



Law Society of Scotland

Assessment of international and domestic risks of money laundering and terrorist financing affecting Scottish solicitors (March 2018)

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Index

Introduction	3
Overall Conclusion	4
Linking Risk to Inspection activity	5
Risk Mitigation by the Law Society of Scotland	7
Background Material (Summarised)	
<ul style="list-style-type: none"> Scotland's Serious Organised Crime Strategy (June 2015) 	9
<ul style="list-style-type: none"> National Crime Agency – High End Money Laundering Strategy (Dec. 14) 	10
<ul style="list-style-type: none"> National Strategy Assessment of Serious and Organised Crime 2015 	10
<ul style="list-style-type: none"> Financial Action Task Force (FATF) – Money Laundering Vulnerabilities of Legal Professionals 2013 	10
<ul style="list-style-type: none"> CCBE – A lawyers Guide to Detecting and Preventing Money Laundering 	11
<ul style="list-style-type: none"> Summary of Scottish solicitor responses to NRA 2018 development questionnaire 	12

Law Society of Scotland - Assessment of international and domestic risks of money laundering and terrorist financing affecting our members (March 2018)

Introduction

Under Regulation 17 of the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017, the Law Society of Scotland (as an AML Supervisor) must identify and assess the international and domestic risks of money laundering to which its members are subject.

In carrying out such a risk assessment supervisors should take into account various reports and guidelines issued by authorities such as the European Supervisory Authorities, HM Treasury and Home Office.

This risk assessment utilises the above reports including the National Risk Assessment of Money Laundering & Terrorist Financing Oct. 17 (NRA) and other relevant material to arrive at an assessment of the money laundering risks faced by Scottish solicitors analysed according to factors such as firm size and services offered by firms.

The risk assessment is intended to assist the Law Society of Scotland to cluster solicitor firms according to risk to enable effective inspection prioritisation. It is also hoped that this document will assist solicitors in their own firm risk assessments which are also required by the regulations.

Law Society of Scotland - Assessment of international and domestic risks of money laundering and terrorist financing affecting our members (March 2018)

Overall Conclusion

The Law Society of Scotland agrees with the conclusion of the NRA that the legal sector faces an inherently high risk of exploitation for money laundering due to the facilities, skills, services and products offered by the sector. While those Scottish solicitors who engaged with the NRA development process were confident that they had the controls in place to prevent their firms from being exploited by money launderers (page 12), the LSS experience from extensive supervisory work is that it is not unusual to identify firms where improvements in policies and procedures are necessary.

The NRA highlights three key risks areas for attention:

- The creation of trusts and companies on behalf of clients (assessed to be the legal service at greatest risk of exploitation) along with other services to trusts and companies
- Conveyancing
- Misuse of client accounts

Mainstream inspection activity already focuses on client account activity including conveyancing and this will continue, augmented with outputs from ongoing work to generate information on risk levels at particular firms. The NRA conclusion regarding property transactions fits with the Law Society of Scotland's historic experience that this is the area where most disciplinary issues regarding ML non-compliance will arise. Most findings to date have arisen with a small minority of solicitors in smaller firms.

We will adapt and improve our supervisory approach in response to the very high risk rating attributed to trust and company work provided by solicitors. This will include further work with larger firms following our extensive large firm risk assessment exercise in 2017. This will include risk based audits. For other firms, increased gathering of risk information will enhance our ability to identify small to medium firms working extensively in this sector so that focused risk based supervisory resources can be allocated to these firms.

It is noted that the NRA 2017 concludes that the terrorist financing risk associated with the legal sector is considered to be low. The Law Society of Scotland will however remain vigilant regarding this risk through its ongoing supervisory activity.

Law Society of Scotland - Assessment of international and domestic risks of money laundering and terrorist financing affecting our members (March 2018)

Linking risk to supervisory activity

Small firms (1-5) Partners

Much of the historic evidence (internal and external) confirms that this type of firm is at the highest risk of being unable to establish and maintain adequate AML/CTF policies and procedures. This increases the risk that such firms will be exploited by money launderers. Work by the Scottish Government (see page 9) indicates that money laundering by domestic criminals may involve smaller businesses that may be clients of this type of law firm. The LSS will address this risk by:

- a) Continuing to carry out AML/CTF inspections at all such firms
- b) Requesting more information to enable more comprehensive risk profiling of such firms. Where a higher level of risk is identified a greater frequency (eg: two yearly or annual) may be appropriate. This approach will for instance provide more information on the extent to which such firms are providing trust and company services to clients, enabling inspection work to be refocused accordingly.

