



Law Society
of Scotland

Trust or company service provision by the Scottish legal profession

Thematic report

February 2020



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Foreword from the Anti-Money Laundering Sub-committee

The Society is pleased to publish the findings of its first Anti-Money Laundering (AML) thematic review.

The AML team, an integrated part of the Society's Financial Compliance Department, embarked on its first thematic review of the supervised population in April 2019. The focus of this thematic review was on solicitors who act as trust or company service providers (TCSPs)¹.

The 30 firms selected to participate in the review were taken from across the spectrum of practices in Scotland to enable us to get a broad indication of the services being delivered by the profession. Given the small sample size reviewed the data contained in this report cannot be taken as wholly indicative of all firms in scope of the Money Laundering Regulations, 2017 (the Regulations) but provides the Society with a snapshot of risks, controls and compliance in this area of service provision by the profession.

Gathering data on firms is an ongoing exercise. The AML Certificate (a compulsory exercise to be completed by all firms in scope of the Regulations), to be issued in February 2020, will be amended to request a breakdown of the trust or company services provided to clients.

We would like to thank the 30 participating firms and, in particular, the four firms asked to accommodate the desktop reviews and interview stage (Stage Three firms). In addition, we would like to thank those individuals who kindly took the time to review and give their feedback on the questionnaire prior to publication.

Three of the four Stage Three firms have been reported to the Anti-Money Laundering Sub-committee (AMLSC).

This report provides the findings of the thematic review and is intended to benefit all firms within scope of the Regulations and not just those who offer trust or company services to their clients. All firms within scope of the Regulations must fully consider the findings of this report, given the fundamental principles of effective, proportionate and adequate understanding and implementation of the Regulations apply regardless of the regulated service being offered and delivered to clients.

¹ As defined in Regulation 12 of The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017

Executive summary

The Society was encouraged by the data provided in the questionnaire submissions, however, from the four firms selected to advance to Stage Three of the review, we found significant deficiencies in a number of instances.

Whilst we have seen examples of good and expected practice during the course of this review we have, unfortunately, identified a number of consistent themes in the firms we took to Stage Three of the review, primarily involving –

- the failure of some firms to fully consider and acknowledge the provision of trust or company services and the associated risks in their firm level risk assessment
- a failure to address those services in their policies, controls and procedures (PCPs) to mitigate the risks
- poor AML file management and record keeping to evidence compliance with the Regulations and the Law Society of Scotland Practice Rules
- a failure to produce AML-specific files relating to client matters and relationships in a timely manner
- inadequate ongoing monitoring of client relationships and documenting “Know Your Client (KYC)”

AML Subcommittee
February 2020

Background

In 2018, the Society implemented a revised approach to AML supervision. To fulfil our responsibilities as an effective AML supervisor, we have adopted the use of a number of tools and resources, including onsite visits, desktop reviews, selected file audits and the requirement to submit the AML Certificate.

Another such tool is the thematic review, which is also used by other AML supervisors such as the Solicitors Regulatory Authority and the Financial Conduct Authority. The reviews are a compulsory exercise which will help us to identify and assess specific current and emerging AML risks within the regulated population.

The decision to focus our attention on TCSP was, in part, based on the HM Treasury National Risk Assessment, 2017, which stated –

“The creation of trusts and companies on behalf of clients is assessed to be the legal service at greatest risk of exploitation.”²

“...law enforcement agencies assess that criminals seeking to hide their wealth or enable money laundering are likely to use companies and partnerships in order to do so. The risk of criminals seeking to launder money through UK and overseas corporate structures is therefore assessed to be high.”³

Given the very nature of trust and / or company services, they can be used by criminals to provide anonymity to the ownership of assets by adding layers to the management, control and otherwise obscuring ultimate ownership. This is further compounded when used in conjunction with other services offered by the legal sector who can provide a legitimacy to an entity of arrangement.

The principal objectives of the AML team’s first thematic review were –

1. to allow the Society to better understand the breadth of provision of trust or company services by the Scottish legal profession and enable us to better direct our resources in terms of supervision
2. to review compliance with the Regulations across the Stage 3 firms
3. to highlight the regulatory obligations placed on solicitors when providing trust or company services to their clients

² & ³ HM Treasury National risk assessment of money laundering and terrorist financing, 2017

Methodology

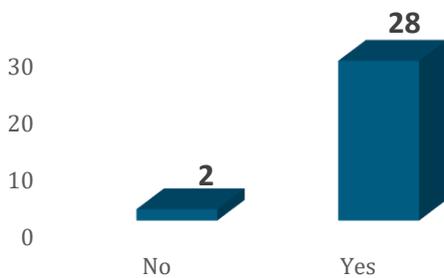
The review comprises five stages –

- Stage One The questionnaire:
After identifying firms who provide trust or company services, 30 firms were selected from the across the profession
- Stage Two Data analysis:
AML team analysed the ingathered data
- Stage Three Firm-level and file reviews:
A cohort of four firms was then selected and requested to provide selected details of their trust or company services clients, the services engaged and copies of their firm-level risk assessment and policies, controls and procedures before we undertook desktop file reviews followed by interviews with those firms
- Stage Four Findings report to Stage Three firms:
Stage Three firms received an individual and confidential report of our findings
- Stage Five Thematic report:
The Society published its thematic report

Firm level risk assessment

The firm level risk assessment demonstrates that a firm has considered all the money laundering risks that it faces through the delivery of its various services to its client base and where they are located. It is also the cornerstone around which a firm’s risk-based policies, controls and procedures must be built.

We were encouraged to see from Stage One – the questionnaire – that 28 of the 30 firms selected to participate indicated they have a firm level risk assessment in place and that this covers the provision of trust or company services. In addition, all 30 firms stated that the trust or company services risks are addressed, aligned to and mitigated through their policies, controls and procedures. This will be expanded upon below.



