



Law Society
of Scotland

Consultation response

Economic Crime Levy: Funding new government
action to tackle money laundering



October 2020

Introduction

The Law Society of Scotland is the professional body for over 12,000 Scottish solicitors. With our overarching objective of leading legal excellence, we strive to excel and to be a world-class professional body, understanding and serving the needs of our members and the public. We set and uphold standards to ensure the provision of excellent legal services and ensure the public can have confidence in Scotland's solicitor profession.

We have a statutory duty to work in the public interest, a duty which we are strongly committed to achieving through our work to promote a strong, varied and effective solicitor profession working in the interests of the public and protecting and promoting the rule of law. We seek to influence the creation of a fairer and more just society through our active engagement with the Scottish and United Kingdom Governments, Parliaments, wider stakeholders, and our membership.

We welcome the opportunity to respond to HM Treasury consultation: Economic Crime Levy: Funding new government action to tackle money laundering.¹ We have the following comments to put forward for consideration.

General Comments

The Scottish legal sector is strongly committed to fighting economic crime and Scottish solicitor firms vehemently take their AML responsibilities seriously, taking a front line defence approach through their AML processes and measures to ensure they diligently prevent, identify and report money laundering activity. We do not agree with the UK Government's view which suggests that solicitors, as well as other professions, '*contribute towards the risks within the UK economy*'.² In addition we note that the consultation paper suggests that the private sector, which will include AML regulated firms within the legal sector, benefit from the agenda to reduce economic crime. Although we do not disagree, it is wrong to suggest that the private sector achieves a separate or greater benefit than wider society and we do not believe this is the case. The impacts of economic crime can and are felt across society as a whole and therefore any benefits that materialise from tackling economic crime are equally beneficial.

Solicitors are highly professional individuals who work to exceptionally high standards. The Law Society of Scotland and the wider Scottish solicitors profession is committed to tackling economic crime resultant from money laundering activities, submitting SARs where concerns arise to ensure the National Crime Agency and other appropriate authorities can take the necessary action over money-laundering and other potentially illegal activity. The impact of money laundering activity is a serious crime which goes beyond the legal sector and touches upon society as whole and as such, should be funded by the UK Government. We believe it is wrong to single out the legal sector, along with other sectors, who contribute very little money-laundering risk and

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https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/902445/Levy_Consultation_Document_-_FINAL_.pdf

² See page 3 of the consultation document

who apply rigorous measures to prevent money-laundering activity, measures that go beyond those of many other sectors.

We are also opposed in principle to the introduction of a further levy being placed on Scottish solicitors, particularly at a time when there is considerable economic uncertainty caused by the current COVID-19 pandemic and many firms face potential long term hardship. As a result of the COVID-19 pandemic, the UK is officially in recession for the first time in 11 years, with the UK economy shrinking 20% in August 2020 in comparison with the first three months of the year. There is widespread acknowledgment that this recession may be deep and lengthy in comparison with previous recessions, with recovery limited by continued anxiety over COVID-19. To introduce a levy on firms already struggling during a period of economic crisis and uncertainty will create further anxiety and may be detrimental to the recovery of the legal sector and the UK economy.

The Scottish solicitors profession is already burdened with heavy costs associated with regulation, which includes the continuous annual increase of the levy imposed by the Scottish Legal Complaints Commission (SLCC) which has seen an increase of 25% in the last three years alone and the annual fee related with current AML regulation.

The size of the Scottish market - around 10% of that in England and Wales - means there is greater sensitivity around cost. Relatively small changes in fees can have big consequences, even affecting the financial viability of smaller high-street businesses, which find it more difficult to absorb new costs. The cost of any additional levy imposed on Scottish solicitors will be ultimately borne by an increase in fees for clients. We note that the consultation document recognises that '*The private sector is the first line of defence and spends substantial sums to prevent economic crime*'.³ Yet, despite this recognition, the UK Government proposes to place further burden on the private sector by increasing what they have already acknowledged is a 'substantial' sum, requiring firms, as the consultation paper states, to 'contribute further'.⁴

We note that the proposals suggest that there will be both private and public funding. However, no information is provided on what will be the respective division between private and public funding. It would be helpful if the UK Government would provide further clarification of this.

Specific Comments

Levy Principles

Question 1: Do you agree with the design principles as set out above? Should the government consider any further criteria?

