uncertain due to the use of the term "*element of duration"* and an expectation of such.

The HMT approved Legal Sector Affinity Group (LSAG) guidance attempts to add some clarity to the position, stating that;

[1] https://assets.publishing.service.gov.uk/media/65e9e1813649a2001aed6492/HM_Treasury_Consultation_on_Improving_the_Effectiveness_of_the_Money_Laundering_Regulations.pdf
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The definition of business relationship under the Regulations requires the legal practitioner to have an expectation at the time the contact is established, that the relationship will have "an element of duration" (R4). This should be interpreted in the broadest sense, as it is reasonable to assume that any legal professional will have an expectation of possible further business from any initial contact made with a client. When dealing with a client for the first time, you should assume that a business relationship is being formed unless you have explicit reasons to know that this is not the case i.e., that there will not be an "element of duration."

It further states that, "*Due to the ongoing duties a practice would have in most foreseeable circumstances, the definition of an occasional transaction is not likely to apply to the relationship between a legal practice and a client for any transaction, although may apply in the case of a limited ancillary service, provided as a one-off or in some examples of notarial work in particular".*

The majority of legal work in scope of the Money Laundering Regulations undertaken by Scottish solicitors is in the field of conveyancing.

These are (generally) "one-off" transactions undertaken on behalf of a client selling or purchasing a house – i.e. not, in the main, a regular occurrence or transaction for most individuals or entities. Conveyancing therefore may intuitively appear to then fit into the category of an "occasional transaction" - however there may also be an expectation of ongoing or repeat work in relation to that conveyance, or further in-scope work undertaken for the client – i.e. there may be "an element of duration" – so therefore this type of transaction (even although at the time potentially limited to a one-off event) may fall under the definition of a business relationship. It should also be noted that there is likely to be an element of duration, even in a "one-off" conveyancing transaction, given the time taken from the start of the process through to sale/purchase.

Additionally, there are many instances where a prospective client may have initial or ongoing preliminary discussions with a solicitor/ legal professional, but at which point, the legal professional may not be aware, know or believe that a business relationship with any element of duration will have been established or an occasional transaction may occur. It is not then clear whether, or at what point a trigger for the application of CDD would occur.

Furthermore, we note that if such "one-off" transactions were deemed to fall under the category of "occasional transactions" we note that the application of ongoing monitoring under r.28 (11) would not apply. We believe ongoing monitoring within the context of such one-off transactions is still relevant however, particular as some of these may be over an extended timeframe, warranting review of the client/matter circumstances and risk factors at regular points to ensure they have not have/have not changed, and whether any change has changed the risk profile of the client/matter, and further whether any additional due diligence is necessary to mitigate any new or additional risks.

It is unclear what an "occasional transaction" means and whether it applies to anything a solicitor does is also unclear. An "occasional transaction" should be defined with consideration given of definitions applicable to each type of relevant person. Clarity in the underlying regulations along with further definition would be helpful. This would help avoid the potential for varying interpretations and inconsistent application across the legal sector.

It is not immediately clear to us (*in the context of on-boarding or at the outset of the relationship)* why CDD should be triggered when the firm suspects money laundering or terrorist financing or when the firm doubts the veracity or adequacy of documents or information previously obtained for the purposes of identification or verification as It occurs to us that in such situations the business relationship should at the very least be questioned, and likely ultimately refused/ceased (and clearly a suspicious activity report be submitted where the firm suspects money laundering or terrorist financing). It may be appropriate to amend r.31 "Requirement to cease transactions" to explicitly refer to such situations where appropriate and credible CDD cannot be satisfied.

Source of funds checks

Q2 In your view, is additional guidance or detail needed to help firms understand when to carry out 'source of funds' checks under regulation 28(11)(a)? If so, in what form would this guidance be most helpful?

We believe further clarity should be provided in respect of r.28(11)(a) – we believe the wording *"where necessary"* adds significant ambiguity to the application of the provision. We believe a change in language to include the use of a risk-based approach would be both in keeping with the overall principles of the regulations and would be easier to apply in practical terms.

Furthermore – and more fundamentally - we would urge the Government to include an explicit requirement to undertake risk-based Source of Funds checks as part of a holistic due diligence approach *at the outset of and during the course of a business relationship or occasional transaction*. It occurs to us that checking, understanding and evidencing the underlying, originating and ongoing source of funds are to the very heart of robust anti-money laundering control - and are fundamental elements of understanding the nature, background and circumstances of the client - both at client take-on and as part of ongoing monitoring.