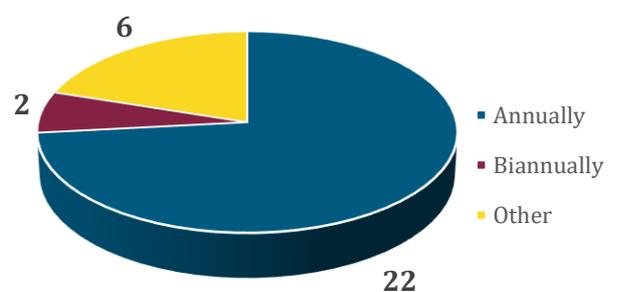
Does your firm level risk assessment acknowledge the inherent money laundering risks associated with the provision of trust or company services?

* The vertical axis is the number of responses received in a category

Firms must include details of each product and service offered to clients in their firm-level risk assessment. Further, they are required to risk grade them accordingly. Ideally, this should be the inherent risk and also conclude with an overall risk grading of the firm. Firms may provide a residual risk grading, however, the steps taken to mitigate the inherent risks must be clearly documented in the risk assessment and / or in the policies, controls and procedures.

Six participating firms keep their firm level risk assessment under constant review. That is, they react to “variances in the risk profile” and “experiences/changes in policy” and said that their risk assessment is “reviewed on an ongoing basis” or is “kept under continual review”.

How often does your firm review its firm level risk assessment?



From the Stage Three firms we inspected, we found examples of good and bad practice.

Good practice

One Stage Three firm submitted a near-perfect risk assessment for consideration. With minor issues, the firm was commended for their application of the process having considered the principle areas of products and services, delivery channels, client and geographical risks. A robust firm level risk assessment allows a firm to develop and implement adequate and effective policies, controls and procedures to help prevent and forestall their services being used and abused by criminals.

This is a clear illustration of how the two documents work in tandem – without identifying the risks your firm faces, you are unlikely to have adequate and effective PCPs in place to mitigate those risks.

Firms are reminded that the firm level risk assessment is not static. The Society appreciates that there may be no changes to a firm's exposure to risk over the period, however, periodic reviews of the firm level risk assessment must be conducted and should be documented and, ideally, signed off by senior management (where applicable) to evidence good governance.

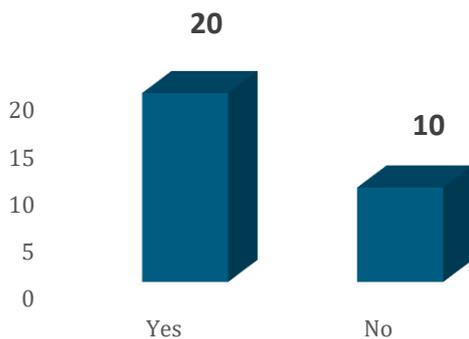
Poor practice

One Stage Three firm failed to detail and risk grade their trust or company services in their firm level risk assessment despite stating in their questionnaire submission that they did.

Firms are again reminded that they must include all products and services in scope of the Regulations in their risk assessment and keep themselves abreast of how their products and services may be exploited by criminals.

Policies controls and procedures

AML policies, controls and procedures (PCPs) are unique to each firm. The PCPs should be detailed and comprehensive and act as a valuable and reliable resource for all relevant persons in the firm. They are organic and should be revisited, reviewed and amended, where applicable, on a periodic basis and / or when a trigger event occurs, for example, offering a new service to their clients. In addition, the PCPs must be approved by senior management pursuant to Regulation 19(2)(b) of the MLR17.



As a legal firm offering trust or company services to your clients, do you feel that your AML policies, controls and procedures in this area can be improved?

From the Stage Three firms, one stated that their PCPs did not need to be improved, however, this was not the case and their PCPs are now subject to quick remediation⁴.

None of the firms we visited detailed in their PCPs the due diligence that should be applied when offering such services. Appropriate and effective PCPs should clearly direct the fee earner / staff member responsible for onboarding clients as to what is expected of them, namely,

1. to adequately comply with their firm's policy
2. to meet the firm's obligations under the Regulations

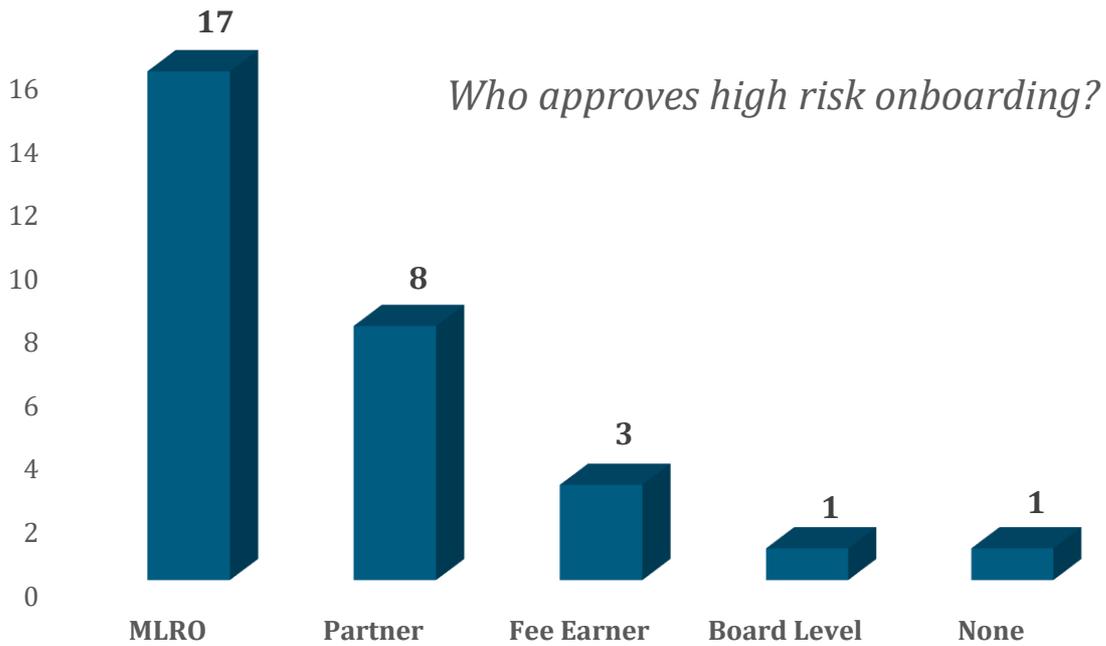
All firms must ensure that their PCPs cover all services offered to clients. When a firm resolves to offer additional services to their client base, we would expect those firms to amend their PCPs immediately so that relevant staff who will deliver the service are made aware as to what is expected of them in terms of AML controls and procedures.