While we are opposed to a levy as outlined above, if a levy is imposed, then yes, we agree with the design principles as set out at Chapter 2 of the consultation document. In reference to the principles, we note that

³ See page 3, first paragraph, of the consultation document

⁴ Ibid third paragraph

these include proportionality and affordability⁵, and we agree that a proportionate approach should be taken to ensure that the legal sector, or individual firms are not disadvantaged by a levy that is disproportionate to the risk posed. The principle criteria, we further note, includes simplicity and transparency.⁶ As we touch upon further in this response, it is crucial that any levy and the regime for collection and enforcement, is fully transparent if it is to have the confidence of the legal profession. Those who will be paying the levy need to be certain that there is a clear and robust formula for calculation to ensure consistency and to support the principle of proportionality.

Spending the levy funds

Question 2: What do you believe the levy should fund? Are there any other activities the levy should fund in its first five years?

Funding raised by the proposed levy should be directed at addressing economic crime arising from money laundering. From an accountability perspective, it is important that the funds are used for their intended and stated purpose, which is to fund measures to tackle economic crime through money laundering. We would be against the funds raised being diverted for either general government spending or to tackle fraud, the funding of which we believe should come from UK Government revenue.

We note the intended and initial recipients and programmes for funding, and we agree with those as set out within the consultation document.

Question 3: Do you agree with the government's approach to publish a report on an annual basis? What do you think this report should cover other than how the levy has been spent?

Yes, we agree. It is a reasonable expectation from those paying the levy, that they will be advised on how the funding is spent. We believe it is important to demonstrate a high level of transparency in how the funding raised by the levy is being directed and used to ensure that benefits are being realised. We suggest the report should provide sufficient evidence to support the continuing need to impose the levy and to justify the continued use of public funds. For example, the extent to which the funding generated by the levy has reduced economic crime activity and is therefore producing value for money.

Question 4: What are your views on what the proposed levy review should consider and when it should take place?

See our response to question 3 above. In addition, we agree with the proposal for a full review and report after a period of five years and we suggest, for example, that this considers and fully reports on;

- the method of calculating the levy and if this method is the most appropriate based on the data from the preceding five years,
- how the money is being spent, if this is being directed appropriately to combat economic crime,

⁵ Page 7 Para 2.2 of the consultation document

⁶ Page 7 Para 2.4 of the consultation document

- the impact the levy may have had on the regulated population, those business paying the levy,
- if the regime imposed for collecting and enforcing is the most expedient and efficient and if this could perhaps be improved and
- whether or not there is strong evidence in the need for the levy to continue.

Levy calculation

Question 5: Do you agree with our proposal that revenue from UK business should form the basis of the levy calculation? Please explain your reasoning.

Subject to our views set out within the above general comments, we agree that basing the levy calculation on the revenue generated from UK business is the most appropriate method.

Question 6: Are there any sectors that would be disproportionately impacted if revenue is used as a metric, or where revenue would be disproportionate to level of risk?

We are not in position to comment on how other sectors, other than the Scottish legal sector, may be disproportionately impacted by the proposals. However, we believe that the legal sector may be disproportionately affected given the potentially lower risk posed by this sector which already imposes rigorous AML measures.

Question 7: Do you believe other levy bases would provide a better basis for the levy calculation? These could be the ones outlined in Table 4.A or those not considered in the consultation document.

See our response to question 5 above.

Question 8: Should a fixed percentage or banded approach be taken to utilising revenue as a metric? Please explain your reasoning.

We suggest that it would be appropriate for a fixed percentage approach. As the consultation paper recognises, this would reflect proportionality and be simpler to calculate for firms.

Question 9: What are your views on the principle of exempting small businesses from paying the levy, and on the level of a potential threshold?

We recognise that for smaller firms the costs associated with calculating the levy fee and the administration required in the payment of this may be greater than the levy itself and we would therefore support an exemption for smaller business. This would also recognise that the levy fee is likely to create a heavier financial burden on smaller firms as opposed to the larger firm. We also believe that it would significantly increase the collection burden, and likewise costs, if a levy were to be imposed on all AML regulated firms.

To ensure consistency for small businesses and ease their regulatory financial burden, our view is that the threshold should be £10.2million, being a higher of the thresholds suggested within the consultation paper.

Question 10: What are your views on having businesses below the threshold subject to a small flat fee?