We believe that risk-based Source of funds/wealth checks should also be extended to third parties, where it is known that a third party has provided funds into a business relationship or transaction. The extent to which a regulated person should obtain, review and evidence third party SoF should be made dependent upon the risk profile of the client or matter. A third party's overall source of wealth should also be considered in higher risk situations.

Clearly these checks should be proportionate and the extent to which evidence in support of the client's statements re source of funds/wealth is collated, should be tailored to the risks inherent in the client or transaction. In most cases, Source of Wealth checking should be reserved to enhanced due diligence scenarios.

The above response is in keeping with our previous response to the Call for Evidence regarding the review of the UK's AML/CFT regulatory and supervisory regime, which stated:

> "*We believe that clarity regarding (and the compulsion to undertake), source of funds/source of wealth (SoF/SoW) investigation by regulated persons is extremely high impact and lies at the very heart of strong risk-based, AML controls. These requirements should be coupled with more pronounced requirements to understand and document the background and circumstances of the client/customer. This is arguably as important, if not more so, than verification of identification in the context of client due diligence (CDD).*
>
> *• The meanings of source of funds and source of wealth should be included in the general interpretation section of the Regulations, in line with recognised Financial Action Task Force (FATF) and 'Wolfsberg' definitions.*
>
> *• Undertaking and documenting appropriate, risk-based SoF/SoW enquiries should be stated as a required CDD measure (the extent a regulated entity should go to should be risk-based and a higher standard of evidence required in enhanced due diligence (EDD) situations). These requirements are currently only stated as a "must-do" under Regulation 35 EDD: PEPs*
>
> *• We suggest that undertaking and evidencing SoF/SoW should be a stated requirement of EDD under Regulation33.*
>
> *• Under Regulation 28 (11a) we suggest an amendment of wording regarding source of funds, to ensure it is central to the concept of ongoing monitoring of a relationship/ transaction.*
>
> *• It is a general suggestion to reframe Regulation 28 (11a). This is to ensure ongoing monitoring of the source of funds is at the heart of this regulation. It is unclear to us what "where necessary" (as stated in Regulation 28) means, and it is further unclear as to why this requirement stands apart in parentheses, apparently subordinate to other requirements?"*

Given the varying scope for application of Source of Funds/Wealth checks across the regulated sector, it may be appropriate for HMT to consider separate requirements for the legal sector, given the nature of client relationships formed/maintained and the work undertaken , and the critical importance of SoF/SoW checks in identifying money laundering risk.

Verifying whether someone is acting on behalf of a customer

Q3 Do you think the wording in regulation 28(10) on necessary due diligence on persons acting on behalf of a customer is sufficiently clear? If not, what could help provide further clarity?

We do not have any reason to believe the wording under r.28 (10) is not sufficiently clear, particularly where coupled with relevant sections of HMT approved Legal Sector Affinity Group (LSAG) guidance.

That said regulation 28 (10) may benefit from providing an exception to state that it does not apply when the customer is a legal person and A is an employee of the customer.

Digital identity verification

Q4 What information would you like to see included in published digital identity guidance, focused on the use of digital identities in meeting MLR requirements? Please include reference to the level of detail, sources or types of information to support your answer.

We believe the widespread and correct use of Digital identity & verification across the regulated sector (along with the development and promotion of consumer confidence in these technologies) is crucial to combat the evolution and increasing sophistication of those involved in money laundering, fraud or other types of economic crime. Trusted and interconnected digital ID&V processes may also encourage prioritisation of other, arguably more add-value parts of the holistic due diligence process such as SoF/SoW checking and understanding the wider background , context and circumstances of the client as set against the nature of the transaction being undertaken.

Given the rapidly evolving nature of Digital ID frameworks/standards, it will be necessary to ensure compatibility and consistency between both divergent UK and EU/international standards and MLR requirements through appropriate ongoing review of requirements and any guidance developed.

Sector-specific guidance should be developed in tandem with practitioners, to ensure understanding of case-uses and typologies. This should also include examples, along with key benefits, risks, limitations and pitfalls regarding their use. Practitioners must also be advised they must consider the use of such technologies taking into consideration the clients, services, geographies and deliver channels specific in their context or business model.

Q5 Do you currently accept digital identity when carrying out identity checks? Do you think comprehensive guidance will provide you with the confidence to accept digital identity, either more frequently, or at all?

Not relevant given our role/responsibilities as a Professional Body supervisor, although we note that comprehensive guidance on the subject can only be a useful addition to the landscape and promote confidence in the use of digital identity.

Q6 Do you think the government should go further than issuing guidance on this issue? If so, what should we do?

In order to lay strong foundations for the ongoing and future use of digital identity it is important that government set strong standards for digital providers to build systems around, and for end-users to understand, trust and rely on. Ensuring trust around privacy & security issues, along with user rights, is especially important, along with setting standards around accessibility.