Medium Sized Firms

While external reports and LSS/SSDT findings provide insights into risk levels at the smallest and the largest of firms, there is little information available on firms which fall between these two categories. Such firms face a mixed potential inherent risk profile as they benefit from the presence of an increasing number of partners, but may not be able justify the set-up of the strongest AML/CTF controls. Despite this they may also be more likely to engage in more complex and higher risk work than smaller firms. Our approach to such firms will be as for small firms until further risk profiling allows further differentiation.

Large Firms

There is little history of identified non-compliance with AML/CTF requirements at large firms in Scotland. Only one solicitor with a large firm has been found guilty of AML related non-compliance and this relates to work done in 2004.

However it is clear that larger firms are more likely to work on higher risk activities as demonstrated by the NRA's very high risk rating attributed to trust and company creation and high end money laundering risks as highlighted by the National Crime Agency (Page 10)

The LSS will supervise these firms by delivering risk based audits and standalone file reviews while carrying out follow up work to track control improvements arising from earlier risk assessment activity.

Law Society of Scotland - Assessment of international and domestic risks of money laundering and terrorist financing affecting our members (March 2018)

Linking risk to inspection activity

Lower risk services

Sham litigation and executry work are not currently considered to pose significant AML/CTF risks for Scottish solicitors. While issues around executry work are a relatively common subject of complaints arising from inspection work, the issues identified historically relate to general accounts rules compliance and not AML/CTF issues.

The Law Society of Scotland inspection approach will treat the following factors as lowering the level of AML/CTF risk associated with a firm:

- Firms with no client account
- Firms which do not carry out property transactions
- Firms which do not provide Trust and Company Services

Where none of these factors are present (eg: at a criminal law/road traffic law specialist) it is likely that no AML inspection will be required other than a low volume of checks to act as deterrent to providing inaccurate information to the Society.

Law Society of Scotland - Assessment of international and domestic risks of money laundering and terrorist financing affecting our members (March 2018)

Key threats & vulnerabilities – Risk Mitigation by the Society:

The NRA 2018 notes that there have been improvements to supervisory activity since the previous NRA was published in 2015. During this period, the LSS has taken forward several initiatives to improve its supervisory approach with plans for further improvements. Our key risk mitigation activities are noted below:

- Inspections (small & medium firms) - The Law Society of Scotland operates a significant programme of inspections which covers approximately 25% of firms each year. The scope of these inspections is currently under review.
- Large firm AML audits - Following a risk assessment exercise with larger firms in 2017, risk based audits and file reviews will be rolled out in 2018.
- Risk Assessment – As noted, an extensive risk assessment exercise focused on larger firms has been completed. Our ability to formally assess risk at individual small to medium sized firms will be enhanced by the introduction of an online data submission tool in 2018. Increased resource will be allocated to risk assessment during 2018.
- Accounts Certificates - All firms holding client money are required to confirm twice per year that they have complied with key aspects of AML/CTF requirements.
- Education & Training – The Society maintains comprehensive AML/CTF website pages. Annual AML/CTF roadshows take place at locations throughout Scotland.
- Guidance – The LSS contributed to the development of the Legal Sector AML Guidance 2018 which has been brought to the attention of practitioners.
- Entry Requirements – Controls are in place to prevent inappropriate people becoming or continuing as a solicitor. All solicitor firms are required to be 100% owned by solicitors. .

Law Society of Scotland - Assessment of international and domestic risks of money laundering and terrorist financing affecting our members (March 2018)

Key threats & vulnerabilities – Risk Mitigation by the Society (Cont.):

- **Skills – AML supervisory skills were enhanced during 2017 by the recruitment of an AML specialist from a financial services background. Further recruitment is underway to enable additional/skilled resource to be applied to address trust and company service provision risk.**
- **Relationships with Law Enforcement – Strong relationships have been built up with law enforcement. Police Scotland have agreed that a formal information sharing agreement with the LSS would further improve this relationship and are currently developing the document.**

Law Society of Scotland - Assessment of international and domestic risks of money laundering and terrorist financing affecting our members (March 2018)

Scottish Government – Scotland’s Serious Organised Crime Strategy (June 2015)

What does Serious Organised Crime look like in Scotland?

