Law Commission
Reforming the law

Anti-Money Laundering: the SARS Regime
A summary paper

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ANTI-MONEY LAUNDERING: THE SARS REGIME
A SUMMARY OF THE CONSULTATION PAPER

THE PROJECT

1.1 In 2017, the Law Commission agreed with the Home Office to review and make proposals for reform of limited aspects of the anti-money laundering regime in Part 7 of the Proceeds of Crime Act 2002 ("POCA") and of the counter-terrorism financing regime in Part 3 of the Terrorism Act 2000. This followed a discussion of ideas for inclusion in the Law Commission's thirteenth Programme of Law Reform. The primary purpose of the review is to improve the prevention, detection and prosecution of money laundering and terrorism financing in the United Kingdom.[1]

1.2 We agreed the following terms of reference with the Home Office:

(1) The review will cover the reporting of suspicious activity in order to seek a defence against money laundering or terrorist financing offences in relation to both regimes. Specifically, the review will focus on the consent provisions in sections 327 to 329 and sections 335, 336 and 338 of the Proceeds of Crime Act 2002, and in sections 21 to 21ZC of the Terrorism Act 2000.

(2) The review will also consider the interaction of the consent provisions with the disclosure offences in sections 330 to 333A of the Proceeds of Crime Act 2002 and sections 19, 21A and 21D of the Terrorism Act 2000.

(3) To achieve that purpose, the review will analyse the functions of, and benefits and problems arising from, the consent regime, including:

(a) the defence provided by the consent regime to the money laundering and terrorism financing offences;

(b) the ability of law enforcement to suspend suspicious transactions and thus investigate money laundering and restrain assets;

(c) the ability of law enforcement to investigate, and prosecutors to secure convictions, as a consequence of the wide scope of the money laundering and terrorist financing offences;

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[1] It should be noted throughout the consultation paper that the Law Commission's remit covers England and Wales only.

(d) the abuse of the automatic defence to money laundering and terrorism financing offences provided by the consent provisions;

(e) the underlying causes of the defensive over-reporting of suspicious transactions under the consent and disclosure provisions;

(f) the burden placed by the consent provisions and disclosure provisions on entities under duties to report suspicious activity; and

(g) the impact of the suspension of transactions under the consent provisions on reporting entities and entities that are the subject of reporting.

(4) The review will then produce reform options that address these issues. In doing so, the review will take into consideration the Fourth Anti-Money Laundering Directive ("4AMLD")[2] and the recommendations of the Financial Action Task Force, as well as the effect of new legislation or directives, such as the Criminal Finances Act 2017, the fifth Anti-Money Laundering Directive ("5AMLD")[3], the Payment Services Directive 2, and the General Data Protection Regulation.[4]

(5) The review will also gather ideas for wider reform which may go beyond the focused terms of reference noted above. These will be intended to provide a basis for future development of the anti-money laundering and counter terrorism financing regimes.

1.3 Work commenced on the project in February 2018. Since the project began, many stakeholders have agreed that the review is timely. The majority of stakeholders have endorsed the view that there are practical problems in the operation of the reporting regime which have a tangible impact on the private sector, law enforcement and the wider public.

BACKGROUND

1.4 It is not possible to value accurately the annual turnover of the proceeds of crime committed nationally or worldwide. Most experts agree that no reliable estimates exist. There have been attempts to place a value on domestic crime over the years. In 2005, HMRC estimated that the annual proceeds of crime in the UK were between £19 billion and £48 billion. They concluded that £25 billion was the best estimate for the

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2 Directive (EU) 2015/849 of 20 May 2015 the European Parliament and of the Council 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.

3 Directive of the European Parliament and of the Council amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU http://data.consilium.europa.eu/doc/document/PE-72-2017-INIT/en/pdf (accessed on 23 May 2018).

4 Regulation (EU) 2016/679 of the European Parliament and of the Council amending Directive 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation).

amount of money laundered per annum at that time.[5] This represented a small fraction of the overall value of transactions conducted by UK-based banks at the same time, estimated at approximately £5,500 billion per annum.[6]

1.5 The United Nations Office for Drugs and Crime[7] estimated the annual value of "all criminal proceeds" for 2009 at approximately US$2.1 trillion (or an average of 3.6% of global GDP (2.3% to 5.5%)). The amount estimated to be available for laundering in the same year through the financial system amounted to some US$1.6 trillion (equivalent to an average of 2.7% of global GDP (2.1% to 4%)).

