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Treasury Committee

Government Response to the Committee's Twenty-Eighth Report: Economic Crime—Anti-money laundering supervision and sanctions implementation

Eleventh Special Report of Session 2017–19

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The Treasury Committee

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Eleventh Special Report

On 8 March 2019, the Treasury Committee published its Twenty-Eighth Report of Session 2017–19, *Economic Crime - Anti-money laundering supervision and sanctions implementation* (HC 2010). The government response was received on 3 May 2019.

Appendix: Government Response

The government has considered the Treasury Select Committee's report titled 'Economic Crime: Anti-money laundering supervision and sanctions implementation' (the report), published on 8 March 2019.[1]

The report's conclusions and recommendations are welcome and add to those made by the Financial Action Task Force (FATF)[2] in their review of the UK's anti-money laundering and counter-terrorist financing (AML/CTF) regime which was published in December 2018. FATF gave the UK the strongest results of the over 60 countries it has assessed to date.

The government intends to consider both the recommendations of FATF and those in the report more fully through an Economic Crime Plan which is being delivered in conjunction with the private sector and is due to be published in July 2019.

This paper sets out the government's response to each of the Committee's conclusions and recommendations. The Committee's text is in bold and the government's response is in plain text. Paragraph numbers refer to the report.

The threat of economic crime

The scale of economic crime in the UK is very uncertain. It seems that it can reasonably be said to run into the tens of billions of pounds, and probably the hundreds of billions. We note that those who gave evidence regarded it as being small in comparison to the total amount of financial activity in the UK, and especially the City of London—for example the daily value of foreign-exchange trading in the UK at around £1.8 trillion. Such a comparison provides no comfort to the Committee. Rather, it suggests that the upper bound of the estimate is unknown. (Paragraph 15)

It is exceptionally difficult to measure economic crime, given those undertaking it are actively trying to hide it. The Committee does not doubt the will of the authorities to combat economic crime. However, it considers there to be merit in attempting to measure its extent, since greater understanding of the scale of the problem will allow those responding to provide sufficient resources to tackle it, and potentially highlight where those resources should be targeted. The Committee therefore recommends that the Government undertakes more analysis to try and provide both more precision on the potential estimate of the size and scale of economic-related crime in the UK, as well as the exposure of different sectors to it. (Paragraph 16)

1 Economic Crime: Anti-money laundering supervision and sanctions implementation', House of Commons Treasury Committee, 8 March 2019: https://publications.parliament.uk/pa/cm201719/cmselect/cmtreasy/2010/201002.htm

2 The Financial Action Task Force is the international AML/CTF standard setter.

The government considers better understanding of the threat of economic crime a key part of its ongoing efforts to combat economic crime, part of which has included attempting to estimate its size and scale. The recently established National Economic Crime Centre (NECC) is leading the first collaborative public-private assessment of the UK's economic crime threat.

The development of the NECC and the public-private threat assessment sits alongside the Government's existing efforts to estimate the size and scale of economic crimes. The Home Office recently undertook a review of the scale and nature of fraud against individuals and businesses to establish the state of the evidence base and identify areas for further research.[3] One of its conclusions was that while significant improvements had been made in the reporting and recording of fraud (e.g. its introduction into the Crime Survey for England and Wales), it is difficult to unpick the true scale of fraud for individuals and businesses.

Other types of economic crime, such as money laundering, are inherently clandestine, making measurement highly challenging. Recently, representatives from the government, law enforcement, academia and the private sector attended a workshop at the Royal United Services Institute (RUSI), exploring how we can better understand the scale of money laundering in the UK. Similar to the Committee, this workshop found that gaining a true and comprehensive picture of the scale of economic crime is exceptionally difficult. However, it also concluded that, with a robust approach, it may be possible to at least establish the lower bounds of the scale of economic crime.

In light of this, the government considers that further attempts to measure the size and scale of economic crime would require considerable resource and are unlikely to improve our overall picture of the scale and threat of economic crime, due to its inherently clandestine nature. While the government recognises the merit in improving our estimates of the size and scale of economic crime, we should therefore only pursue this where further improvements in our estimates are both possible and practicable. Further, this needs to be balanced against other key evidence gaps around understanding the impacts, enablers and drivers, and future trends of economic crime.

The government will prioritise reforms that will deliver the highest impact in combatting economic crime. Further work to improve our understanding of the size and scale, and broader understanding, of economic crime, will be an important part of the Economic Crime Plan the government will publish later this year. That in turn will help ensure resources are allocated towards identifying the threat as effectively as possible.