Such standards would also ensure consistency across the industry, enable interoperability between data providers, set clear governmental expectations and guard against the increasing fraudulent use of AI in this space. They should, where appropriate, also tie in with global standards in this space.

Undertaking suitable initiatives to raise public knowledge and education will also be key to ensuring success.

Timing of verification of customer identity

Q7 Do you think a legislative approach is necessary to address the timing of verification of customer identity following a bank insolvency, or would a non-legislative approach be sufficient to clarify expectations?

We do not have a view on this question given our role/responsibilities as a Professional Body Supervisor.

Q8 Are there other scenarios apart from bank insolvency in which we should consider limited carve-outs from the requirement to ensure that no transactions are carried out by or on behalf of new customers before verification of identity is complete?

(As the question is framed around the verification of identity as opposed to wider due diligence requirements) we do not believe that there are any other scenarios which should considered.

Enhanced Due Diligence

General triggers for enhanced due diligence

Q9 (If relevant to you) Have you ever identified suspicious activity through enhanced due diligence checks, as a result of the risk factors listed above? (Regulations 33(6)(a)(vii), 33(6)(a)(viii) and 33(6)(b)(vii)). Can you share any anonymised examples of this?

Not relevant given our role/responsibilities as a Professional Body Supervisor.

Q10 Do you think that any of the risk factors listed above should be retained in the MLRs?

To ensure the regulated sector continues to apply the correct focus and rigour in their risk-based approach, we believe it is important to retain the requirement to conduct EDD where "*there is a transaction related to oil, arms, precious metals, tobacco products, cultural artefacts, ivory or other items related to protected species, or other items of archaeological historical, cultural or religious significance or rare scientific value".*

Significant money laundering and wider economic crime risks remain associated with the trade in natural resources , including gold and other precious metals along with the global oil market (particularly in relation to sanctions evasion and the wider geopolitical context).

Furthermore, and quite rightly, there has been increased focus in recent years (including at intergovernmental/FATF level) on the illegal money flows associated with both wildlife trafficking and other environmental crimes, along with the art and antiquities markets.

It is right that the government ensures that these factors attract a higher degree of scrutiny under the regime, including mandatory enhanced due diligence. Keeping this provision supports wider government policy objectives regarding the environment and climate change It is noted that even within the context of mandatory enhanced due diligence, it is open to the regulated person to adjust the type of due diligence performed in order to mitigate associated risk.

Q11 Are there any risk factors for enhanced due diligence, set out in regulation 33 of the MLRs, which you consider to be not useful at identifying suspicious behaviour?

No. All factors as set out in r.33 are useful in identifying suspicious behaviour.

Q12 In your view, are there any additional risk factors that could usefully be added to, for example, regulation 33, which might help firms identify suspicious activity?

It occurs to us that certain customer risk factors under r.33 6(a) should be extended in application to third parties to the proposed transaction, particularly where that party is funding or contributing funding to that transaction. E.g. "*whether the customer or a third party to the transaction, is resident in a geographical area of high risk".*

Furthermore, we would welcome additional risk factors focussing on the risks associated with the source of funds/wealth used in the relationship or transaction – e.g.., Where it is indicated the source of funds/wealth used in the transaction will be derived from or associated with locations of higher geographical risk, or from a product or arrangement which might favour anonymity, or from a higher risk business sector etc.

We believe this would significantly strengthen the UK system by ensuring sufficient focus is put on identifying higher risk sources of funds/wealth, and mitigating these risks via appropriate, proportionate and risk-based EDD.

Finally, we believe that Regulation 33 (1a) could usefully be extended to include an express requirement to apply EDD in any case identified as high risk under Regulation 28 (12a) ii – that is "an assessment of the level of risk arising in any particular case".

To this end, we believe it is critical that there is an express requirement in r.28 to ensure documented client/matter level risk assessments are undertaken, and key risk factors as outlined in sectoral guidance are considered and assessed as part of this process.

'Complex or unusually large' transactions

Q13 In your view, are there occasions where the requirement to apply enhanced due diligence to 'complex or usually large' transactions results in enhanced due diligence being applied to a transaction which the relevant person is confident to be low risk before carrying out the enhanced checks?

Please provide any anonymised examples of this and indicate whether this is a common occurrence.

Not relevant given our role/responsibilities as a Professional Body Supervisor.

Q14 In your view, would additional guidance support understanding around the types of transactions that this provision applies to and how the risk-based approach should be used when carrying out enhanced check?