1.6 One of the difficulties inherent in estimating the value of proceeds of crime is that many forms of criminal activity are cash intensive. Any offender who wants to spend or invest money obtained from their crimes without attracting the attention of law enforcement will seek to disguise or hide the source of their funds. This process is called money laundering. Whilst money laundering techniques vary,[8] it is generally agreed that there are three stages to the process; placement, layering and integration:[9]

(1) Placement: the money launderer seeks to put criminal funds into the financial system without attracting attention, for example by making small cash deposits into multiple bank accounts;

(2) Layering: the aim of layering is to reduce the risk of tracing criminal funds back to their source by conducting further transactions to give the appearance of legitimacy. The aim is to distance the funds from their true origin.[10] For example, a criminal may gradually increase the size of cash deposits into a bank account to mimic the growth of a legitimate business. More sophisticated methods may involve using company structures to obfuscate the source of funds or offshore bank accounts;

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5 Corporation of London, *Anti-Money Laundering Requirements: Costs, Benefits and Perceptions* (June 2005), p 15.

6 Corporation of London, *Anti-Money Laundering Requirements: Costs, Benefits and Perceptions* (June 2005), p 16.

7 United Nations Office on Drugs and Crime (UNODC): '*Estimating illicit financial flows resulting from drug trafficking and other transnational organized crimes: Research Report*' (October 2011); key findings, cited in '*UK national risk assessment of money laundering and terrorist financing*' (HM Treasury and Home Office, October 2015); and EUROPOL '*Criminal Asset Recovery in the EU: Does crime still pay? Survey of statistical information 2010-2014*'; 2016, p.5. Estimates of worldwide turnover of organized crime, set out in Table 31, page 38, to the 2011 UNODC Report, is reproduced at Appendix A.

8 A Kennedy, "Dead Fish across the Trail: Illustrations of Money Laundering Methods" (2005) *8 Journal of Money Laundering Control*, 306-315. For a review of current money laundering techniques, see also National Crime Agency, *National Strategic Assessment of Serious and Organised Crime* (2018).

9 *Millington and Sutherland Williams on the Proceeds of Crime* (5th Edition, 2018) para. 20.42. The three-stage process above does not necessarily apply to terrorist financing. Where funds are to be used for the purposes of terrorism, the source of funds may not be illegal. For example, a mother whose son is fighting alongside ISIS may transfer money to him from her legitimate earnings to support his cause.

10 N Ryder, "The financial services authority and money laundering – A game of cat and mouse*." The Cambridge Law Journal,* 67(3), November 2008, p 635.

(3) Integration: the money launderer brings the funds back into the economy having disguised the source so they appear to be legitimate earnings. Money may be withdrawn from a bank account and spent by the offender or their family. It may also be reinvested in further criminal activity or in assets such as property.

1.7 Given the difficulties in identifying criminal funds once they are within the financial system, intelligence from the private sector at the placement stage is crucial. The safety, convenience and legitimacy conveyed by a bank account means that the majority of people, including criminals, will conduct some of their financial affairs through large financial institutions. Banks are able to monitor unusual activity and provide information to the authorities within a legal framework set down by part 7 of POCA.[11] In this way, they perform a vital law enforcement function.

THE CURRENT LAW

Overview

1.8 The existing anti-money laundering and terrorism financing regime in the UK can be divided into four parts.

(1) The Proceeds of Crime Act 2002 received Royal Assent on 24 July 2002. Part 7 was intended to replace and improve upon the preceding money laundering legislation. Part 7 created:

(a) three offences of money laundering which apply to the proceeds of any criminal offence;[12]

(b) legal obligations to report suspected money laundering bolstered by criminal offences for failures to disclose;[13]

(c) a complementary "consent regime" of authorised disclosures which offer protection from criminal liability;[14] and

(d) a prohibition on warning the (alleged) money launderer that a report had been made to the authorities or an investigation had begun ("tipping off").[15]

(2) A parallel regime operates in relation to counter-terrorism financing and is contained in Part 2 of the Terrorism Act 2000. We will consider terrorism financing in detail in Chapter 3.

(3) Domestic anti-money laundering provisions have been supplemented by successive EU Directives on money laundering. These have been implemented by Regulation in the UK. The 4th Anti-Money Laundering Directive ("4AMLD")

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11 The parallel regime under the Terrorism Act 2000 will also be considered in the consultation paper.