The questionnaire asked, *"Are the Trust or Company services risks addressed, aligned to and mitigated through your Policies, Controls and Procedures?"*, to which each respondent answered "Yes". However, none of the Stage Three firms visited were able to evidence this in the documentation provided. Firms

⁴ The firms in question given an opportunity to improve their firm level risk assessment before potential disciplinary action may be taken.

should revisit, review and amend, where applicable, their PCPs to ensure that each risk identified in their firm level risk assessment is addressed, aligned to and mitigated through their PCPs.

Three of the four firms interviewed stated that the onboarding process and the due diligence required is known to staff, however, this was not documented.



Having robust PCPs provides assurances that relevant staff are not working in isolation when the PCPs state who is responsible for onboarding high-risk clients. The decision-making processes should be clearly documented.

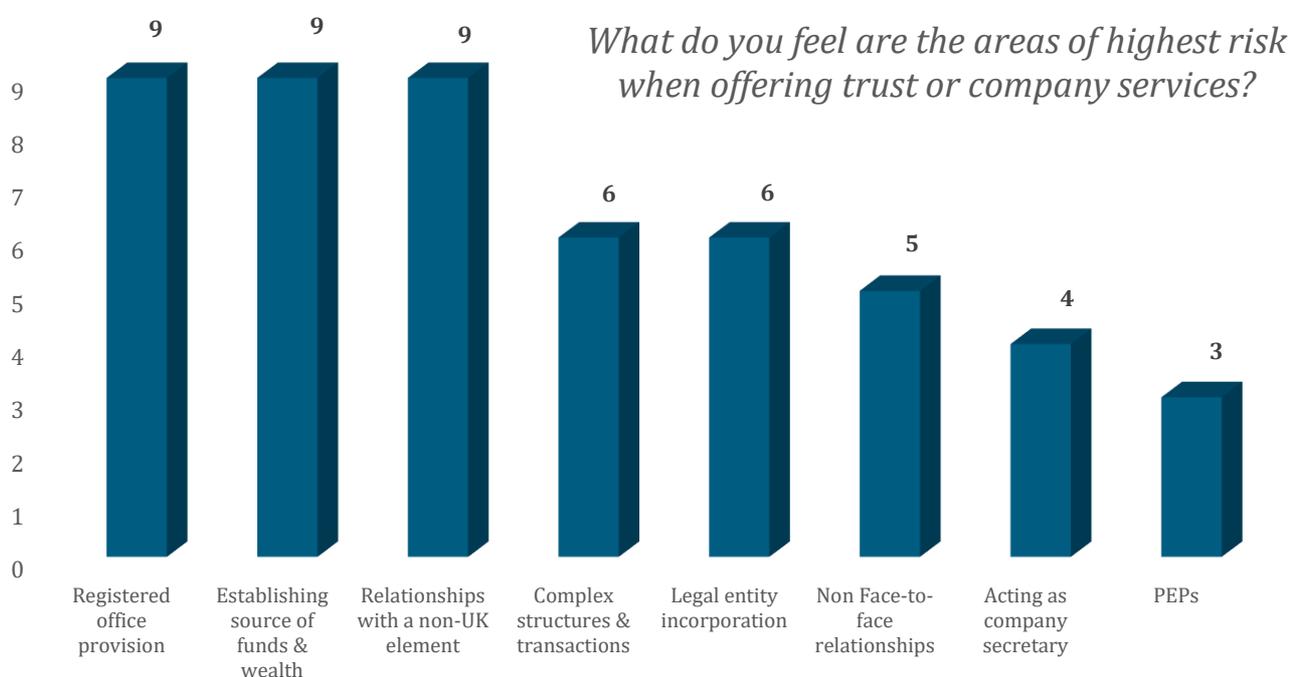
Poor practice

One firm submitted PCPs by another identifiable author (an AML reference book) and has been asked to address this as a matter of urgency. Whilst templates can provide a starting point and provide direction, firms are reminded that PCPs must be tailored to their particular products, services, clients, method of delivery, resources etc. No two firms are identical and a one-size-fits-all approach to PCPs will not be accepted.

Firms are reminded that their PCPs must include the following,

19.—(3) The policies, controls and procedures referred to in paragraph (1) must include —

- (a) risk management practices;
- (b) internal controls (see regulations 21 to 24);
- (c) customer due diligence (see regulations 27 to 38);
- (d) reliance and record keeping (see regulations 39 to 40);
- (e) the monitoring and management of compliance with, and the internal communication of, such policies, controls and procedures.⁵



Participants were able to provide their response in free text and listed above are the most common answers. Others included clients “*attempting to avoid tax or duties*”, and “*high value transactions*”.

⁵ Regulation 19(3) of The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017

Client base

The data received from the participating firms provides a valuable insight as to the geographical spread and types of clients engaging with the profession. Although clients are predominately UK based, there is a number of clients, which includes both natural and legal persons, who engage with the profession or are associated to a client structure –

<p>Non-UK resident and UK domiciled individuals (99 natural persons as clients)</p>	<p>Australia, Austria, Belgium, Bermuda, Cayman Islands, China, Colombia, Faroe Islands, France, Germany, Greece, Guernsey, Hong Kong, Indonesia, Japan, Jersey, Malta, Monaco, Netherlands, New Zealand, Oman, Qatar, Saudi Arabia, Singapore, Spain, Switzerland, United Arab Emirates, United States of America, Vietnam</p>
<p>Non-UK resident and non-UK domiciled individuals (141 natural persons as clients)</p>	<p>Argentina, Australia, Austria, Bermuda, Brazil, BVI, Brunei Darussalam, Canada, China, Denmark, Egypt, Faroe Islands, France, Germany, Guernsey, Hong Kong, Hungary, India, Indonesia, Ireland, Italy, Malta, Netherlands, New Zealand, Norway, Poland, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Thailand, Turkey, United Arab Emirates, United States of America</p>

10 firms engage with clients who are UK licensed and regulated service providers such as other law firms, banks, trust and company service providers. This number falls to four firms who deal with clients who are non-UK licensed and regulated service providers, the jurisdictions being France, Ireland, Jersey, Norway, Switzerland and the United States of America.