It is noted that the FATF Recommendation 10 interpretative note is in the context of Financial Institutions only, albeit we note that the MLRs then proscribe this across the regulated sector in the UK, including DNFPBs

We believe that what constitutes a "complex or unusually large" transaction undertaken by a regulated person is unique to that regulated person and the regulations should be determined in the context of and as set against what is laid out/described in a regulated person's r.18 firm-level risk assessment. We believe that this could usefully be outlined in an amendment to the general interpretation section of the MLRs.

To aid the regulated sector further, supervisory authorities could also further outline what may be defined as standard, non-complex or not unusually large transactions in the production and publication of r.17 sectoral risk assessments.

Q15 If regulation 33(1)(f) was amended from 'complex' to 'unusually complex' (e.g. a relevant person must apply enhanced due diligence where… 'a transaction is unusually complex or unusually large'):

• in your view, would this provide clarity of intent and reduce concern about this provision? Please explain your response.

While we do not hold strong views on this proposition, we believe that the addition of "unusually-complex" may aid regulated persons in the application of a risk-based approach and the identification of higher risk scenarios – as long as further guidance as outlined in our response to Q14 is published.

• in your view, would this create any problems or negative impacts?

We do not foresee any substantive problems/negative impacts, as long as good quality guidance is in place to avoid misinterpretation/confusion.

High Risk Third Countries

Q16 Would removing the list of checks at regulation 33(3A), or making the list non-mandatory, reduce the current burdens (cost and time etc.) currently placed on regulated firms by the HRTC rules? How?

In our experience, the prescriptive requirement to apply EDD where "a business relationship is established with a person established in a high-risk country" may be misinterpreted by regulated persons insofar as they then mistakenly believe that EDD is not required when geographical risks are high, but where the jurisdiction concerned is not on the UK list of High Risk Third Countries (HRTCs).

It would be anticipated that removing the list of checks or making it non-mandatory would reduce costs/time etc.

That said we believe strongly that the list of checks under r.33 (3a) is a suitable list and should be amalgamated with those checks listed under r.33 (5) and widened to be applicable across *all* EDD situations (not simply in respect of HRTCs) on a non-mandatory basis. This would be entirely in keeping with a risk-based approach and would allow regulated persons greater flexibility in the application of controls according to the risks present in the client or transaction.

We do note however, the definition of being "established in" an HRTC under r.33 (3c) and would suggest that this definition should be expanded (on a non-mandatory basis) to include any nexus to an HRTC, including clients, UBOs or third parties providing funds to the transaction resident in, or where source of funds/wealth involved in a transaction are from. It should also extend to considering any social, cultural or language ties which might increase a link to a HRTC or higher-risk jurisdiction.

Importantly, regulated persons should be encouraged in the regulations to expand this list to include other high-risk geographies/jurisdictions which may affect them in the context of their own business, by the addition of text directing them to consult HMT approved guidance and other authoritative sources in relation to wider jurisdictional risks.

Q17 Can you see any issues or problems arising from the removal of regulation 33(3A) or making this list non-mandatory?

Although we advocate above for the undertaking of all checks to be made non-mandatory, we urge government to ensure regulations are worded to sufficiently ensure the risk-based application of key checks under r.33 (3a) and r.33 (5) - to ensure regulated persons perform relevant and effective enhanced due diligence in mitigation of the higher risk factors posed by the client or transaction.

Importantly, we believe that Source of Wealth checks should be a mandatory element of enhanced due diligence, where appropriate in the context of the client/transaction being undertaken.

Q18 Are there any High Risk Third Country-established customers or transactions where you think the current requirement to carry out EDD is not proportionate to the risk they present?

Please provide examples of these and indicate, where you can, whether this represents a significant proportion of customers/transactions.

It occurs to us that there may be customers, transactions affected by HRTC requirements, which do not otherwise pose significant money laundering risk when risk profiled/assessed holistically and in context of other geographical, client, service or delivery channel factors.

Q19 If you answered yes to the above question, what changes, if any, could enable firms to take a more proportionate approach? What impact would this have?

Please see our responses to Q16 & Q17

Simplified Due Diligence - Pooled client accounts

Q20 Do you agree that the government should expand the list of customer-related low-risk factors as suggested above?

Yes, we agree with the expansion of low risk factors as suggested – although we recommend caution in respect of "*whether the business's source of funds is regulated by a government approved scheme (e.g. as for many letting/property/estate agents in England) in a way which is relevant to the risk presented by the business relationship".*

It is our understanding that there have been examples of cash-based money laundering undertaken whereby criminal cash is spent in the undertaking of work which is guaranteed to be reimbursed through government backed schemes – e.g. the Green Deal scheme, where it may have been possible for criminal enterprises to pay upfront for energy saving improvements to homes (labour/parts etc), and then reclaim monies spent, from the government , thus potentially laundering the proceeds of criminality.