12 Proceeds of Crime Act 2002, ss 327-329.

13 Proceeds of Crime Act 2002, ss 330-332.

14 Proceeds of Crime Act 2002, ss 327(2)(a), 328(2)(a), 329(2)(a).

15 Proceeds of Crime Act 2002, s 330A.

was agreed in June 2015 and implemented in the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (The Money Laundering Regulations 2017). The Money Laundering Regulations 2017 create a system of regulatory obligations for businesses under the supervision of the Financial Conduct Authority and the relevant professional and regulatory bodies recognised within the Regulations. At the time of writing, the UK is negotiating its exit from the EU. It is unclear how this may impact on the UK's obligations under EU law in respect of anti-money laundering and counter terrorism financing. However, it is assumed for the purposes of the consultation paper that the drive to harmonise standards across states as far as possible is unlikely to change and we will continue to comply with the terms of 4AMLD for the foreseeable future.

(4) Whilst POCA and the 4AMLD form the foundation of the UK's anti-money laundering regime, domestic law must be considered in the context of agreed international standards. The UK is one of the founding members of the Financial Action Task Force (FATF), an inter-governmental body established in 1989 to set standards in relation to combatting money laundering and terrorist financing. Its recommendations are recognised as the international standard for anti-money laundering regulation. The recommendations set out a framework of measures to be implemented by its members and monitored through a peer review process of mutual evaluation.[16]

The consent regime

Required and authorised disclosures

1.9 The consent regime refers to the process whereby an individual who suspects that they are dealing with the proceeds of crime can seek permission to complete a transaction by disclosing their suspicion to the UK Financial Intelligence Unit ("UKFIU") which is housed within the National Crime Agency ("NCA"). In order to understand how the consent regime operates, it is necessary to consider the types of disclosure that a bank or business might make when they suspect someone is engaged in money laundering or, for example, comes into possession of hat they suspect may be the proceeds of crime.

1.10 There are two types of disclosure that a bank or business may make: "required disclosures" and "authorised disclosures." We will consider this in more detail in Chapter 2, but for present purposes, the important distinction is between whether the disclosure is required by law or whether the reporter wishes to protect themselves from a potential money laundering charge.

1.11 Required disclosures are triggered by one of the statutory duties to disclose under POCA where a person knows, suspects or has reasonable grounds to know or

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16 See http://www.fatf-gafi.org/. Mutual Evaluation Reports can be accessed at http://www.fatf-gafi.org/publications/mutualevaluations/?hf=10&b=0&s=desc(fatf_releasedate) (last visited on 24 April 2018).

suspect that a person is engaged in money laundering.[17] If they are not made, the person who ought to have reported is liable for prosecution for a criminal offence.

1.12 In contrast, authorised disclosures have a dual function: they both provide intelligence to the law enforcement agencies, and protect the discloser from relevant criminal liability. For example, a bank may become suspicious that funds in a customer's account are the proceeds of crime. If their customer asks the bank to make a payment in accordance with their mandate, disclosure is made to obtain consent to proceed with the transaction and bring the individual within a statutory exemption effectively precluding any future money laundering charge against the reporter.[18]

1.13 Whilst both types of disclosure will be examined in detail in the consultation paper, authorised disclosures and the consent exemption ("the consent regime") will be the principal focus of the consultation paper.

Suspicious activity reports

1.14 Suspicious activity reports (SARs) are the mechanism by which the private sector make disclosures in relation to money laundering and terrorism financing under POCA.[19] The SAR is the format in which the UKFIU receive information. The UKFIU facilitates the disclosure process by acting as the intermediary for intelligence between the private sector and law enforcement agencies. When a SAR is submitted, it is analysed and made available to law enforcement agencies to investigate and decide whether to pursue further criminal or civil proceedings. Because of the time it takes to conduct an investigation and intervene to preserve criminal assets, the scheme obliges the bank to refrain from processing the transaction once a SAR is submitted. That allows the law enforcement agencies to take a fully informed decision on whether to consent to the transaction.

1.15 High quality SARs can be a vital source of intelligence.[20] They can provide evidence of money laundering in action. Furthermore, SARs are one of the primary methods of sharing information to produce intelligence for law enforcement to investigate and prosecute crime more generally.[21] Identifying the proceeds of criminal activity can establish an investigative trail leading law enforcement back to the original criminal activity. A SAR may trigger an investigation or provide a useful resource for an investigation that is already ongoing.

1.16 Multiple SARs on the same subject can trigger investigations into a new target. For example, if a bank and a law firm are both working on the same transaction and each reports suspicious activity, this provides a richer intelligence picture to the authorities. Information from these reports leads to the recovery of the proceeds of crime by assisting in restraint orders, confiscation orders and cash seizures. Although the

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17 Proceeds of Crime Act 2002, ss 330, 331 and 332.