24 firms have trust or company services clients who are legal persons, that is, limited liability companies, Scottish limited partnerships and limited liability partnerships, totalling 7,557 relationships.

22 firms have 5,440 relationships with clients who are trusts governed by UK laws. Three firms have non-UK trusts as clients who have engaged their trust or company services, the governing laws primarily being those of the Crown Dependencies or British Overseas Territories namely Bermuda, Cayman Islands, Guernsey, Isle of Man and Jersey. Other jurisdictions included France, Liechtenstein and Switzerland.

As detailed above, those engaging, or connected to, trust or company services provided by the profession are international. Firms are reminded to be aware of the potential geographical inherent risks when dealing with natural and legal persons from jurisdictions perceived to be of a higher risk. This extends to the source

of funds and source of wealth; how and where the assets / associated funds were generated.

Politically exposed persons (PEPs)

Almost two thirds of participating firms have PEPs clients who use or are connected to their trust or company service provision.

Firms are reminded that the definition of a PEP was broadened in 2017 to include domestic individuals as well as bringing into scope "...a family member or a known close associate of a PEP".⁶

Two firms stated that they have non-UK clients who are PEPs; one firm has one client whilst the other firm has ten clients from Australia, Brazil, Saudi Arabia and the United States of America.

Of the four firms whose PCPs we have had sight of –

- two had not addressed PEPs in their PCPs
- one had a policy but no clear procedure
- one firm who deals with PEPs addressed PEPs in the firm level risk assessment but had no clear PCPs

Firms are statutorily obliged to consider PEPs in their PCPs⁷, regardless of whether they offer their services to PEPs or not, and should detail –

- who is responsible for approving the establishment of or continuing the relationship with a client who meets the definition of a PEP
- the measures in place to establish the source of funds and source of wealth
- the enhanced ongoing monitoring procedures⁸

Please note: not all clients will disclose their PEP status, therefore it is imperative that firms have the appropriate level of systems in place to identify PEPs.⁹

⁶ Regulation 35, The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017

⁷ Regulation 19(3)(c), The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017

⁸ Regulation 35(5), The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017

⁹ Regulation 35(1) & (2), The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017

Face-to-face clients

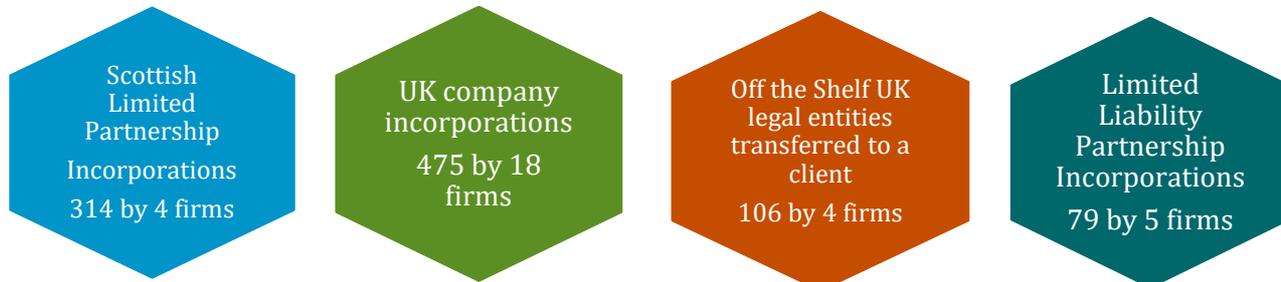
Almost two thirds of the firms questioned stated that they meet +90% of their TCSP clients face-to-face with 11 of those firms meeting 100% of their TCSP clients face-to-face. Conversely, four firms meet 51% or less of their TCSP clients face-to-face.

It has been noted above that the majority of TCSP clients are resident in the UK. Where circumstances prevent face-to-face meeting with clients, firms must document the reasons why and the measures they take to mitigate the risks. Firms are also reminded that a client showing reluctance to meet in person could be a red flag and this factor should be given due consideration.

Services offered

Legal entity incorporation

We were keen to establish how many firms incorporated UK entities on behalf of clients, including limited liability companies, limited liability partnerships and Scottish limited partnership.



Focus on Scottish Limited partnerships (SLPs)

It has been noted that only four firms have incorporated SLPs, 314 in total, on behalf of clients during the period, however, none of those firms were taken to Stage Three.

We cannot determine without seeing the files how those firms performed the due diligence on the clients but it is expected that those firms clearly documented the rationale and intended activity of the SLP before incorporating the entity in light of adverse media attention TCSPs have received in recent years when providing this particular service.

This will be tested when auditing those firms.

Again, when incorporating any type of legal entity for a client it is imperative that firms establish and document the rationale, proposed activity, management and control of the entities.

Off-the-shelf companies

Four of the 30 participating firms stated that they create “off-the-shelf” companies in order to expedite and facilitate client matters and transactions. Each of the four firms stated that they have appropriate PCPs in place when transferring such companies over to the client.

This will be tested when auditing those firms.

Interestingly, none of the respondents were instructed to arrange or facilitate the incorporation of non-UK legal entities.

The HM Treasury states that –

*“Law enforcement agencies assess that corporate structures are being created by criminals or on their behalf both in the UK and overseas, frequently using the services of regulated professionals, with the intention of subsequently using the structure to hide wealth or enable money laundering”*¹⁰

Firms must be mindful of this when providing legal entity formation to clients. Although, as a standalone service, their regulatory obligation ends once the matter has concluded, they may run a risk of being linked to a future illegal activity. Therefore, when offering such a service to a client a firm must ensure that it conducts and documents the due diligence processes to mitigate the inherent high risks.