Although in principle we are opposed to any fee and believe that those business whose revenue falls below the threshold of £10.2m should be exempted, we do recognise that there may be some merit in the proposal for a 'small' flat fee from the context of spreading the cost burden amongst the regulated population. Although it may be considered equitable for those firms below the threshold to pay a flat fee, we would be greatly concerned with the possibility that this would be increased annually, and we refer to our comments in response to question 15 below, of ensuring that any increase was proportionate, transparent and justified. We also re-emphasize our concerns of introducing a levy at a time of economic uncertainty and hardship, in particular for those smaller 'high street' firms.

In addition, careful consideration must be given to the practicalities of collecting a 'small flat fee' from over 800 firms within Scotland, this may not be viable from a cost's perspective.

Also, it would be helpful if the UK Government could provide clarification of what will be considered as 'small' flat fee and how would this be calculated?

Question 11: Do you believe the small business threshold should be determined by reference to revenue alone or to all three of the Companies Act 2006 criteria? Please explain your reasoning.

We suggest that the threshold should be determined by revenue derived from AML regulated activity alone, recognising the rationale, and on the basis, of proportionality and given that this is the focused area of risk.

Question 12: For businesses not exempted by a threshold, how should their revenue below the level the threshold is set at be treated – as an allowance, levied at the same level as the main levy rate, or levied through a fixed amount?

We suggest that revenue below the threshold should be treated as an allowance. However, if a flat fee is to be levied against all businesses, then this should be consistent across all firms, in which case we suggest that it would be appropriate to levy the flat fee against all revenue below the threshold and thereafter the revenue beyond the threshold to be levied and the main rate.

At the opposite end of the spectrum, to apply the levy at the same level for all revenue below and above the threshold may place a significant financial burden on businesses.

Question 13: How do you think money laundering risk should be accounted for in the levy calculation?

As the consultation recognises, it will be exceptionally difficult to account for the money laundering risk within the levy calculation. As noted, the use of supervisor risk assessments would result in AML supervised firms being made aware of their risk assessments and could undermine the supervisors' position. We note that the suggestion is made that initially the levy may be based on revenue. As stated earlier in this response, it is crucial that those paying the levy can have confidence in the levy regime and that this demonstrates transparency and proportionality. Therefore it is crucial that an appropriate money laundering risk metric is

developed and brought forward as soon as possible and the levy should not be introduced until this has been determined.

Question 14: Do you believe using number of SARs reported as a metric through a banded approach would be an appropriate means of achieving this objective? Please explain your reasoning.

We do not believe this is an appropriate way of calculating the levy. This potentially risks penalising firms for meeting their legal obligations by reporting SARs. This would seem unfair and unjust as it will be very unlikely that the suspicious activity has arisen through fault on the part of the reporting firm. This may also have the potential to incentivise an under reporting of SARs. In addition, we note that the consultation recognises that the current SARs regime is in need of modification and therefore it would seem unreasonable to base a levy on a SARs regime which is to be subject to reform.

Further in relation to SARs, we know that many of our members remain concerned over the specific follow-up action which is taken by the National Crime Agency when time and care is taken by our members to submit a report and it is rare that feedback is given following a SAR submission. If a levy is to be imposed then, quite rightly, those firms contributing will have an expectation of greater transparency and feedback following a SAR report.

Applying the levy calculation

Question 15: Do you believe there should be a periodic or annual process for setting the levy rate? If periodic, what would an appropriate period be?

We believe that there should be an annual and fully transparent review and setting of the levy rate, with a duty placed on ministers to consult with stakeholders throughout the process, such as professional and regulatory bodies and AML supervisors and the opportunity given to engage in a meaningful way through open dialogue. There must also be accountability and oversight in the setting of the levy to prevent unjustifiable increases without evidence of increased mischief. We note that the consultation advises that the levy will also recover costs associated with the administration and collection of the levy⁷. We are concerned that without transparent accountability, this will give carte blanche for an ever-increasing annual levy.

Our concern is borne out from our own experience of other levies. In Scotland, the Scottish Legal Complaints Commission (SLCC) is a good comparator as the body responsible for the handling of all legal complaints. At present, all practising Scottish solicitors must pay an annual levy of up to £492 per year for the financing of the SLCC. This has risen from £275 when the levy was first introduced in 2009/10. At present, there is no oversight or accountability of the setting of the fee – it is decided entirely by the SLCC. Whilst the SLCC must, by law, lay its budget before the Scottish Parliament, there is no mechanism for the Scottish Government or Members of the Scottish Parliament to intervene if they feel the budget or associated fees are excessive. There is provision to ensure the SLCC consult with stakeholders. However, our experience is that this is

⁷ Page 9 Para 3.10 of the consultation document

simply an administrative requirement with no real opportunity to engage in a productive and meaningful manner or to influence the outcome in any way.