18 Proceeds of Crime Act 2002, ss 327(2), 328(2) and 329(2).

19 More specifically it is the regulated sector who are most heavily impacted by the SARs regime. The regulated sector is defined in Schedule 9 to the Proceeds of Crime Act 2002.

20 National Crime Agency, *Suspicious Activity Reports Annual Report* (2017), p 5.

21 HM Treasury and Home Office, *National risk assessment of money laundering and terrorist financing*, (October 2017).

quality of the intelligence gathered depends, in part, on the quality of the information provided in the SAR. Inferior quality SARs are more time intensive, can contribute to delay and may ultimately remain of little effect or value.

Cost to the economy

1.17 This reporting regime impacts on the legitimate economy in two ways. First, there is a considerable cost to businesses in ensuring compliance with their reporting obligations. Secondly, there is a cost to the taxpayer in resourcing the receipt and analysis of reports to assist law enforcement agencies. It is worth considering whether the cost of the regime is proportionate and whether it is as efficient as it could be.

1.18 The level of burden placed upon the reporter depends upon whether they are operating within or outside the regulated sector. The legislation brings a broad range of businesses within the scope of the regulated sector. For example, it includes financial institutions, those providing accountancy services, tax advisory or investment services, those participating in financial or real property transactions (including legal professionals), insolvency practitioners, high value dealers and casinos amongst others.[22]

1.19 The largest reporting sector is banking. Between October 2015 and March 2017, banks accounted for 82.85% of the 634,113 SARs submitted to the UK Financial Intelligence Unit.[23] Adding together the percentages of SARs from all other types of credit or financial institutions brings this figure to 95.78%. Overwhelmingly, the financial sector bears the greatest burden.[24] This is understandable when we consider the volume of transactions processed by the financial sector. The large retail banks are conducting transactions on an industrial scale. One of the largest reporting banks receives an average 3300 automated alerts per month highlighting unusual activity. However, this can fluctuate and has been known to rise to over 7,000 alerts per month. In addition, a further 14,200 internal reports (inclusive of fraud referrals) of potentially suspicious activity from staff will be submitted each month.

1.20 It has been estimated that the cost of the anti-money laundering system to a large reporting bank is in the region of tens of millions of pounds per year[25]. The British Bankers' Association (now UK Finance) estimated that its members are spending at least £5 billion annually on core financial crime compliance, including enhanced systems and controls and recruitment of staff.[26] High costs attributed to anti-money

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22 POCA 2002, s 330(12) and schedule 9 "has effect for the purpose of determining what is a business in the regulated sector."

23 National Crime Agency, *Suspicious Activity Reports Annual Report* (2017), figure i.

24 National Crime Agency, *Suspicious Activity Reports Annual Report* (2017), p 12 to 13.

25 "Individual institutions are dedicating very large sums of money to fulfilling their statutory obligations- as much as £36 million a year from one bank."

HL Paper 132-1 *Money Laundering and the financing of terrorism – European Union Committee*, Session 2008-2009, volume 1 at para 124.

26 Joint Home Office and HM Treasury *Action Plan for anti-money laundering and counter-terrorist finance* (2016), para 2.1.

laundering requirements may reduce confidence in the efficiency of the system.[27] It is also essential to identify the right balance between reputation and competitiveness and whether this has been struck in the UK. Anti-money laundering regulation is essential to ensuring that the integrity of the UK's financial sector. However, the UK's competitive position has the potential to be undermined by unnecessary regulation or regulation which fails to produce verifiable results.[28]

1.21 Whilst the financial sector is the largest reporting sector, there are significant compliance costs for every sector with reporting obligations. However, the cost of compliance may be difficult to quantify. In December 2009, the Law Society responded to a call for evidence as part of a Government review of the Money Laundering Regulations 2007. The Law Society conducted a costs survey of its members in 2008 and highlighted the problems inherent in estimating the cost of compliance with the anti-money laundering regime. Their members identified difficulties in quantifying costs on matters such as monitoring clients and transactions for warning signs and discussing suspicions and internal reports in deciding whether or not a SAR is required to be made.