Q21 Do you agree that as well as (or instead of) any change to the list of customer-related low-risk factors , the government should clarify that SDD can be

carried out when providing pooled client accounts to non-AML/CTF regulated customers, provided the business relationship presents a low risk of money laundering or terrorist financing?

No, we do not agree with this. We believe that PCA's can and do present significant money laundering risk potential, and a fundamental control in preventing the abuse of such facilities is that the PCA provider is effectively supervised for money laundering purposes. We consider it highly likely that the integrity of the system could be compromised, and risk crystallised as criminals would take advantage of less stringent controls applied to non-regulated PCAs. A loosening of controls around such business relationships would make them vulnerable to potential money laundering abuse, and thus make them of higher risk.

Q22 In circumstances where banks apply SDD in offering PCAs to low-risk businesses, information on the identity of the persons on whose behalf funds are held in the PCA must be made available on request to the bank. How effective and/or proportionate do you think this risk mitigation factor is?

Should this requirement be retained in the MLRs?

We believe this requirement should be retained as it is a significant risk mitigation factor, allowing for transparency and accountability in line with international/FATF standards.

We do however believe that the requirement should be adjusted to ensure banks take a risk-based approach, use this power proportionally, and with good reason. To this end, we would suggest that the regulations dictate that banks must only request such information where they have reasonable cause to do so due to specific higher risk factors or intelligence available to them.

Q23 What other mitigations, if any, should firms consider when offering PCAs? Should these be mandatory under the MLRs?

We believe that, in addition to the changes suggested in our response to Q22, many of the mitigations and risk factors already outlined in JMLSG guidance Annex 5 are useful additional factors/context on which to determine the risks associated with PCAs, and consequentially the level and type of due diligence to be applied.

Given how fundamental PCAs are to the legitimate business conducted by law firms across the UK, and the significant impact any additional checking may have on the functioning and integrity of the system, banks must not be able to de-risk PCAs without justifiable reason, restrict the functioning of the PCA or otherwise act as de-facto supervisors to those they offer PCAs to, by demanding changes be implemented to policies, controls or procedures at the firm – as per measures outlined under JMLSG Annex 5 , s 1.5.

There should be facility in the MLRs to allow banks to contact their PCA customer's AML supervisor to discuss concerns/issues which may have arisen, and potential action to mitigate risk.

We also believe that specific measures should be put in place to prevent PCAS (regulated or unregulated) being used as an alternative banking facility, without any associated/underlying transaction.

Q24 Do you agree that we should expand the regulation on reliance on others to permit reliance in respect of ongoing monitoring for PCA and equivalent scenarios?

Yes, we agree with this proposition albeit we believe that a restriction of liability on relying parties must also be introduced to make reliance work as it is intended and to encourage its use more broadly (e.g., those responsible for ensuring the information meets the needs of your checks, but not of its accuracy)

Q25 Are there any other changes to the MLRs we should consider to support proportionate, risk-based application of due diligence in relation to PCAs?

Please see our response to Q23

Chapter 2: Strengthening system coordination

Information sharing between supervisors and other public bodies

Q26 Do you agree that we should amend the MLRs to permit the FCA to share relevant information with the Financial Regulators Complaints Commissioner?

Not relevant given our role/responsibilities as a legal sector supervisor

Q27 Should we consider extending the information-sharing gateway in regulation 52(1A) to other public bodies in order to support system coordination? If so, which public bodies?

Please explain your reasons.

We believe that information sharing cross-sector is fundamental in tackling economic crime, and the r.52 (1a) gateway should be opened to other public bodies – particularly such bodies which deal with fraud prevention and public service/delivery/ procurement – given the obvious linkages between fraud and money laundering and known money laundering and corruption risks associated with procurement.

This would further allow system alignment and co-ordination, increase efficiency and ensure a holistic view of economic crime, transcending organizational boundaries.

Q28 Should we consider any further changes to the information sharing gateways in the MLRs in order to support system coordination? Are there any remaining barriers to the effective operationalisation of regulation 52?

We believe r.52 gateways to be fit for purpose at a strategic level but further changes should be introduced to ensure and promote the implementation of operational delivery frameworks for data sharing - including the use of technology, data sharing agreements and MoUs between stakeholders.

For example, to this end and to ensure r.52 works efficiently at an operational level, the Society has recently put in place data sharing agreements with partners such as Police Scotland and HMRC.

We recommend further specific consultation should be undertaken on these matters.

Cooperation with Companies House

Q29 Do you agree that regulation 50 should be amended to include the Registrar for Companies House and the Secretary of State in so far as responsible for Companies House?