Question 16: Would you prefer to calculate the levy based on total revenue or revenue from AML-regulated activity only? Please explain why.

We believe that the calculation of the levy must be based on the revenue generated from AML regulated activity only. If this were to be based on total revenue then this may have a disproportionate impact of imposing a levy on a firm where only a small amount of revenue is derived from AML regulated activity and therefore poses a significantly reduced risk. In addition, it would be counter intuitive to the reason for the levy being imposed on the AML regulated sector.

Question 17: If applicable, what is your initial estimate of the proportion of your UK business which is AML-regulated (in revenue terms)? How many labour hours would initially be required to enable your business to robustly calculate the proportion of regulated business on an ongoing basis?

As this question is individual business focused, we are not able to answer this question.

Question 18: Which is your preferred option for defining revenue?

We suggest that the definition as provided within the Companies Act 2006, would be the most appropriate, being: *'the amounts derived from the provision of goods and services, after deduction of (a) trade discounts, (b) value added tax, and (c) any other taxes based on the amounts so derived'*.⁸ This is a readily recognised definition, as opposed to the alternative suggested definition, that set out by the UK Financial Reporting Standards and used by the FCA. This definition, we suggest, is ambiguous and would not be consistent with the levy principles as set out within Chapter 2 of the consultation document, in particular 2.4 (simplicity and transparency) – *'The levy should, as far as possible, be simple to understand and calculate by firms'*⁹

Question 19: Do you agree the levy should be based on UK revenue only? How easy would it be to split out your UK revenue from your total global revenue?

We agree this should be based on UK revenue only. As the second part of the question is specific to each individual business, we are not able to answer this.

Question 20: Do you think it would more appropriate to use total income or net operating income as a metric for calculating levy liability for deposit-taking institutions, and if so, which metric would be the most appropriate?

As this relates to deposit-taking institutions, we are not able to answer this question.

⁸ Companies Act 2006 section 539

⁹ Page 7 para 2.4 pf the consultation document

Question 21: Do you agree that the reference period for the levy calculation should be a business's accounting period? Please explain your reasoning.

This would seem the most sensible approach and would assist firms in calculating the levy as there would be certainty of the revenue generated from the AML regulated activity. This would also help in preparing cashflow forecasts.

Question 22: Do you agree that the levy should apply to activity carried out from the date from which the activity is regulated? Please explain your reasoning.

Yes, this would seem the most sensible and fair approach. We do not think it would be just or appropriate to impose a levy on revenue generated before a firm's AML activity became subject to regulation. To do so would be problematic, as this would, effectively 'back date' a levy which may have not been budgeted for in the firm's financial planning and budgeting.

Question 23: Do you believe levy liability should be calculated and invoiced at entity or group level? Please explain your reasoning.

We suggest that group level would be the most appropriate method as this would ensure that the levy was calculated based on the regulated activity of all entities within that group and would avoid the possibility, as detailed in the consultation paper, of the group allocating revenue across entities to take advantage of the de minimis principles and any thresholds in place.

Question 24: Do you agree limited partnerships should pay the levy at partnership level? Do you have any other views on how partnerships should be treated for the purposes of the economic crime levy?

Yes, we agree that any levy should be imposed at partnership level. This would ensure consistency across business structures and provide clarity as to liability.

Collecting the levy

Question 25: Do you think the agency should issue a notice to file or that businesses should be required to submit a return proactively? Please explain your reasoning.

We suggest that the agency should issue a notice to file. Without this how would a firm be made aware of the information necessary for paying the levy, i.e. payment dates / deadlines, amount of levy and basis of calculation? The issuing of a notice to file will ensure that there is no uncertainty by any business as to the requirements of the agency and would provide an audit trail for accounting purposes.

Question 26: Do you think all businesses should report their levy liability to the agency? If not, do you think small businesses should report a nil declaration or nothing at all?