1.22 The Law Society reported that on average most firms were spending around four hours each week on discussing suspicions and making disclosures. In terms of time spent by the person responsible for making reports (the "nominated officer"), 50% said it cost them up to £500 a year, the top 25% said it cost them £7,500 or more, with one firm reporting costs of around £164,000. In 2009, a further survey was conducted of some of the top 100 firms. Of the 21 firms that responded, cost estimates for a year ranged from £4,000 to £300,000 in lost fee earner and chargeable time. Total expenditure on quantifiable anti-money laundering compliance costs for each of the firms ranged from £26,800 to £1,035,000 per year. For all 21 firms combined, it was almost £6.5 million.[29] These figures exclude the broader costs of anti-money laundering systems development, conducting due diligence, training and staff salaries which may be substantial in larger organisations.

1.23 As we will discuss in Chapter 5, whilst the legal sector does not produce the same volume of SARs as the financial sector, the SARs that are submitted may be more complex. The amount of resources required to conduct due diligence and lodge these disclosures may not be proportionate to the value of the criminal property involved or the seriousness of the crime in every case.

1.24 In addition to the costs to the private sector, it is of fundamental importance that law enforcement resources are deployed appropriately. The NCA, which is responsible for overseeing the UKFIU, has confirmed that the volume of SARs is increasing. In its most recent annual report, the NCA highlighted a substantial growth in the total

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27 Corporation of London, *Anti-Money Laundering Requirements: Costs, Benefits and Perceptions* (June 2005), p 9.

28 Corporation of London, *Anti-Money Laundering Requirements: Costs, Benefits and Perceptions* (June 2005), p 4.

29 The Law Society, The costs and benefits of anti-money laundering compliance for solicitors: Response by the Law Society of England and Wales to the call for evidence in the Review of the Money Laundering Regulations 2007 (December 2009), p 25-27.

number of SARs and the number of cases where consent (now referred to by the UKFIU as a defence against money laundering or "DAML") had been requested.[30]

1.25 On average, 2000 SARs are received per working day by the UKFIU. Of this figure, on average 100 will be SARs seeking consent to proceed with a financial transaction (DAML and defence against terrorist financing ("DATF") SARs).[31] Twenty-five members of staff are dedicated to processing DAML and DATF SARs at the UKFIU. Increases in the intake of SARs have a consequent impact on processing times. This is a pressing problem where further information is required because the SAR is of poor quality or where a SAR requires input from one of the law enforcement agencies. Based on the current volume of DAML SARs, senior managers spend approximately 20-30% of their time making decisions on consent.[32] All stakeholders we have spoken to felt that the consent process was overburdened and leads to delay.

1.26 Where SARs are unnecessary, of little practical effect or simply of poor quality, essential resources are diverted from the investigation and prosecution of crime. As the consultation paper will explain, these issues have substantial consequences for both the private sector, law enforcement agencies and the public.

1.27 To remedy some of the most pressing problems, the Law Commission is asking consultees for their views on the suitability of a range of proposed solutions.

THE CONSULTATION PAPER

The purpose of the paper

The consultation paper has two principal aims: to identify the most pressing problems and consult on reforming the consent regime; and to generate and consider ideas for long-term reform. Our proposals are intended to improve the prevention, detection and prosecution of money laundering and terrorism financing in England and Wales.[33] We will consider whether the current regime is proportionate and efficient.

1.28 After extensive fact finding meetings with stakeholders, the following issues are noted as causing particular difficulties in practice:

(1) the large volume of disclosures to the UKFIU (634,113 between October 2015 and March 2017, of which 27,471 were DAML SARs);

(2) the low intelligence value and poor quality of many of the disclosures that are made in accordance with the present legal obligations;

(3) the misunderstanding of the authorised disclosure exemption by some reporters;

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30 National Crime Agency, *Suspicious Activity Reports Annual Report* (2017) p 6.

31 These Consent SARs are now referred to as "Defence Against Money Laundering" (DAML) SARs or "Defence Against Terrorism Financing" (DATF) SARs.

32 Interviews with UK FIU Staff on 28 March 2018.

33 Although the Proceeds of Crime Act 2002 and Terrorism Act 2000 apply to the UK as a whole the focus of the project is limited to England and Wales.

(4) abuse of the authorised disclosure exemption by a small number of dishonest businesses and individuals;

(5) defensive reporting of suspicious transactions;

(6) the overall burden of compliance on entities under duties to report suspicious activity;

(7) the impact of the suspension of transactions on reporting entities and those that are the subject of a SAR.