The UK holds a prime position in global financial services, with the City of London a dominant financial centre. Despite Brexit challenges, the UK must work to keep it that way. A 'clean' City is important, so the Government must recognise the responsibility to combat economic crime that comes with that position. Recent moves by the Government in this area are welcome, but must be sustained, and match the UK's ambitions to continue to be a global leader in financial services. (Paragraph 21)

The UK's departure from the European Union will inevitably result in a change in international trading relationships. Such new trading relationships may also provide

3 'The scale and nature of fraud: a review of the evidence', Home Office, 16 July 2018: https://www.gov.uk/government/publications/the-scale-and-nature-of-fraud-a-review-of-the-evidence

opportunities to those wishing to undertake economic crime in countries that are more vulnerable to corruption. The UK must remain alert to that risk, including when it conducts trade negotiations. The Government must be consistently clear about its intention to lead in the fight against economic crime, and not compromise that in an effort to swiftly secure new trading relationships. (Paragraph 26)

The government agrees with the Committee's conclusion that the UK's prime position in global financial services provides the UK government with a responsibility to combat economic crime. Indeed, the government would go further and argue that much of what attracts commercial activity to the UK in the first place is its reputation as a clean and safe place to do business. Protecting and promoting the UK as a leading global financial centre is therefore one reason why the government has made combatting economic crime such a priority. This commitment can be seen both internationally, where the UK is leading the global anti-corruption agenda, and domestically where the government's pioneering recent initiatives include the introduction of new powers in the Criminal Finances Act 2017, the creation of the National Economic Crime Centre, and the establishment of the Office for Professional Body AML Supervision (OPBAS). The government was pleased that its commitment and efforts were recognised in FATF's recent evaluation of the UK's AML/CTF regime which gave the UK the strongest results of over 60 countries assessed to date.

The government's commitment to combatting economic crime will not diminish once the UK has exited the European Union (the EU). Instead, the UK hopes to strengthen its status as a world leader in this field through continuing to implement and champion international standards and by driving forward the global 'race to the top' through both our bilateral and multilateral engagement (as the Chancellor set out in his speech on the global regulatory landscape in December last year).

We recommend that the Government retains, or replicates, the arrangements with the EU to maintain the flow of information between the UK and EU member states' law enforcement agencies on economic crime. We recommend that the Government work to develop strong relationships with other countries and strengthen mutual information sharing and law enforcement powers. (Paragraph 27)

The government has been clear that it wishes to work with the EU (and EU Member States) to tackle money laundering and terrorist financing once the UK has left the EU, and this will include maintaining the flow of information. The government has demonstrated this commitment through opting in to the recent EU Directive on information sharing between Financial Intelligence Units (FIUs) which will bring benefits to the UK and other EU Member States through ensuring that our operational agencies are able to seek and receive financial intelligence, including bank account details, where appropriate, in order to tackle both money laundering and wider criminality.

The Committee may consider taking further evidence on the findings of the Financial Action Task Force (FATF) mutual evaluation in due course. The Committee does, however, note the zeal with which the Government has considered reform in this area as the FATF mutual evaluation has approached. With the previous full mutual evaluation occurring over a decade ago, the UK should not solely rely on prompting by FATF to ensure its economic crime prevention, detection and enforcement systems remain fit for purpose and it should not rely on FATF alone to identify areas where improvement

is needed. The Committee therefore recommends the Government institutes a more frequent system of public review of the UK's AML supervision, and law enforcement, that will ensure a constant stimulus to improvement and reform. This review should take a holistic view of the entire system, rather than be undertaken by each individual component supervisor or agency. There may be a role for the recently announced Economic Crime Strategic Board in this work. (Paragraph 33)

The Committee's conclusion that the government has approached economic crime reform with zeal is welcome. The government intends on using the FATF's recommendations as a springboard to further bolster the UK's defences against economic crime. As previously mentioned, the government is producing an Economic Crime Plan in conjunction with the private sector which will respond to the FATF's recommendations as well as those put forward by the Committee. This will be the first major output under the direction of the new Economic Crime Strategic Board. The Board, which is co-chaired by the Chancellor and the Home Secretary, is driving the public and private sector response to economic crime, by setting strategic priorities, ensuring resources are allocated to address capabilities and to scrutinise overall performance against the economic crime threat.

In addition to the Economic Crime Plan, it is worth re-iterating the government has taken extensive reforms in this area. These include: publishing National Risk Assessments (NRAs) in 2015 and 2017; delivering against the 2016 AML/CTF Action Plan; providing new powers to law enforcement agencies to identify and recover corrupt and criminal funds through the Criminal Finances Act 2017; and passing the Money Laundering, Terrorist Financing, and Transfer of Funds (Information on the Payer) Regulations 2017 (MLRs), which bring the UK's AML/CTF regime in line with the latest international standards. In this context, it is important to balance the need for further reforms with embedding current reforms and ensuring their impact is most effectively understood.

However, there are certain aspects of the UK's AML/CTF regime that the government has already committed to reviewing in the future. For example, HM Treasury publishes an annual report reviewing the performance of the AML supervisors. HM Treasury will also review the MLRs and the legislation establishing OPBAS by June 2022.

These are in addition to the other reviews the government has recently conducted of parts of the UK's AML/CTF system. In 2016, HM Treasury reviewed the AML supervisory regime (which consequently led to the creation of OPBAS).[4] As mentioned, the government has also published two National Risk Assessments in the last four years. These provide a comprehensive, cross-sector assessment of the AML/CTF risks across the UK. The government is committed to regularly updating its risk assessment under the MLRs. These risk assessments include identifying where new and evolving risks require a response from the government, as well as evaluating the efficacy of existing regulations and activity in mitigating risks.

Separately, the Law Commission is due to publish the findings of its review into the AML reporting regime in the Proceeds of Crime Act 2002 (POCA) and the CTF reporting regime in the Terrorism Act 2000 shortly, and is due to further review the confiscation regime in POCA later this year.