We do not object to such amendment as long as the wording "as it considers appropriate" and as it relates to co-operation in relation to AML/CTF policies and co-ordination. We also believe that such steps should be made reciprocal between all stakeholders – i.e. coordination, in order to be effective, flows in both directions.

That said, that it may not be entirely necessary to amend r.50 in such a way, given that we believe the strong relationships between stakeholders, the current provisions under r.52, along with new powers given to Companies House under the Economic Crime and Transparency Act 2023 are sufficient to deliver appropriate and timely co-operation and information sharing between supervisors and companies house.

Q30 Do you consider there to be any unintended consequences of making this change in the way described? Please explain your reasons

Not relevant given our role/responsibilities as a Professional Body supervisor.

Q31 In your view, what impact would this amendment have on supervisors, both in terms of costs and wider impacts? Please provide evidence where possible.

Given our close working relationships with Companies House, along with our experience working with r.50 as it stands, we do not anticipate significant additional impacts or costs associated with such a change.

Regard for the National Risk Assessment

Q32 Do you think the MLRs are sufficiently clear on how MLR regulated firms should complete and use their own risk assessment? If not, what more could we do?

No, we do not believe that the MLRs are sufficiently clear in this respect.

Although R.18 stipulates both the sources of information to be used (incl. r.17 supervisory/sectoral risk assessments) and types of risk (geographical, products & services, customer, transactional, delivery channel) to be considered, and legal sectoral guidance then expands upon these factors, the MLRs themselves do not then stipulate how firms should use or what the firm-level risk assessment should be used for.

In our supervisory experience, a large number of firms are still unclear/unsure what their firm-wide risk assessment should be used for – i.e. a robust risk assessment will help firms identify and assess the particular risks their business is exposed to and then develop appropriate policies, controls & procedures (PCP's) to mitigate these risks.

In order to promote a truly risk-based approach, the regulations should stipulate that (above and beyond certain mandatory requirements such as the requirement to perform CDD/EDD or implement Suspicious Activity Reporting processes) PCPs should be aligned to outcomes of the firm-level risk assessment.

Furthermore, the regulations should promote further interconnectivity between the firm-level risk assessment and client/matter risk assessments – to ensure those firm-wide risks identified in the firm level risk assessment are adequately and effectively reviewed in the context of individual clients and matters.

As per our response under Q12, we believe there should be a regulatory requirement for firms to complete a written CMRA, to be modelled on PWRA factors such as geographical, client risk (etc) with further and stronger emphasis on completing holistic due diligence incorporating source of funds/wealth, and wider review of client background and profile.

Q33 Do you think the MLRs are sufficiently clear on the sources of information MLR-regulated firms should use to inform their risk assessment (including the NRA)? If not, what more can we do?

We believe that the MLRs are relatively clear in this respect however further expansion in terms of the sources to be consulted, would be beneficial.

Consideration should be given to widening these sources to include:

- The UK National Risk Assessment
- Relevant FATF literature and other authoritative sources such as MoneyVal, Wolfsberg, Basel, Egmont.
- Risk Assessments and guidance issued by other relevant supervisors in the firm's sector
- Enforcement data from law enforcement and financial intelligence units

- Intelligence reports made available to regulated persons by law enforcement agencies
- Other credible 3rd sector organisations such as Transparency International, RUSI and others
- Established academic sources
- Relevant and corroborated open-source information
- The Regulated Person's own knowledge/experience of industry practice, risks and issues

Inclusion of some or all of the above would help ensure firms have a consistent understanding of the information they should use to inform their risk assessments, and ensure firm level risk assessments are well rounded, informed and inclusive of all relevant risks. In turn this would support the government's wider objective of promoting a risk-based approach to money laundering risk.

Q34 One possible policy option is to redraft the MLRs to require regulated firms to have a direct regard for the NRA. How do you think this will impact the activity of: a) firms b) supervisors? Is there anything this obligation should or should not do?

Although we are not against a new requirement for firms to have direct regard for the NRA, we believe risks outlined at national level are incorporated and expanded upon in r.17 supervisory/sectoral risk assessments, and these assessments are better placed to identify and assess the specific AML/CTF risks at regional and local levels across the UK, and by sector.