1.29 In addition, the following legal difficulties have been identified:

(1) the "all-crimes" approach whereby *any* criminal conduct which generates a benefit to the offender will be caught by the regime as "criminal property" and hence will have an impact of this on the scope of reporting;

(2) the terminology used in part 7 of POCA and the meaning of appropriate consent;

(3) the meaning of suspicion and its application by those with obligations to report suspicious activity;

(4) fungibility, criminal property and issues arising from mixing criminal and non-criminal funds;

(5) the extent to which information should be shared between private sector entities;

(6) the wide definition of "criminal property" which applies to the proceeds of any crime and has no minimum threshold value;

(7) what should constitute a "reasonable excuse" within Part 7.

Scheme of the paper

The current law and its effectiveness

1.30 Chapters 2 and 3 set out the current law surrounding the operation of the suspicious activity reporting regime in relation to money laundering and terrorism financing.

1.31 In Chapter 2, by using the example of a large bank we outline how transactions are monitored by the private sector. We look at required and authorised disclosures, focussing on the obligations on reporters and the process of making disclosures to the UKFIU housed within the National Crime Agency. We also consider the money laundering offences, including some of the key concepts - such as criminal property, suspicion and criminal conduct - which have generated issues in practice. Further, we consider the available exemptions or defences to those offences. We also outline the tipping off provisions, where an individual risks criminal liability if they inform the subject of a disclosure or investigation that a SAR had been submitted. We examine the issues that arise from these provisions in practice. We summarise the current law on information sharing between the private sector and the NCA. Finally, we look at

regulatory requirements on banks and businesses and how their compliance is supervised and monitored.

1.32 In Chapter 3, we consider the objectives of the terrorism financing regime and how they differ from money laundering. We look at the disclosure regime in so far as it differs from our summary in Chapter 2. We examine the terrorist financing offences in the Terrorism Act 2000 and the relevant exemptions or defences. We also look at the tipping off provisions in the context of terrorism financing. We observe that whilst there are similarities across the money laundering and terrorist financing regimes, there are also important differences to consider. In particular, the policy objectives between the two regimes are not necessarily the same; preventing terrorist attacks and disrupting organised criminal activity are separate and distinct aims. The methods used to raise finance for terrorism can also differ from money laundering techniques. For this reason, the types of intelligence that are useful to law enforcement will also be different. Finally, the risk of harm arising from an ineffective counter-terrorism financing regime could be an immediate threat to public safety. We conclude by analysing some of the issues that arise from the current regime and identifying that the principle issue relates to the application of suspicion by reporters.

1.33 In Chapter 4, we examine the effectiveness of the current consent regime by analysing the statistics on authorised disclosures[34] and conclude that it is likely that the vast majority of consent SARs do not lead to restraint or seizure of assets. However, we acknowledge that restraint and seizure are not the only measures of effectiveness for SARs. They can provide a range of intelligence which may assist with an investigation. SARs provide value through:

(1) intelligence on which to base investigations;

(2) intelligence to assist and develop existing investigations into criminality;

(3) Intelligence about criminals and their networks, which may be of value in the future as part of the general intelligence gathering process; and

(4) reliable information to identify criminals with assets obtained from their criminality.[35]

1.34 We observe that there are two important caveats to this analysis. First, it is difficult to account for disruption of criminal activity. Secondly, there is an absence of data from law enforcement agencies as to when a SAR is integral to an investigation or leads to a prosecution. We observe that the UKFIU receives the highest number of SARs in comparison with other EU States and this trend looks likely to continue. We set out the potential causes for such high reporting volumes. We identify four principal pressures for change: the low threshold for criminality, individual criminal liability, confusion amongst those in the regulated sector as to their reporting obligations and the application of suspicion. We proceed to examine these factors in subsequent chapters.

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34 Now referred to by the NCA as DAML SARs.

35 https://www.app.college.police.uk/app-content/investigations/investigative-strategies/financial-investigation-2/using-financial-information/ (last accessed 5 July 2018).

Pressing problems and possible solutions

1.35 Chapters 5 to 13 identify the most pressing problems with the current law, and identify some provisional solutions to improve the current regime.

1.36 In Chapter 5, we discuss the "all-crimes" approach to criminal conduct in POCA and the fact that the proceeds of any crime fall within the definition of criminal property. We consider the consequences of this approach and its impact on the volume of reports made. We analyse particular problems faced by the legal sector in identifying what are perceived as "technical" cases of money laundering; where lawyers must comply strictly with their obligations but consider the intelligence value of their disclosure to be low or negligible. We examine the alternative "serious crimes" approach and the benefits and disadvantages of moving away from an all-encompassing definition of criminal conduct. We form the provisional view that a change to a serious crimes approach could prove to be problematic and undesirable. However, we invite consultees' comments on the merits of three alternatives to the current "all crimes" approach:

(1) a "serious crimes" approach based on a list of offences or threshold penalty;

(2) extending the reasonable excuse defence for those who do not report non-serious crimes (as could be defined in a schedule);

(3) maintaining a formal required disclosure regime for offences on a schedule of serious offences but providing a complementary voluntary scheme for the regulated sector to draw to the attention of the UKFIU any non-serious cases.