4 https://www.gov.uk/government/consultations/anti-money-laundering-supervisory-regime-response-and-call-for-further-information

Finally, the government notes that the FATF's mutual evaluation process includes a holistic review mechanism which operates to a shorter timeframe than once every decade. Under the FATF's follow-up procedure, the government will report back to FATF on its progress:

- in addressing deficiencies in the UK's AML/CTF laws and regulations ('technical compliance') in 2021, and
- in improving the effectiveness of the UK's AML/CTF regime, in 2023.

A fragmented approach to AML supervision

The property sector poses a risk from an anti-money laundering perspective. Yet the AML supervisory regime around property transactions is complicated. Banks are supervised by the Financial Conduct Authority, solicitors by their relevant professional body, and estate agents by HMRC. While there may be debate over which part of the transaction chain bears most responsibility from an AML perspective, each part has a role in reporting, or preventing, a transaction that may be used for money laundering. There is a risk that some estate agents may be unsupervised, having not registered with HMRC. We recommend that HMRC carries out further work to ensure estate agents are registered with them and following best anti-money laundering practice. (Paragraph 45)

The government agrees the property sector poses a risk from an AML perspective, particularly in relation to high-end money laundering. While the 2017 National Risk Assessment for Money Laundering and Terrorist Financing (the NRA) concludes that much of the risk lies with those closer to the client and their funds (such as legal professionals), it also notes that effective and comprehensive due diligence on all parties by estate agents can help mitigate the money laundering risks around property.

In line with the government's commitment to tackle economic crime and maintain the integrity of the UK financial system, and following the recommendations from the recent FATF Mutual Evaluation Report, HMRC has recently increased the charges for all businesses it supervises under the MLRs, including estate agents, to support a more comprehensive and harder-edged approach to its supervisory responsibilities.

This increase will enable HMRC to build capacity, to provide increased education and guidance for those businesses who want to do the right thing, increase interventions on supervised businesses, and take a more robust approach to those who fail to comply with their obligations under the regulations.

HMRC recognises the importance of ensuring all estate agency businesses are registered for supervision. HMRC has a team dedicated to identifying businesses not registered for supervision, which actively seeks information on individuals or entities engaging in activity under the MLRs which would require them to be registered with HMRC for supervision. To identify such businesses and develop understanding of relevant indicators, HMRC analysis draws on multiple data sources from within and outside of HMRC, including tax records. Proactive awareness-raising campaigns with industry and the public, and close collaboration with other supervisors and professional and trade bodies, generate referrals to identify and tackle businesses suspected of trading whilst unregistered or unsupervised.

In February 2019, routine checks were supplemented by a concentrated, high profile 'week of action'. This was aimed at rooting out unsupervised agents to confirm whether they were conducting relevant activity whilst unregistered. While follow up work is underway to issue penalties and consider criminal action, we have already seen from trade and media interest that this action sent a clear message across the sector.

HMRC also supports those businesses who seek to comply with the regulations through the provision of educational material, including guidance, targeted emails and webinars for all HMRC supervised sectors. Updated guidance for estate agency businesses was also published earlier this month and is available at: https://www.gov.uk/government/publications/money-laundering-regulations-2007-supervision-of-estate-agency-businesses.

There is a clearly identified risk that company formation may be used in money laundering. There are a number of entities that undertake company formation, and therefore a number of supervisors. More worryingly, there appears to be a number of unsupervised entities engaged in company formation. These should be identified by HMRC and dealt with as a matter of urgency. (Paragraph 51)

In addition to its broader work to detect unregistered individuals and businesses, HMRC is working closely with Companies House to identify those acting as unsupervised formation agents with the aim of either bringing them within supervision or preventing them from continuing to conduct business. HMRC collaborates with relevant professional and trade bodies, and encourages them, as well as supervised businesses and other interested parties such as pressure groups, to report all suspected unsupervised formation activity.

The recent increase in charges to businesses supervised by HMRC under the MLRs will enable HMRC to develop a more comprehensive and robust approach to its supervisory responsibilities. This approach will similarly apply to those entities which are brought under HMRC supervision through its efforts to detect unregistered individuals and businesses.

There must be no weak areas in the UK's systems for preventing economic crime. At present, Companies House presents such a weakness. The UK cannot extol the virtue of a public register of beneficial ownership and yet not carry out the necessary rigorous checks of the information on that register. The Government must urgently consider reform of Companies House to ensure it has the statutory duties and powers to ensure it plays no role in helping those undertaking economic crime, whether here or abroad. It is welcome that the Economic Secretary has noted that BEIS is considering reform in this area, but the Government should move quickly and now publish detail of this reform by summer 2019. (Paragraph 63)

BEIS will publish a consultation on reforming Companies House shortly. This consultation will seek views on measures that will strengthen the contribution of Companies House in support of UK efforts to combat economic crime. Issues to be consulted on will include options for reforming the information which companies are required to disclose, increasing the checks on this information, and measures to improve the exchange of intelligence between Companies House and UK law enforcement authorities.