Should the government decide to require firms to incorporate the NRA itself, it may have the following impacts:

a) Firms:

- Given the relatively infrequent revision to the NRA, firms would still be compelled to regularly look beyond the NRA to ensure their own PCPs keep pace with changes in AML risks and vulnerabilities – to ensure their ensuring their risk-based approach and AML/CTF PCPs remain effective.
- Smaller, potentially less sophisticated firms with limited resources may struggle to fully understand and incorporate the wider NRA findings in the context of their own businesses - potentially requiring more guidance and support from supervisors.

b) Supervisors:

- Supervisors would have a clearer legal basis to hold firms accountable for failing to adequately consider the NRA in their risk assessments and AML programs.
- Supervisors could more easily identify firms that are not properly addressing the risks outlined in the NRA and use this information in risk profiling methodology required under r.46

- Supervisors may need to provide more detailed guidance to firms on how to effectively incorporate the NRA into their compliance frameworks.

This obligation should:

- Clearly define how firms must demonstrate consideration of the NRA in their risk assessments and AML regime.
- Provide flexibility for firms to tailor their approach based on their specific risk profile and business model.
- not disproportionately burden smaller firms that may have limited compliance resources and where the potential impact is likely to be very limited.

System Prioritisation and the NRA

Q35 What role do you think the NRA versus system prioritisation should play in the allocation of regulated firms' resources and design of their AML/ CTF programmes?

We believe the NRA and system prioritisation are both critically important in terms of firm resource allocation and design of PCPs

It occurs to us that the main, overarching and long-standing AML/CTF risks to the regulated sector will not fundamentally change significantly over time given the underlying drivers of such risk (e.g. services provided offering anonymity, or the facilitation of fast moving/cross border transactions, exposure of PEPs to potential corruption). These will therefore be identified through the NRA, expanded upon and evaluated in a local/regional/sectoral context in r.17 sectoral risk assessments, and further put into the context of a firm's own business through the firm level and client/matter risk assessments.

It is our view therefore, that the current holistic risk assessment framework underpinned by the NRA should remain a cornerstone of a firm's PCPs and resource allocation, which should also then be regularly complimented and informed by information flows regarding system priorities at a dynamic, operational level as facilitated by public/private partnership.

Chapter 3: Providing clarity on scope and registration issues

Currency Thresholds

Q36 In your view, are there any reasons why the government should retain references to euros in the MLRs?

No - although we believe alignment to international standards should be retained, we do not see any reason why specific references to euros should remain. The equivalent GBP amounts could and should be reviewed should European or international standards be changed.

Q37 To what extent does the inclusion of euros in the MLRs cause you/your firm administrative burdens? Please be specific and provide evidence of the scale where possible.

Not relevant given our role/responsibilities as a Professional Body Supervisor

Q38 How can the UK best comply with threshold requirements set by the FATF?

See response to Q36

Q39 If the government were to change all references to euros in the MLRs to pound sterling which of the above conversion methods (Option A or Option B) do you think would be best course of action?

Option B.

Q40 Please explain your choice and outline with evidence, where possible, any expected impact that either option would have on the scope of regulated activity.

We believe option B would be preferable, to keep alignment with international standards and to avoid fluctuations in exchange rates which may cause misalignment.

Regulation of resale of companies and off the shelf companies by TCSPs

Q41 Do you agree that regulation 12(2) (a) and (b) should be extended to include formation of firms without an express request, sale to a customer or a person acting on the customer's behalf and acquisition of firms to sell to a customer or a person acting on the customer's behalf?

Given the money laundering risk associated with such activity - yes

Q42 Do you consider there to be any unintended consequences of making this change in the way described? Please explain your reasons.

While there may be some consequences in terms of the impact on legitimate business transactions, customer experience and risk displacement to other areas, these can be managed and as AML supervisors we consider the inclusion of such activity as essential in closing a loophole in the UK's defences against ML/TF.

Q43 In your view, what impact would this amendment have on TCSPs, both in terms of costs and wider impacts? Please provide evidence where possible.

We believe this is best answered by regulated TCSPs themselves. That said, as AML supervisors we consider that the overall benefits of closing this gap (including more robust AML defences, enhanced market perception/integrity) will invariably outweigh any costs, including resource allocation, compliance costs and impact on efficiency/transaction processing.

Change in control for crypto asset service providers

Q44 Do you agree that the MLRs should be updated to take into account the upcoming regulatory changes under FSMA regime? If not, please explain your reasons.

It would occur to us that such alignment would be beneficial. The FSMA 2023 has brought crypto assets within the regulatory perimeter, recognizing them as a specified investment and requiring authorization for related activities. This significant change aims to create a regulatory environment that fosters innovation while maintaining financial stability and clear regulatory standards.

Given these developments, it seems prudent for the MLRs to be updated to align with the new FSMA regime. This would ensure a cohesive regulatory framework that addresses the unique risks associated with crypto assets, such as their potential use for money laundering and terrorist financing.

Q45 Do you have views on the sequencing of any such changes to the MLRs in relation to the upcoming regulatory changes under the FSMA regime? If yes, please explain.