The National Risk Assessment elaborates further –

*“While trust and company services pose a relatively high risk, the risks are assessed to be greatest when provided in conjunction with other financial, legal or accountancy services....”*¹¹

¹⁰ HM Treasury National Risk Assessment, 2017, Page 61

¹¹ HM Treasury National Risk Assessment, 2017, Page 59

Provision of officers – natural and legal persons

Directors

One third of participating firms provide an officer of their firm to act as director of a client UK company and the rationale provided in the questionnaire submissions for doing so included “...*provide the appropriate skill set and advice...*” and “...*the partner’s knowledge of the business allows him/her to carry out a constructive non-executive/advisory role.*” and “...*is to utilise the officer’s knowledge, experience and expertise...*”.

The rationale for providing this service appears to be well considered, however, this has not been tested.

Acting as a director of a client company is not without its risks. Provision of directors will be reviewed when firms offering this service are inspected. We will expect to see a clear and detailed understanding of the client company as well as the requisite due diligence applied and documented.

None of the participating firms provide directors to non-UK client companies.

Secretaries

17 firms provide a body corporate to act as secretary to a UK incorporated client company, whilst five firms provide an officer of the firm to act as secretary.

The rationale for doing so includes “...*to assist them with their compliance by receiving reminders from Companies House...*” and “...*always link to the provisions of an underlying professional service*” and “*clients prefer their solicitors to act as company secretary and/or prefer the company secretary to have limited liability*”.

Good practice

One firm was able to thoroughly evidence their compliance with the Regulations when providing this service by establishing and maintaining the appropriate statutory records to be held by a company as well as handling statutory filings in accordance with the services detailed in the letter of engagement.

Firms are encouraged to maintain regular contact with their clients when providing this service to ensure that the statutory records they maintain are up-to-date and relevant. The letter of engagement provides a firm with the ideal opportunity to inform clients of their obligations when engaging such services.

When acting as company secretary, a regulated service, we expect firms to act responsibly and meet their obligations under the Regulations.

Nominee shareholders

Six respondents stated that they provide a body corporate to act as a nominee shareholder whilst one firm, temporarily, had one of their officers acting as a nominee shareholder.

The rationale that a firm provided for doing so included *“greater flexibility in execution of documents”, and “client confidentiality or legitimate sensitivity in relation to details being on the public register.”*

Firms offering this service have stated that they do so for administrative reasons, for example, *“We own the shares in the company until such times as our client wishes to take control over the companies, and we will transfer the shares to them at that time”*.

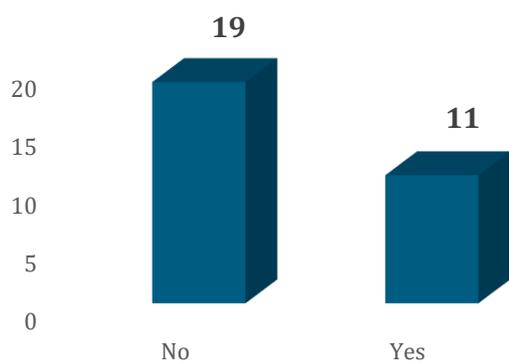
When delivering the service, the Society expects all firms to exercise caution and conduct the due diligence required and document the rationale for doing so. Nominee shareholders, by their very nature, can create an additional layer of ownership and *“...create obstacles to identifying the true beneficial owner/s of a legal person, particularly where their status is not disclosed.”*¹² and may be used for illicit purposes.

¹² Section 202, FATF Guidance for a Risk-Based Approach – Trust and Company Service Providers, June 2019

Provision of a Registered Office

The UK National Risk Assessment, 2017, regards the provision of a Registered Office to clients as inherently high risk as well as those trust or company service providers which offer a wide range of services including Registered Office services¹³, and the Society agrees. However, not all participants agree.

Do you regard the provision of a registered office service as high risk?



19 firms provide a Registered Office service. None of the Stage Three firms regard this service offering as a high-risk activity.

From the AML-specific files we have reviewed, two firms have neither established nor maintained the actual registers of the client firms they are providing this service to; they rely on the information held at Companies House to “identify and verify” the principals, namely the directors, secretaries and members. Please note: Companies House is a

depository of information submitted by or on behalf of companies – the information provided is not, as a matter of course, checked or verified by Companies House. Firms who rely on Companies House specifically for verification of Persons of Significant Control, are reminded of the Regulations which state in Regulation 28(9) –

“Relevant persons do not satisfy their requirements under paragraph (4) by relying solely on the information—

(a) contained in—

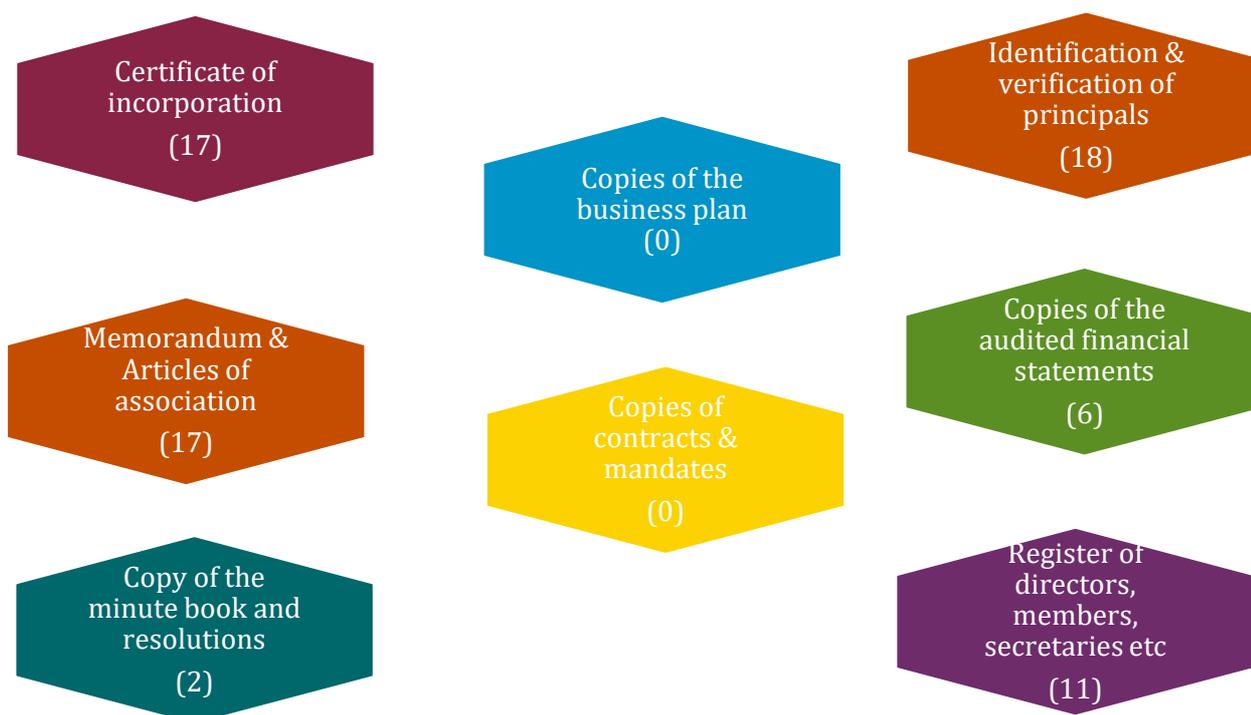
(i) the register of people with significant control kept by a company under section 790M of the Companies Act 2006 (duty to keep register)(a);