Though the emphasis has been on the risk presented by enablers, such as accountants or solicitors, there should also be a sharp focus on the supervision of the core financial

services. To the extent that this risk is not ameliorated by supervision, the FCA needs to ensure that they keep up a constant pressure on the core financial services businesses and take appropriate enforcement action against them. (Paragraph 72)

The FCA agrees with the Committee's observation that there should be a "sharp focus on the supervision of the core financial services" and the recommendation that the FCA keeps constant pressure on core financial service businesses and to take appropriate enforcement action against them. The FCA agrees that this is important and that is why AML is one of the FCA's cross sector priorities and has always been an FCA priority. The FCA's current approach, set out below, is set up to keep a focus on core financial services firms. The FCA is closely considering the relevant FATF recommendations, and is developing its response to these. The FCA will continue to keep its approach to AML supervision under review

The FCA's supervisory approach is risk-based and outcome-focused. It concentrates resources where the risks are greatest. Its Financial Crime Guide sets out clearly its expectations of firms and it regularly reminds the industry of the importance of having effective systems and controls. Where new money laundering typologies become apparent, the FCA will then undertake exploratory work. For example, it is currently looking at money laundering risks in the capital markets.

When the FCA opens an investigation into serious misconduct it is to ascertain a full understanding of the facts so that it can make a decision about whether action, and if so what kind, may be necessary. This helps the FCA fully understand what happened, how to proceed and which of its tools would be best used. In its recent review of the UK's AML regime, FATF recognised the impact and deterrent effect the FCA achieves through the use of its tools such as publication of its detailed Notices (Final/Decision), the use of its other enforcement tools such as disgorgement and taking action against individuals, and the introduction of the Senior Managers and Certification Regime. FATF recommended that the FCA continues to ensure proportionate, dissuasive and effective sanctions are applied and it continues to hold individuals to account.

Since the FCA provided written evidence to the Committee, where it set out recent fines against Barclays and Deutsche Bank and its change in approach to investigations, it has fined Canara Bank £896,100 and Standard Chartered Bank £102m for their inadequate AML systems and controls and published a Decision Notice in respect of the former CEO of Sonali Bank (UK) Ltd. The FCA currently has over seventy investigations open into AML/financial crime, with a number of these investigations being run on a dual civil and criminal basis.

The evidence we have received has directed our attention to those who act on the periphery of the financial system, rather than its core, the so-called enablers or facilitators. External witnesses suggested that there is a requirement for education as well as enforcement—the Security Minister pointed towards the responsibility of the enablers to play their part. It is welcome that in its Serious and Organised Crime Strategy, the Government has acknowledged a similar focus. The Committee recommends that the Government steps up education of facilitators, to ensure they have all information about their role, recouping any additional costs through fees. Once this has been completed, it should be followed with an enforcement campaign to ensure compliance. (Paragraph 78)

Designated AML supervisors are responsible for educating their supervised populations about obligations under the MLRs. This is primarily achieved through the issuance of HM Treasury-approved guidance. Law enforcement also contribute through sharing information on typologies and emerging threats and how regulated entities should counter these risks. Further developing the facilitation of information and intelligence sharing between designated AML supervisors and law enforcement is a core objective of OPBAS. OPBAS has already made substantial progress in developing effective channels between the accountancy sector professional bodies and law enforcement, enabling a two-way flow of information to aid in investigations and prosecutions of professional enablers.

The government is also working with the accountancy, legal and property sectors through its Flag It Up campaign, which promotes best practice in AML compliance and reporting suspicious activity.

The Committee supports the role that The Office of Professional Body Anti-Money Laundering Supervision (OPBAS) has been given in relation to the Professional Body Anti-Money Laundering Supervisors. The inherent conflict in a membership organisation also monitoring its own members means that there is a need for external supervision. The number of such supervisors also shows there is a need for a single organisation to look at the system as a whole to identify weaknesses. We consider the concerns around whether the statutory AML supervisors also need such a coordinating body later in this Report. (Paragraph 86)

At present, OPBAS also has the responsibility of recommending to the Treasury whether a professional body should remain an AML supervisor. It is not clear how the Treasury would consider such an OPBAS recommendation, and where it would envisage placing such AML supervisory responsibilities in such a case. Without adequate preparation in this area, AML supervisors may become too important to fail, and therefore risk undermining standards in this area. We recommend that the Treasury publishes—within six months—a detailed consideration of how it would respond to such a recommendation from OPBAS. (Paragraph 87)

The government accepts the Committee's recommendation and HM Treasury will publish a detailed consideration of the process for responding to an OPBAS recommendation for the removal of a professional body status as an AML supervisor, including management of changes in supervisory responsibilities, within six months of the date of the Committee's report.

In evidence to this Committee, the Chief Executive Officer of HMRC noted that he was considering, as part of the 2019 Spending Round, querying whether HMRC should retain its role in Anti-Money Laundering supervision. The Committee agrees that this should be given proper consideration, not only to support HMRC concentrating on its core tasks but also to address concerns expressed to the Committee about HMRC's work as an AML supervisor, and whether its approach to its supervisory responsibilities may be unduly influenced by its role as a tax authority. The Treasury must send the Committee a report on this consideration well ahead of the Spending Review and we will take oral and written evidence. (Paragraph 106)

HM Treasury will send the Committee a report on HMRC's role as an AML supervisor and its relationship with OPBAS by September 2019.