- 232 Serious Organised Crime Groups (SOCG) operating in Scotland
- 3700 individuals involved
- 70% of SOCGs are located in the West of Scotland, 18% in the East and 12% in the North
- 65% of SOCGs involved in drug crime
- 65% of SOCGs are involved in seemingly legitimate businesses (eg: licenced premises, taxis, restaurants, shops, garage repairs, vehicle maintenance and property development
- Over 650 such businesses identified

Case Studies:

- Operation Frizz -“money laundering on an industrial scale” involving fraudulent VAT repayment claims and complex international complex structures. In this case a Scottish solicitor was jailed and faces confiscation procedures
- Operation Trust- Resulted in the seizure of many millions of pounds of controlled drugs and confiscation of £600,000
- Major financial institutions noted to have robust structures in place for monitoring and reporting suspicious activity, but notes that money laundering can impact on the smallest financial institutions

Conclusions:

- The role of regulatory bodies in combating SOCGs is noted throughout the Strategy
- Operation Frizz demonstrates the serious money laundering risks faced by solicitors outwith property transaction work
- The scale of SOCG activity means that there is significant risk that Scottish solicitors will encounter SOCGs in their professional lives
- The nature of businesses highlighted in the strategy suggests that the highest risk may be faced by smaller legal practices

Law Society of Scotland - Assessment of international and domestic risks of money laundering and terrorist financing affecting our members (March 2018)

A) National Crime Agency High End Money Laundering Strategy (Dec. 14)/ B) National Strategy Assessment of Serious and Organised Crime 2015 (June 2015)

A) This report noted the need to focus increasingly on high end money laundering (as opposed to the laundering of street cash) involving specialist services such as tax planning and noted:

“Professionals such as lawyers, trust and company formation agents, investment bankers and accountants are among those at greatest risk of becoming involved, either wittingly or unwittingly.

B) “The use of professional enablers increases the complexity of money laundering activities, for example with the setting up of shell companies, trusts and other instruments providing anonymity. We believe the professions posing the greatest risk are within the financial and legal sectors, for example accountants and solicitors”

Law Society of Scotland - Assessment of international and domestic risks of money laundering and terrorist financing affecting our members (March 2018)

Financial Action Task Force (FATF) – Money Laundering Vulnerabilities of Legal Professional 2013 / CCBE – “A Lawyers Guide to Detecting and Preventing Money Laundering”

FATF - Key money laundering typologies:

- Misuse of Client Account
 - conversion, accessing the financial system, hiding ownership, as part of other fraudulent activities
- Property Purchases – “a key area of potential ML/TF vulnerability for legal professionals”
- Creation of Companies and Trusts
- Management of Companies and Trusts
 - adding credibility through ongoing involvement in management of companies and trusts
- Managing Client Affairs and making introductions
- Litigation - risk of sham litigation noted
- Specialised Legal Skills
 - Applying in all key activities – property, company services etc
 - Lower risk but still possible that relevant activity will be encountered through work in other areas such as probate etc

CCBE - Key money laundering typologies:

- Use of client accounts
- Purchase of real estate
 - Lawyers involved in real estate transactions should be “particularly vigilant”
 - Property represents 30% of all criminal assets
- Creation of trusts, companies, charities
- Management of trusts, companies, charities
- Sham litigation

Law Society of Scotland - Assessment of international and domestic risks of money laundering and terrorist financing affecting our members (March 2018)

Summary of Scottish practitioner responses to the ongoing National Risk Assessment update exercise

Overall Conclusion

36 (31 small to medium firms and 5 large firms) Scottish practitioners completed the Home Office/HM Treasury practitioner questionnaire issued as part of the ongoing exercise to update the NRA. This is a significant response indicating a good level of engagement with the subject.

The responses generally provide a positive picture of solicitor understanding of the ML/TF risks they face and their ability to manage these risks. Summarised responses to key questions are noted below.

Can services offered by solicitors be used to mask sources/ownership/destination/purpose of funds?

All respondents acknowledged that this was possible but nearly all respondents thought it was unlikely to occur due to the control environments established by firms and the nature of services provided.

What is the level of complexity and exposure to high risk jurisdictions in the services provided?

Nearly all small to medium firms reported very low levels of complexity and exposure to high risk jurisdictions.

Large firms pointed out the broad range of services provided and the absence of any typical client. While some complexity and exposure to high risk jurisdictions was reported it was clear that in most cases, the firms activities fell into lower risk categories.

Law Society of Scotland - Assessment of international and domestic risks of money laundering and terrorist financing affecting our members (March 2018)

Summary of Scottish practitioner responses to the ongoing National Risk Assessment update exercise (Continued)

Would suspicious activity be reported to the National Crime Agency?

All respondents were very confident that suspicious activity would be reported. Some respondents commented that the need to submit a report only arose occasionally.

Do firms have the capacity and capability to mitigate their ML and TF risks?

Firms reported that their risk mitigation capacity and capability was in the range from adequate to very good.

Six small firms while confirming the above commented on the resource pressure arising from compliance work.