(ii) the register of people with significant control kept by a limited liability partnership under section 790M of the Companies Act 2006 as modified by regulation 31E of the Limited Liability Partnerships (Application of Companies Act 2006) Regulations 2009(b)”

¹³ HM Treasury National Risk Assessment, 2017, Page 63

When providing a Registered Office to a legal entity, firms must be aware of the associated risks and the role, as a TCSP, the firm plays in identifying and verifying the beneficial ownership of the entity. Firms have to rely on information provided by the client and, as such, “*they may be challenged in obtaining and keeping current and accurate beneficial ownership information.*”¹⁴ The same applies to firms keeping themselves aware of the actual of activity of the entity.

Firms were asked to state the statutory and due diligence documentation that they hold at the Registered Office –



As detailed above, two firms do not hold the Certificate of incorporation or Memorandum and Articles of association on the companies that they provide the Registered Office service to, with one participating firm not obtaining and holding identification and verification documentation on the principals connected to the client (the company). This firm is in breach of the Regulations by failing to adequately identify and verify the client.

Only 11 of the participating firms hold the Registers which is cause for concern for the Society. Firms must hold the statutory documentation of legal entities that they provide a Registered Office to, pursuant to the Companies Act, 2006.

¹⁴ FATF Guidance for a Risk-Based Approach for Trust and Company Service Providers, 2019. Page 15

Good practice

One Stage Three firm holds a comprehensive range of due diligence including the statutory documentation as well as a copy the minutes and resolutions book and financial statements. This allowed the firm to clearly evidence the management and control of the client as well as its day-to-day activities.

The Society's website contains a guide¹⁵ on how to comply with your statutory obligations when providing this service. The guidance details what must be held at the Registered Office as well as providing examples of best practice. How firms evidence the management, control and activity of a legal entity is to be determined by each firm, however, we will want to see clear, documented evidence and the rationale behind a firm's policies, controls and procedures when we review the client relationship.

Poor practice

One firm under review who provides a Registered Office service to a client also failed to keep adequate registers. This was further compounded by the fact that the corporate secretary of the company in question was also a licensed and regulated service provider. The Society would expect there to be a greater level of cooperation and interaction between the two service providers to establish and maintain statutory records and other due diligence / KYC.

Poor Practice

One Stage Three firm failed to submit any documentation to evidence compliance with the Regulations when providing a Registered Office to a client. The client is known to the firm as they provide other services to that client which are not in scope of the Regulations.

Firms must ensure that their staff are fully aware of the regulated services their firm offers and the statutory obligations that must be complied with when doing so.

¹⁵ <https://www.lawscot.org.uk/members/business-support/financial-compliance/anti-money-laundering/tcsp-toolkit/>

Relationships depend on the cooperation of the client who plays a vital role in providing information and updating the firm as and when material changes take place. Again, the letter of engagement and terms of business issued to each client should emphasise the client's duty to cooperate with firms to ensure that they play their part with the firm's compliance obligations.

All firms are reminded to familiarise themselves with the UK National Risk Assessment as well as other publications such as the recent Financial Action Task Force (FATF) Risk Based Approach Guidance for the Legal Profession and for Trust and Company Service Providers. This documentation can be found on the website.¹⁶

The provision of a Registered Office, business address, a correspondence or administrative address for a company – although permissible – is not without risk. Firms must ensure that they are able to provide clear and detailed documentary evidence of the actual activity of the company (including jurisdictions of activity), its management and control, where it trades from and offers its services. Providing standalone services to clients can result in a lack of knowledge and understanding of the business. However, where some of the Stage Three firms have provided a Registered Office service in addition to other services, there remained a lack of KYC on file, or at least in the files presented for inspection.

Significantly, of the four Stage Three firms, three mooted removing the provision of Registered Offices to their clients due to the amount of due diligence which they are now aware that they should be conducting.

The Society expects firms who provide this service to comply with their statutory obligations and to be able to provide evidence when requested.

¹⁶ <https://www.lawscot.org.uk/members/business-support/financial-compliance/anti-money-laundering/tcsp-toolkit/>
<https://www.lawscot.org.uk/members/business-support/financial-compliance/anti-money-laundering/aml-toolkit-1/>