Notwithstanding the above recommendation, the Committee has heard a number of concerns around the work of HMRC as an AML supervisor, including around its work on unregistered firms. If it is to retain its AML supervisory responsibilities, HMRC should:

- **include within its departmental objectives a single stand-alone objective related to its anti-money laundering supervisory work; and**
- **keep a clear reporting line between its AML supervisory work and its work investigating tax crime and associated money laundering offences. HMRC should have a separate strategy for its AML supervisory work which would include key performance indicators on which HMRC can report. (Paragraph 107)**

HMRC views its AML work as critical to its role in ensuring the integrity of the UK financial system. Reducing the abuse of the sectors HMRC supervises is a key part of the organisation's own strategy to tackle economic crime which seeks to drive an increase in the number of criminal investigations and, consequently, the number of prosecutions for both regulatory failures and money laundering.

HMRC uses the full spectrum of its criminal, civil and AML-supervision powers to deliver an effective system-wide response. To help facilitate this whole system approach to money laundering, in November 2017 HMRC's AML Supervision teams were moved into the Fraud Investigation Service, bringing together all of HMRC's resource targeted at economic crime and helping to deliver a more cohesive response to the threats in this area. Almost all tax evasion and organised crime involves money laundering. Being able to deploy those supervisory teams, the full enforcement functions, the full tax powers and the proceeds of crime powers all together is a powerful mix which can make a real difference to tackling economic crime in this country.

HMRC will ensure that its AML-supervision work is captured in its business plan, and, as part of its programme to build capacity following its increase in funding, is reviewing its key performance indicators to ensure the organisation can demonstrate effective delivery of its core supervision obligation.

With the creation of OPBAS, the Government acknowledged that consistency across AML supervisors was important. The Committee recommends that it should go one stage further, by creating a supervisor of supervisors. The aim of this institution would be to ensure that there is consistency of supervision across all the AML supervisors, whether statutory or professional body. There is a strong case for this to be OPBAS, given it already has a role in the coordination of the professional body AML supervisors, and a role in information sharing. (Paragraph 111)

The Government should then also consider moving the supervisory responsibilities of HMRC to OPBAS. This would reduce fragmentation in the current supervisory landscape and allow HMRC to focus on its tax authority responsibilities. It would also mean that OPBAS could act as supervisor of last resort in the case of a failure of a professional body supervisor. The close relationship between OPBAS and the FCA, a fellow supervisor, would also be beneficial. (Paragraph 112)

OPBAS should be placed on a firmer statutory footing, more akin to the Financial Ombudsman Service, in having its own distinct identity protected under primary legislation. The Committee will monitor how OPBAS is working through regular evidence sessions. We will consider the funding model of OPBAS including the retention of penalties. (Paragraph 113)

OPBAS' mandate as the supervisor of the professional body supervisors addresses the previous lack of accountability for the AML performance of these bodies. It ensures that, like the statutory supervisors, they are directly answerable to government and not just their members. The mandate also reflects the need to ensure consistently high standards across the professional body supervisors. The 2018 FATF Mutual Evaluation Report of the UK found that, while there was scope for improvement across the supervision regime, the greatest weaknesses were with the professional body supervisors. OPBAS' initial assessments identified a range of weaknesses and OPBAS is now ensuring that the professional body supervisors implement action plans which effectively respond to these.[5]

OPBAS and HM Treasury will continue to work closely with statutory supervisors to ensure a strong, effective and collaborative regime. As noted in the response to paragraph 106 of the report, HM Treasury will send the Committee a report on HMRC's role as an AML supervisor and its relationship with OPBAS by September 2019.

The Oversight of Professional Body Anti-Money Laundering and Counter Terrorist Financing Supervision Regulations 2017 place a requirement on HM Treasury to periodically carry out a review of the regulatory provision contained in the regulations and to publish a report setting out the conclusions of the review. The first report must be published before 26th June 2022.

Other issues

The resources to combat economic crime available to the private sector dwarf those currently available to the public sector. The private sector support to the public sector, provided either through direct payments or through undertaking tasks one might expect Government to undertake on AML, is therefore welcome. (Paragraph 124)

One significant issue is the maintenance of expertise in the public sector to undertake this work, considering the salaries available in the private sector. The Government and public sector bodies should consider whether there is the pay flexibility available to ensure that the appropriate skills are maintained. (Paragraph 125)

The Committee is also concerned that the Government may have not allocated enough resource to effectively marshal the private sector resources to achieve a 'hostile environment'. The Economic Secretary confirmed that there is no cross-government assessment of public resources being brought to bear in this area. The Committee recommends that such an assessment is made, and that any potential funding shortfalls are rectified. (Paragraph 126)

5 'Anti-Money Laundering Supervision by the Legal and Accountancy Professional Body Supervisors: Themes from the 2018 OPBAS anti-money laundering supervisory assessments', OPBAS, March 2019: https://www.fca.org.uk/publication/opbas/themes-2018-opbas-anti-money-laundering-supervisory-assessments.pdf

The government is working in partnership across the public and private sectors to create a whole system approach to tackle economic crime. As announced alongside the launch of the Serious and Organised Crime Strategy in November 2018, the government will invest at least £48m in FY19/20 to bolster law enforcement capabilities to tackle economic crime. These investments include money for the new National Economic Crime Centre, to increase numbers of financial investigators and to improve the regional and local response. For the first time a joint public and private sector threat assessment is being developed as well as a joint plan to tackle the threat of economic crime. As part of the Economic Crime Plan we will be considering how we can prioritise our activity and deliver our commitments using both public and private sector capabilities, looking across both sectors to assess where extra investment is needed. We are also considering how we can share capabilities across sectors, including people, to enhance the skills and expertise in both sectors and maintain the ability of the public sector to tackle the most complex economic crimes. The upcoming Spending Review will then be the process for assessing where and how resources should be allocated within government.