We do not hold any view on this matter given our role/responsibilities as a Professional Body Supervisor to Scottish solicitors.

Q46 Do you agree that this should be delivered by aligning the MLRs registration and FSMA authorisation process, including the concepts of control and controllers, for crypto assets and associated services that are covered by both the MLRs and FSMA regimes? If not, please explain your reasons.

Yes, please see our response to Q44.

Q47 In your view, are there unique features of the crypto asset sector that would lead to concerns about aligning the MLRs more closely with a FSMA style fit and proper process? If yes, please explain.

We do not hold any view on this matter given our role/responsibilities as a Professional Body Supervisor to Scottish solicitors.

Q48 Do you consider there to be any unintended consequences to closer alignment in the way described? If yes, please explain.

We do not hold any opinion on this matter given our role/responsibilities as a Professional Body Supervisor to Scottish solicitors.

Chapter 4: Reforming registration requirements for the Trust Registration Service

Registration of non-UK express trusts with no UK trustees, that own UK land

Q49 Does the proposal to make these trusts that acquired UK land before 6 October 2020 register on TRS cause any unintended consequences? If so, please describe these, and suggest an alternative approach and reasons for it.

We believe these questions are best responded to by regulated firms/practitioners.

We believe however that the collation of such information well after the event may be a challenge. It might be easier for TRS to identify all such land-owning trusts and contact them directly to ensure better coverage of registration.

Q50 Does the proposal to change the TRS data sharing rules to include these trusts cause any unintended consequences? If so, please describe these, and suggest an alternative approach and reasons for it.

See response to Q49.

Trusts required to register following a death

Q51 Do the proposals to exclude these trusts for two years from the date of death cause any unintended consequences? If so, please describe these, and suggest an alternative approach and reasons for it.

We believe these questions are best responded to by regulated firms/practitioners

Q52 Does the proposal to exclude Scottish survivorship destination trusts cause any unintended consequences? If so, please describe these, and suggest an alternative approach and reasons for it.

We agree with the proposal to exclude Scottish survivorship destination trusts from TRS registration, given the lower risk of money laundering/terrorist financing associated with these trusts, and do not anticipate any significant unintended consequences.

We would however advocate for the implementation of a regular review process for all trust types to assess whether the exclusion still aligns with the evolving regulatory landscape and financial practices.

De minimis exemption for registration

Q53 Does the proposal to create a de minimis level for registration cause any unintended consequences? If so, please describe these, and suggest an alternative approach and reasons for it.

We support the introduction of a de-minimis albeit we foresee situations where a small increase in income or assets could push a trust over the threshold, resulting in a disproportionate administrative burden.

As an alternative, a graduated scale of registration requirements could be introduced - involving lower requirements for trusts with income or assets just above the de minimis level, increasing in complexity with the trust's size and activity, including the ownership of high value property and other assets.

The introduction of other measures may also alleviate any unintended consequences - such as an annual review process (where the de minimis level could be reviewed to ensure relevance) and an option to opt in to registration even where they do not meet requirements if it's more convenient for their filing and tax payment patterns.

Q54 Do you have any views on the proposed de minimis criteria?

We agree that the proposed criteria are in keeping with a risk-based approach to AML/CTF. By excluding lower-value trusts, the TRS can focus its efforts on trusts with a higher risk of tax evasion or money laundering. The limits may also reduce administrative burden on smaller trusts which may not have the resources to comply with registration requirements. It occurs to us that the thresholds could be disputed as arbitrary, and evidence regarding rationale should be outlined in any further consultation on the position.

Q55 Do you have any proposals regarding what controls could be put in place to ensure that there is no opportunity to use the de minimis exemption to evade registration on TRS

Beyond any proposed restrictions put in place to prevent the creation of multiple trusts under the limit, it is important that Regular reviews are conducted of trusts that fall under the de minimis threshold to ensure that Trust scale and activity remains appropriate for the application of the de minimis exemption. Checking should be risk-based, using risk profiling of known red flags and risk factors, to identify any suspicious patterns of activity. Clear guidance and educational resources should be made available to trustees to understand their obligations under the de minimis exemption and the importance of TRS registration.

Information re. trusts under the threshold should be shared across tax authorities, law enforcement agencies, and other relevant bodies to help identify red flags, risk indicators or other discrepancies.

Cross-agency data-matching techniques and other technology could also help identify red flags and trusts that may be manipulating their assets to stay below the threshold.

Making aggregated data on trusts (without revealing individual details) publicly available may also enhance transparency and encourage scrutiny – therefore encouraging compliance and deterring misuse.

For further information, please contact:

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