1.37 Chapter 6 considers the key concept of suspicion. We observe that POCA sets the minimum threshold of the mental element for the money laundering offences at suspicion. It is also the minimum threshold for reporting obligations. We consider the importance of the concept being understood and applied consistently in the context of reporting volumes and quality of reports. We outline the ordinary meaning of suspicion and its place in the hierarchy of fault in criminal law. We discuss the meaning of suspicion in an investigative context and consider the approaches taken in some other jurisdictions.

1.38 In Chapter 7, we look at how the concept of suspicion has been applied in the context of money laundering offences. We examine the case law on suspicion and on reasonable grounds to suspect. We also consider industry-led guidance on suspicion and its application. We outline the criticisms of the suspicion test in the context of the money laundering offences and the challenges it creates. In particular, we highlight the possibility that suspicion is inconsistently understood and applied by those with reporting obligations. We suggest that this contributes to poor quality disclosures. A poor quality authorised disclosure may still have severe economic consequences for the subject of the disclosure if access to their funds is restricted. We conclude by recognising the need for the system to find a fair balance between the interests of law enforcement agencies, reporters and those who are the subject of a disclosure.

1.39 Chapter 8 examines the application of the test of suspicion in the context of the disclosure offences. We outline the approach to suspicion in the context of reporting obligations and examine the interpretations of the alternative test of reasonable

grounds to suspect. We analyse the two possible interpretations of reasonable grounds to suspect as either a purely objective test, or a mixed test requiring subjective suspicion and objective grounds. We consider the approaches of other jurisdictions, focussing on Canada which sets the threshold for reporting at reasonable grounds to suspect and provides guidance on indicators of money laundering. We go on to consider whether the disclosure offences in sections 330 and 331 of POCA set down an objective test, the fairness of such an approach and the likely consequences for reporting volumes. We conclude that it is strongly arguable that "reasonable grounds to suspect" in the context of sections 330 and 331 is a wholly objective test. Finally, we state that there are compelling arguments to suggest that the threshold for liability is too low.

1.40 In Chapter 9, we bring together all of the analysis in Chapters 6 to 8 and consider the options for reform. We consider whether "suspicion" should be defined in Part 7 of POCA, and identify a number of difficulties with attempting to do that. However, we invite consultees views on whether and how it might be defined. We provisionally propose that the better approach would be for Government to issue formal guidance under a statutory power setting out factors indicative of suspicion. We also provisionally propose that the Secretary of State should introduce a prescribed form pursuant to section 339 of POCA. We invite consultees' views on both of these conclusions. Notwithstanding these proposals, we set out the case for amending the reporting threshold and the fault threshold for the disclosure offences to reasonable grounds to suspect in order to make the regime more effective. We outline the benefits of altering the threshold to require a subjective suspicion and objective supporting grounds. We examine whether such a change would comply with the provisions of the 4th Money Laundering Directive and conclude that it is unclear whether such an approach would be FATF compliant. At present, we foresee that the UK will continue to comply with its obligations under the 4th Money Laundering Directive subject to the terms of our withdrawal from the EU.

1.41 In relation to the money laundering offences, we come to the view that, in the absence of compelling evidence to the contrary, the fault threshold of suspicion should not be amended. However, we provisionally propose a new defence for the regulated sector. Where an individual in the regulated sector has no reasonable grounds to suspect that property is criminal property within the meaning of section 340, they would not commit an offence. We provisionally conclude that such a change would be likely to have a positive impact on the overall volume of authorised disclosures (DAML SARs). Finally, we form the provisional view that no change should be made to the terrorism financing regime for two reasons. First, the evidence suggests that the main issue in reporting relates to the application of suspicion by reporters, which could be resolved by way of guidance. Those SARs requiring consent (DATF SARs) are submitted in much lower volumes in respect of terrorism financing. Secondly, the objectives of the terrorism financing reporting regime are different to money laundering and may justify a lower threshold. We acknowledge that this creates clearer divide between the two regimes and seek consultees' views on whether this would create problems in practice.