There has been great emphasis on the need for information sharing in combatting economic crime. Such information should be shared both within sectors, and between sectors. Banks have asked for additional powers to share information between each other. Such a move would require that the privacy of lawful consumers of financial services is maintained. At the very least, there should be a number of safeguards to protect both consumers' information, and to ensure that as a consequence of such information sharing no consumers unfairly lose their access to financial services. We recommend that the Government reviews the scope to increase information flows at the bank level and report back to this Committee within six months. (Paragraph 135)

The government has implemented provisions in the Criminal Finances Act 2017 that permit information sharing between regulated sector entities where there is a suspicion of money laundering or terrorist financing. The government will continue to work with the banks and others on how information sharing can be done, within the appropriate data protection frameworks.

The Government has placed a lot of emphasis on the benefits the National Economic Crime Centre will bring. It is welcome that a single centre will provide an element of leadership to this complex web of interacting agencies and firms. The Committee will continue to monitor the impact of NECC, and recommend that annual updates of the measures of success of the NECC are published or provided to the Committee. (Paragraph 141)

The Committee's support for the NECC is welcome. The NECC is a collaborative, multi-agency capability established to deliver a step-change in the UK's response to serious and organised economic crime (SOEC). The NECC sets threat priorities, which inform operational coordination between partners and facilitates the exchange of data and intelligence between the public and private sectors.

The NECC's collaborative, threat-focused approach maximises the capabilities and expertise of both the public and private sectors to tackle SOEC through:

- Being the collective voice on the economic crime threat to the UK, informing operational priorities and strategic decision-making.

- Enhancing the collective understanding of SOEC through coordination and delivery of a shared response across the public and private sectors.
- Working with partners to use all appropriate and necessary tools and powers available to lead a Pursue, Prevent, Protect and Prepare response to the SOEC threat.

In February 2019, the NECC published details of its first major operational success - a multi-agency day of action which sought to freeze 95 bank accounts suspected of being used to launder an estimated £3.6 million.

Details of further NECC activity will be published in due course and this information will be available to the Committee for its consideration.

Suspicious Activity Reports (SARs) are one way in which the authorities can receive intelligence from the private sector. The SARs reform programme is therefore an exceptionally important piece of work for the AML regime. The Committee's evidence suggests that reform should focus on increasing the number of SARs reports by those outside the core of the financial system, the so-called enablers. We have heard a number of reasons why SARs may not be submitted by the enablers. It is a legal requirement for SARs to be submitted, so the system needs to be as robust and simple to use as possible. Thought should also be given, in a world of faster payments, to how NCA requested delays to payments can be better handled. Confidence in the SARs system, at present, appears to be weak outside the core financial service. In its response to this Report, the Government should set out how it will increase confidence in the SARs regime. (Paragraph 165)

We also heard evidence that quality, rather than the quantity of SARs, should be encouraged. While an increase in quality is always desirable, modern data analytics means that quantity may also be useful. The review will have to be careful not to stifle SARs that in and of themselves may seem of low quality, but when analysed in the round may provide far more useful information. (Paragraph 166)

The government is committed to reforming the SARs regime. In particular, the government wants to reduce tick-box compliance, direct the regime to focus on the highest threats, help firms better protect themselves and improve law enforcement outcomes.

The SARs Reform Programme, led by the Home Office, has been established to deliver on this ambition. It aims to transform the SARs regime to strengthen the UK's response to money laundering and terrorism financing as well as enhance SARs as an intelligence source for law enforcement across all-crimes. The programme is being developed as a public-private partnership with representatives from both sectors forming the programme team, working collaboratively to drive forward improvements in the regime. Private sector support is essential in helping the government reform the regime and building confidence in its ability to tackle economic crime.

The programme encompasses the development of a new IT system for reporting and analysing SARs, enhanced feedback, guidance and information-sharing between reporters and the public sector, increased training of law enforcement and consideration of legislative changes.

Replacing the IT system which underpins SARs is a significant part of overhauling the regime. The current system is unable to cope with the ever-increasing numbers of SARs. A new IT system will be created to meet the challenges of the volume and complexity of financial transactions. It will improve user experience by making the process for submitting SARs simpler and more efficient while ensuring feedback is provided to reporters. The new IT will also enable greater exploitation of SARs, as an all crime intelligence source, using data analytics.

Training for financial investigators and wider law enforcement is also being developed to further enhance the use of SARs in investigations. The value of SARs intelligence is not limited to economic crimes and the programme aims to ensure that its full potential is realised. A new public-private delivery model will lead to improved feedback and guidance, efficient and effective reporting of SARs, aligned supervision of industry and enhanced enforcement.

The government is currently awaiting the publication of the Law Commission's review into limited aspects of the Proceeds of Crime Act 2002, which establishes the SARs regime. The outcomes of this review will inform any decisions on changes to legislation, and guidance to reporters on when to submit SARs.