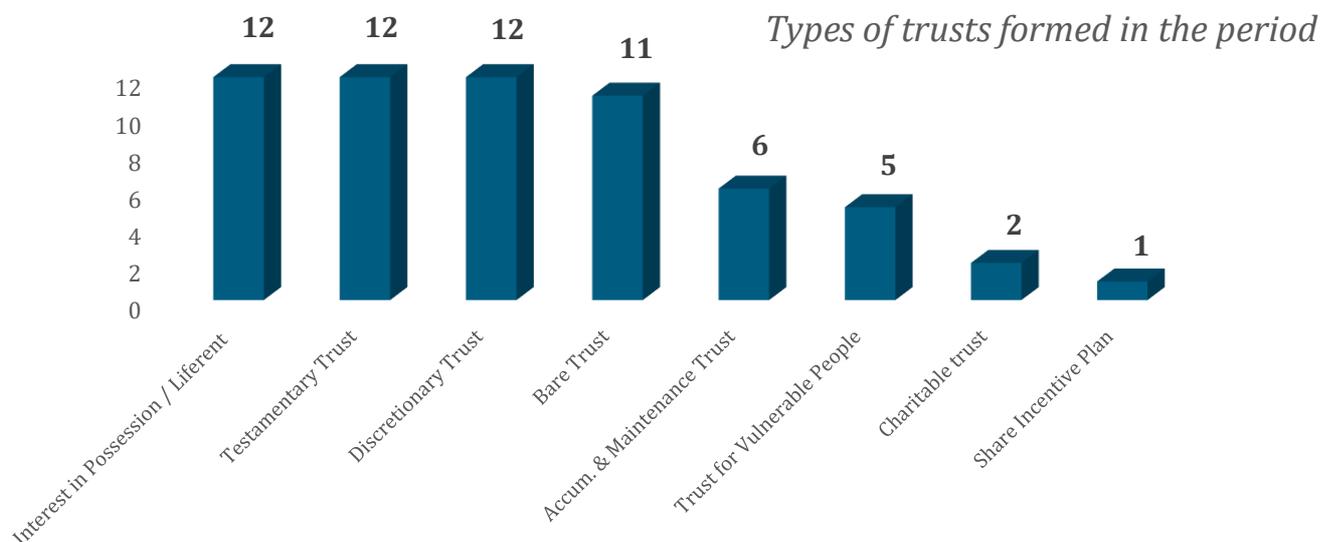
Arrangements

The creation and provision of services to UK trusts (those governed by UK law and / or administered in the UK)¹⁷ is assessed to be low risk of exploitation by criminals, however, this does not eliminate a firm's duty to exercise and evidence their obligations under the Regulations.

From the trust services files reviewed, we have instructed those firms to fully consider and document their compliance with the Regulations. The duty to maintain clear and detailed AML records remains, in particular –

- periodic review of the risk assessment and ongoing monitoring
- resolutions of the trustees and their decision-making processes
- duty to register applicable trusts with the Commissioner¹⁸
- FATCA and CRS disclosures, where applicable

The types of trusts which the Society would expect to see settled during the period, include –



11 firms have provided a corporate trustee across 1,805 trusts during the period under review.

¹⁷ HM Treasury National Risk Assessment, 2017, Page 58

¹⁸ Regulation 45, The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017

This is compared to 15 firms who have provided an officer to act as trustee to some 860 trusts during the period

Only one firm has provided a corporate trustee to non-UK law trusts during the period, the governing law being that of the Isle of Man.

Two firms provided an officer to act as trustee to two non-UK law trusts during the period, the governing laws being those of the Isle of Man and Guernsey.

One firm has provided a corporate entity to act as protector.

Internal controls – training

The Society is encouraged to see that almost two thirds of firms questioned stated that their staff receive specific training to ensure that they have the skills, knowledge and expertise to carry out trust or company work.

Poor practice

One participating firm does not maintain a training register. All firms are reminded that they are obliged to maintain a record detailing the AML-related training conducted for all relevant staff, pursuant to Regulation 24.

Recording when relevant staff received their tailored training not only allows firms to evidence that they have complied with Regulation 24, it also acts as a reminder as to when the next training should take place.

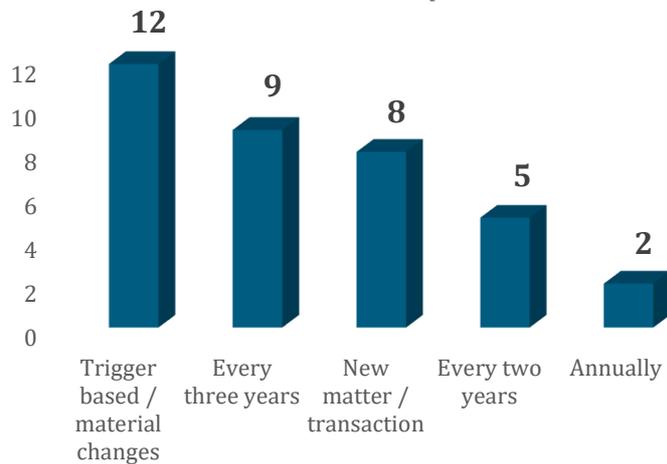
15 participating firms have relevant staff who are members of the Society of Trust and Estate Practitioners. In addition, seven firms have staff who are members of the Association of Tax Technicians and three who are members of the International Compliance Association. Other memberships include the Chartered Institute of Tax, the Institute of Chartered Secretaries and Administrators and the International Academy of Estate and Trust Law.

Firms are advised to provide TCSP staff with sufficient training to equip them with the necessary skill sets to effectively deliver trust or company services.

Due diligence – customer due diligence, enhanced due diligence and ongoing monitoring

Firms were invited to provide a “free text” response to this question and the information here represents the most common themes in the answers submitted. Whilst reviewing and updating Customer Due Diligence (CDD) at trigger events and when material changes occur, none of the participating firms stated that CDD was reviewed as part of their ongoing monitoring PCPs.

How often do you update CDD in an ongoing relationship?



The Regulations require all firms to have Enhanced Due Diligence (EDD) PCPs¹⁹ regardless of the regulated service being provided. Firms who do not have EDD PCPs in place must include this in their PCPs as a matter of urgency. Given the nature of certain trust or company services, as well as other regulated services, firms must have EDD PCPs in place so relevant staff have a point of reference to consult for guidance when the situation presents itself.

As with the other areas for consideration and inclusion in the PCPs, having robust processes in place should allow a firm to deliver the engaged services to their clients in a more expedient and professional manner.

Our website provides guidance on how firms should approach their individual PCPs.

Again, firms were asked to provide their answers in free text. There is a correlation between updating client due diligence and when firms monitor their trust and company services clients’ relationships. Nearly two thirds of respondents said that they review client relationships when prompted to do so by a trigger event or working on a new matter for that client.