1.42 Chapter 10 considers the issue of criminal property and identifies problems for the regulated sector arising from the current law where legitimate funds are mixed with criminal funds. In particular, we examine the case law on mixed funds and the problems that arise if adding criminal funds to legitimate funds is considered to taint

the whole pot. We highlight the problems faced by banks and the subjects of authorised disclosures when whole accounts are frozen, even where the suspicion relates to only part of the funds in an account. We compare approaches to mixed property across POCA and identify a potential way forward. We provisionally propose statutory protection by way of a defence for banks who elect to ringfence the suspected criminal funds whilst they await a decision on consent. We invite consultees to respond to this provisional proposal.

1.43 In Chapter 11 we consider the scope of reporting on the basis of the current law. On the assumption that an all-crimes approach is retained, we examine ways in which the intelligence value of SARs can be enhanced. We identify a list of types of SAR which stakeholders consider to be of little effect or value. We go on to consider the merits of legislative change to account for these types of SARs but provisionally conclude that this would be unworkable. Any legislative amendment defining 'reasonable excuse' in Part 7 of POCA would need to take the form of an exhaustive list. As this would be liable to change, such an approach risks inhibiting valuable flexibility in the system. We provisionally propose that the Government should issue statutory guidance listing matters indicative of the types of things which might be regarded as a "reasonable excuse" for failing to make a disclosure. We invite consultees' views on whether such guidance would be beneficial in reducing the volume of low-intelligence value SARs.

1.44 Chapter 12 examines the meaning of "consent" and problems arising from the interpretation of the term by those with reporting obligations. We outline the problems identified by the National Crime Agency which it believes arises from the use of the term consent in POCA. We set out the legal consequences of a grant of appropriate consent and consider alternative wording which may better describe the process of obtaining consent. We consider the options for reform. We provisionally propose that there should be a requirement in POCA that Government produces guidance on the term "appropriate consent" under Part 7 of POCA and invite consultees' views on the issue.

1.45 Chapter 13 examines the current provisions for obtaining and sharing information in relation to money laundering and terrorism financing. We also look at other ways of sharing information such as financial information sharing partnerships. We consider obligations arising under the General Data Protection Regulation and the Data Protection Act 2018. We set out stakeholders' views on whether the current provisions are adequate. We analyse the benefits and risks of extending information sharing provisions to allow institutions with reporting obligations to share information with each other even when an unusual transaction does not meet the suspicion threshold. In particular, we look at the risks of debanking and financial disenfranchisement and data protection considerations. We conclude that there are strong arguments against allowing private sector institutions to operate at a lower threshold than law enforcement agencies for the obtaining and onward disclosure of information without external scrutiny. We re-iterate the arguments presented in Chapters 6-9 that suspicion is already a low threshold. We invite consultees' views on whether pre-suspicion information sharing by those in the regulated sector is necessary or desirable, and if so we invite thoughts on how such a provision might be formulated.

Longer term reform

1.46 In Chapter 14, we discuss the significance of our narrow terms of reference and the ideas that we have considered for reforming the current consent regime. Our provisional proposals are based on the current legislative structure, EU obligations and agreed international standards. However, we recognise that alternative models exist. The UK is one of a small number of countries which operates a consent regime and throughout the consultation paper we draw upon the different regimes adopted in a number of other jurisdictions for comparative analysis. We confirm that we do not advocate removal of the consent regime. We believe that the adjustments that we have proposed will improve efficiency and provide a better balance between the interests of law enforcement agencies, reporters and those who are the subject of a disclosure. However, we outline what a non-consent model might look like and how it might operate in practice. We examine the benefits and disadvantages of operating without a consent regime. We invite consultees' views on the retention of the current regime. In addition, we look at other proposals that may enhance the existing regime. We consider whether the addition of thematic reporting would be beneficial. In doing so, we examine the use of Geographic Targeting Orders in the USA. We invite consultees' views on whether there should be a power to require additional reporting and record keeping requirements targeted at specific transactions.

ACKNOWLEDGMENTS

1.47 In order to ensure we had a thorough grasp on the practical problems inherent in the current regime, we have engaged with a large number of stakeholders in our pre-consultation discussions (a full list can be found in **Error! Reference source not found.**government departments, organisations and individuals consulted). We are grateful to them for identifying some of the issues of concern and their ideas on how to improve the current system.

1.48 We are indebted in particular to Rudi Fortson QC (Visiting Professor at Queen Mary, University of London and practising barrister, 25 Bedford Row) who has acted as a consultant on this project.