The Politically Exposed Persons regime is an important part of the system for preventing money laundering. We have heard that defining PEPs remains difficult for institutions, both large and small. While commercial solutions are available, they may be beyond the resources of very small companies. We recommend that the Government creates a centralised database of PEPs for the use of those registered by AML supervisors. (Paragraph 171)

The latest MLRs are clear that firms must apply a risk-sensitive approach to identifying politically exposed persons (PEPs) and then apply enhanced due diligence (EDD) measures appropriately. The FCA published guidance in July 2017 on how firms should identify and apply EDD to PEPs. This says that UK PEPs should be treated as a low risk of money laundering, unless a firm within the FCA's AML supervisor remit assesses that other risk factors not linked to their position as a PEP mean they pose a higher risk. Further, paragraph 2.11 of the FCA guidance provides a list of prominent public functions which firms should have regard to when determining PEP status. The FCA guidance enables firms to identify PEPs themselves, and is in line with the UK's proportionate, risk-based approach to AML.

Creating a centralised database would be at odds with the UK's risk-based approach to AML. In accordance with FATF Recommendation 12, the MLRs (together with FCA guidance) facilitate a genuine risk-based approach, whereby low-risk and high-risk PEPs are subjected to proportionate levels of due diligence. A centralised database would subsequently focus firms' efforts on a PEP's origins, rather than their level of risk. Further, it would be more difficult to update a PEP's status and risk in a centralised database than in a firm's individual assessments. This would lead to a less dynamic and appropriate treatment of PEPs than under the current approach; the government therefore does not accept the Committee's recommendation.

Derisking, where financial institutions cease customer relationships with certain 'high risk' customers, can have a significant impact on both individuals and businesses.

As we have seen, it can also potentially move illicit flows underground. While there has seemingly been much effort, progress in tackling derisking has been achingly slow. We recommend that the Government publishes its strategy on how to address disproportionate derisking strategies within six months. That strategy must include how it will take the conclusions of the G20 taskforce forward. (Paragraph 183)

The government recognises that derisking can inhibit the government's progress in achieving its objectives on promoting financial inclusion, supporting international development and reducing levels of economic crime.

However, certain features of the sectors most affected by derisking, including the remittances market, can mean they pose a higher risk for abuse by illicit actors committing economic crime, both in the UK and globally. In the case of remittances, the government's 2017 NRA has assessed the money service business (MSB) sector, which tends to provide remittance services, as presenting a high level of risk for money laundering and terrorist financing. The government is clear that regulatory and commercial activity with respect to the MSB sector and cross-border remittances should reflect that assessment, as is the case with other sectors identified as high risk.

The government recognises the need to stop criminals from accessing the global financial system, while ensuring that legitimate transactions are able to move through the regulated sector. That is why the government has taken action both internationally and here in the UK. As the Economic Secretary to the Treasury emphasised in his appearance before the Committee, derisking is a global issue that requires coordinated, concerted effort across borders to resolve. The UK has led international efforts to put derisking on the agenda at the G20 and in other international fora.

Domestically, the government works with industry to ensure firms are taking a risk-based approach in relation to economic crime and to improve the management of risk by MSBs and banks. Further, the government's regulatory regime is designed to encourage innovation that could reduce the level of risk in the sectors and the cost of compliance, and also promote competition. The government will continue to work with all relevant parties and industry groups to achieve these aims, and to implement the recommendations contained in the Financial Stability Board's report to the G20 on this matter.

Legislative reform

The Government's proposals on reforming the law on corporate liability around economic crime have stalled. Though the Solicitor General realises the importance of this issue, preparations for Brexit seem, in part, to have waylaid this important work. Despite Brexit, the Government must progress domestic priorities. Without reform in this area, multi-national firms appear beyond the scope of legislation designed to counter economic crime. That is wrong, potentially dangerous and weakens the deterrent effect a more stringent corporate liability regime may bring. (Paragraph 199)

There is clear evidence that legislative reform is required to strengthen the hand of law enforcement in the fight against economic crime. We recommend that the Government sets out a timetable for bringing forward legislation to improve the enforcement of corporate liability for economic crime. The Serious Fraud Office's suggested reforms should be considered as part of those proposals. (Paragraph 200)

The Solicitor General emphasised the importance of getting the detail of new legislation right. The consultation process can help with that task and need not be delayed until proposed legislation is in near final form. (Paragraph 201)

We recommend that the Government responds to the evidence submitted in response to the 2017 Corporate liability for economic crime: call for evidence and undertake further consultation on proposals for legislation by the next Queen's speech. (Paragraph 202)

As the Committee notes, the Ministry of Justice (MoJ) conducted a call for evidence in 2017 on the case for reform of the law of corporate liability for economic crime. Analysis of the responses to this call for evidence has concluded, and the MoJ will respond shortly.

Financial Sanctions

The Office of Financial Sanctions Implementation (OFSI) has only been in existence for a year and a half. It has a number of potential sanctions breaches under investigation. While all breaches will have to be investigated thoroughly, and treated on their own merits, public examples of enforcement will be necessary if OFSI is to be recognised as an effective deterrent. It is necessary for the Government to review the effectiveness of OFSI. We recommend that two years after its formation marks the time for such a review to take place. (Paragraph 213)

Since its creation, OFSI has implemented new approaches and powers to strengthen the implementation of financial sanctions in the UK. OFSI regularly reviews its processes and structures as part of its continuous improvement, for example with the establishment of the OFSI Governance Advisory Board in 2018 which helps to ensure the department has adequate oversight and is able to support strategic choices, performance and capability, risk management and decision making. OFSI now also systematically publishes key statistics on its work in an annual review and proactively publishes compliance information.