Given the nature of trust or company service provision we would expect firms to review the relationships on an ongoing basis and not just when trigger events occur. For example, should a firm provide a Registered Office to a client’s company, then it is possible that a trigger event may not occur for a considerable period

¹⁹ Regulation 19(3), The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017

of time. Firms should diarise when they are going to review the relationship, keeping in mind that it is an opportunity to reconsider the risks associated with the services being provided to the client whose circumstances may have changed since the relationship was last reviewed.

We found when inspecting client files that all firms failed to adequately monitor the relationships with their TCSP clients on an ongoing basis. Firms are required to evidence periodic reviews of relationships with clients and this period should be determined by the risk grading applied. It is the responsibility of each firm, using the risk-based approach, to determine how often relationships should be monitored and reassessed.

Whilst we are aware that firms have longstanding relationships with clients – sometimes spanning decades – the duty to monitor and document the relationship is not eliminated by how long or how well a firm knows the client. If it is not physically evidenced in the files then there is no information to be reviewed for compliance with the Regulations.

The provision of trust or company services to clients is often an ongoing relationship. The Society appreciates that when providing, for example, trust services to clients, the relationship may not change (with the exception of changes to tax legislation etc). However, firms providing such services are obliged to acknowledge and document that they have reviewed the relationship and, confirm where applicable, that there have been no material changes to that relationship nor to the risk grading applied.

Furthermore, due diligence goes beyond identification and verification. Know Your Client (KYC) forms a vital part of a firm's client relationship and the due diligence exercise. Firms must document the relevant knowledge they have and consolidate it with other documentation to evidence their compliance with the Regulations.

Poor practice

It was apparent from the interviews held with firms that they know their clients, having provided services to, for example, the family and the structure for a considerable amount of time. However, the relevant staff responsible have failed to document this either during periodic reviews or in easily accessible file notes.

Reliance

We asked firms the following question regarding Reliance pursuant to Regulation 39 –



Does your firm place Reliance on third parties to apply the CDD measures required by the Money Laundering Regulations, 2017?

From the responses received there is a definite misunderstanding as to what constitutes Reliance. This was evident from those firms we visited as well as from the answers received in the questionnaire.

Reliance, as defined in Regulation 39, is exercised when a firm relies on another regulated person to apply any of the customer due diligence measures required by Regulation 28(2) – (6) and (10).

Accepting certified due diligence from a third party does not constitute Reliance.

Firms are advised to familiarise themselves with Regulation 39 and to visit the AML and TCSP toolkits on the Society's website for definitions of Reliance²⁰ as well as the guidance on suitable certifiers²¹. Further, should a firm accept certified documentation from a third party, it is considered best practice to detail in your PCPs what constitutes a suitable certifier as well as the wording to be used in such certifications.

²⁰ <https://www.lawscot.org.uk/members/business-support/financial-compliance/anti-money-laundering/tcsp-toolkit/>

²¹ <https://www.lawscot.org.uk/members/business-support/financial-compliance/anti-money-laundering/aml-faqs/>

Record keeping and submission of documentation to the Society

A significant shortcoming with Stage Three firms was their management information and filing systems which impacted on their ability to submit the requisite information to evidence compliance with the Regulations on the files we reviewed.

Two of the four Stage Three firms explained at interview that their filing systems mean that there are occasions where they have some documents in electronic format and some located in different physical filing locations.

Firms should take one of two positions; either being certain that all the files we needed for our review were in the AML pack sent to us or checking first and collating any missing documents before sending them to the Society. Unfortunately, one firm submitted an inadequate pack on two occasions with no apparent attempt to check the files beforehand for their completeness and to wait to see if we requested anything further. This is not acceptable.

Firms have a statutory duty to provide requested documentation to the Society in a timely manner.²² The documentation should be clearly labelled and provide us with sufficient supporting records to enable us to reconstruct the subject / client matter, the risk assessments conducted and the due diligence conducted as well as the ongoing monitoring of the relationship and / or transaction.²³

We urge all firms to ensure that they are in the position to provide such information when requested and in a format that readily evidences compliance with the Regulations.

AML-specific files and guidance

Firms must play an active and positive role to meet their statutory obligations, both with the Regulations and with the Society.

To aid firms in this process, the Society will issue guidance on how to prepare for an audit which will be published in early 2020.

²² Rule B9: Money Laundering and Terrorist Financing. The Law Society of Scotland Practice Rules, 2011, as amended

²³ Regulation 40, The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017

Conclusion

The Society appreciates the general willingness of firms to accommodate our requests for information as well as to accommodate the interviews and onsite visits.

The Society recognises that the sample of firms participating on this thematic review was relatively small and there are numerous examples of good practice as highlighted in this report. However, the findings of the review indicate that there are systemic deficiencies and breaches in firms' AML policies, controls and procedures in this area of practice which breach regulatory obligations.

Significant improvements must be made to safeguard the reputation not only of firms but of the whole profession. Solicitors and their firms must increase their understanding of and adherence to the Money Laundering Regulations.

The legal profession under our direct supervision must fully understand and appreciate the role that they play to prevent and forestall their products and services being used and abused for criminal purposes. All firms who offer services in scope of Regulation 12 must meet their statutory obligations when doing so.

This can be achieved by –

- allocating time and resource to fully establish and consider the inherent risks when providing trust or company services (as well as all other regulated services) to their clients in the firm level risk assessment
- addressing and aligning those risks in the policies, controls and procedures to prevent and forestall products and services from being used for illicit purposes
- periodically reviewing and systematically documenting ongoing monitoring of client relationships, risk assessments, updating and documenting "KYC"
- establishing and maintaining AML-specific client and matter files which will allow firms to evidence compliance with the Regulations to the Society as their supervisor

The Society recommends that the 26 firms who submitted the questionnaire but were not asked to accommodate a desktop review and interview, review their submissions to assess if their answers provide a fair representation of their firms' position. We will consider the data submitted by such firms in any future supervisory action.

All firms within scope of the Regulations must fully consider the findings of this report, given the fundamental principles of effective, proportionate and adequate understanding and implementation of the Regulations apply regardless of the regulated service being offered and delivered to clients.