Since the Committee's oral evidence sessions, FATF has published its Mutual Evaluation Report of the UK. In measuring effectiveness, this independent, inter-governmental body gave the UK the highest possible rating for its work promoting the global use of financial sanctions against terrorism and proliferation of weapons of mass destruction. The US is currently the only other country in the world to achieve these ratings. The report commended OFSI for its "extensive outreach" and issuance of "useful guidance" as well as noting that the introduction of powers to impose monetary penalties has had "a substantial deterrent effect."

OFSI considers every suspected breach that is reported and takes some form of compliance action on every breach that is substantiated. This can include issuing warnings, calling on companies to improve their compliance, calling in companies to discuss their actions and referring cases to law enforcement for criminal investigation. This approach has been widely publicised. Since evidence was submitted to the inquiry in October, OFSI has imposed its first monetary penalty for a breach of financial sanctions in the UK. Civil monetary penalties are the most public example of enforcement of sanctions that OFSI can take in response to serious breaches.

The EN+ listing occurred due to a weakness in sanctions policy, not implementation. The evidence heard by the Committee suggests that while the proposed listing was carefully analysed given its sensitivities, the narrowness of the sanctions regime meant that the listing could not be blocked. (Paragraph 222)

In the face of this seeming failure of the sanctions regime, the Economic Secretary has suggested that there should be a power for the Government to block a listing on National Security grounds. On the face of it, this would create a new focussed power outside the sanctions regime. If the Committee is to be persuaded that such a power is necessary and appropriate, the Government needs to set out very clearly when such a power would be used, what effect it might have on UK listings and financial services, and most importantly, why it would be needed, especially when sanctions are in the full control of the UK post-Brexit. We would expect full, wide and timely consultation on such a power to inform its scope and design. (Paragraph 223)

The government agrees with the Committee that any new power to block a listing on national security grounds should be fully investigated and justified.

The government is currently investigating whether such a power would be appropriate, taking into account the existing legislative framework – including analysis of the UK's post-Brexit sanctions powers under the Sanctions and Anti-Money Laundering Act – and the impact it could have on UK financial markets. If the government concludes that a new power is necessary, the government will clearly set out: a robust justification for the power, the scenarios in which it could be used, how the power would work in practice, and the timing of the new legislation. The government would also undertake a full consultation on this power.

There has been, without doubt, a malign influence on the UK financial system from certain elements of Russian money. This fact has been acknowledged by both financial services and law enforcement. However, as noted by the FCA, illicit Russian money does not need to use novel or unique ways to enter the UK. The UK must achieve a balance between focussing on financial flows from one country, while not distorting the AML system, and creating a risk that other criminals slip by while attention is focussed on individuals with a specific nationality. (Paragraph 230)

The government's 2017 NRA identifies the key money laundering risk from Russia for the UK as the proceeds of crime and corruption being channelled through the UK economy. The Criminal Finances Act 2017 introduces new powers to mitigate this risk. The government has also introduced reforms that will help to ensure corporate vehicles, such as Scottish Limited Partnerships, are not misused by criminals.

However, the government is absolutely clear that these measures have been introduced to tackle suspicious wealth originating from anywhere in the world and agrees with the Committee that other criminals cannot slip by while attention is focussed on individuals with a specific nationality. The government is constantly improving its understanding of high-risk jurisdictions with the 2017 NRA outlining the risks posed by multiple jurisdictions and how these have evolved.

The United Kingdom's departure from the European Union could allow additional flexibility in its use of sanctions, though there will always be a need to ensure a

multilateral approach. The Government must ensure it is ready to introduce any new powers it believes are necessary as soon as any further flexibility has become available, having consulted appropriately. (Paragraph 236)

The Sanctions and Anti-Money Laundering Act received Royal Assent in May 2018. It provides the legal framework through which the UK will impose sanctions in future. The government commenced certain provisions of the Act in November 2018 to enable the laying of secondary legislation in preparation for exit from the EU without a deal. This secondary legislation is required to establish the structures and processes by which the Act will operate, and to transfer existing sanctions regimes into UK law.

During the Implementation Period (IP), the UK will remain bound by EU sanctions. We will look to use the powers provided by the Act to the fullest extent possible during the IP, but there are some limitations on the measures that we can impose autonomously.

The UK is seeking a strong security partnership with the EU after exit, including close consultation and cooperation on sanctions. We will continue to share the same values and face the same threats as our European neighbours, and we recognise that sanctions are most effective when implemented collectively. As set out in the Political Declaration on the Future Framework, we will aim to adopt mutually reinforcing sanctions where our foreign policy objectives align.

Beyond the EU, the UK will also develop closer cooperation on sanctions with its allies and partners active in the use of sanctions, including, but not limited to, the United States, Canada and Australia. There is also the potential for the UK to leverage its strong bilateral and multilateral relationships to bring together small groups of like-minded countries to agree joint proposals on sanctions.