To require businesses to report their levy liability to the agency will create further bureaucracy requiring resource on the part of those business subject to the levy. Although this will affect all businesses, it will be particularly burdensome on small businesses. Therefore, we suggest that, at the very least, small businesses

should not make any return. This is in line with current government policy on lifting the burden on small businesses. Businesses will of course require satisfying themselves as to whether they have liability for the levy or otherwise, but small businesses should not be expected to report a nil declaration.

Question 27: Do you agree with the proposed approach for calculating the levy rate, invoicing, and payment of the levy? If not, please explain why.

We agree that the regime for calculating, collecting, and enforcing, the levy should be kept as simple as possible to ensure clarity and understanding by both regulated business and the agency responsible for invoicing, collecting, and enforcing. We also agree with the proposed approach but emphasise our view (see response to question 15) that the levy amount should be reviewed annually and adjusted accordingly based on reliable evidence.

Question 28: What are your views on the proposed compliance framework in a single agency model?

We agree with the compliance framework as proposed, any unpaid levy amount should be recoverable as a civil debt. However, we also suggest that every opportunity should be given to the business to pay any unpaid amount in full before enforcement action is taken. There should also be a transparent mechanism for appeal for when the regulated business believes the due amount is incorrect and they wish to challenge this.

Question 29: Do you agree that supervisors should be able to determine the frequency of reporting and payment, provided they transfer levy payments to the government a maximum of a year after the end of a business' accounting period?

If the supervisor model is determined to be the most appropriate and cost-effective model, then yes it would be sensible to provide supervisors with the power to determine frequency of reporting and payment. This would ensure that any new requirements could be embedded into the existing processes and timeframes with minimum disruption to both supervisors and the regulated population. However, our view is that the single agency option would be the most appropriate, efficient, and cost-effective model.

Question 30: What are your views on the supervisor carrying out compliance activity as set out above?

We do not believe that the supervisor model is the most appropriate. The single agency should conduct compliance activity, rather than multiple supervisors (22 as set out in the consultation paper)¹⁰ being responsible for this. This would help to ensure consistency in approach, efficiency within the process, allowing cost to be managed effectively, and transparency of the process. We are concerned that anything other than a single agency model will provide scope and potential for increased costs in another guise.

Question 31: Which model do you prefer? Please explain why. Do you have suggestions for any other models that could be used?

¹⁰ Page 26, Para 6.2 of the consultation document

We believe the single agency model, Option 1 as set out within the consultation,¹¹ is the most appropriate for the reasons as set out in question 30 above.

Question 32: If you are a supervisor, what do you estimate your costs would be in each model?

In any of the models, there would be a significant cost associated with embedding the necessary IT programmes and processes. This is at a time when many supervisors and regulatory bodies, including ourselves, are having to make very difficult decisions as a result of economic uncertainty caused by COVID-19 and have very tight budget constraints in which to deliver core regulatory functions.

Funding for fraud

Question 33: How much did your organisation spend on countering fraud in 2019? What are these funds spent on, in high level terms?

As this question is individual business focused, we are not able to respond in detail. However, we suggest that the most significant investment firms will make to counter fraud will be in their IT infrastructure to counter cyber-fraud. This is likely to vary depending on the size of the firm, and with some areas of legal practice being more attractive to fraudsters than others.

Question 34: What additional financial contribution should the private sector contribute towards improving fraud outcomes?

As we stated in our general comments, we do not believe the private sector should be funding anti-fraud and economic crime activity which is undertaken for the public interest. This should be funded by UK Government revenue. We again emphasise that it is crucial that funding raised by the levy is directed at funding AML activity which raises economic crime risk and it would be wholly inappropriate for this funding to be diluted to finance anti-fraud measures.

In addition, the consultation is unclear as to what is under consideration by the UK Government, is the proposal to introduce a second levy, over and above the levy proposed in this consultation document, and for this to be sector risk-based? This needs to be clarified in more detail to allow for meaningful response. We would be strongly opposed to the suggestion of a further second levy on our members to finance anti-fraud activity.

Question 35: Which sectors do you think should be involved in countering the system-wide fraud risk? Please explain your rationale – for example whether you believe that those included should be included based on benefit, or risk?

We suggest that those sectors most at risk and targeted by fraud should be heavily involved in any countering system-wide fraud, in particular the banking and insurance sector. In comparison, we believe that the legal sector, although not immune to fraudulent activity, is much less exposed and the cost impact is significantly

¹¹ Page 26 Para 6.4 of the consultation document

less than other sectors. The financial sector is a major target of fraudulent activity, and poses the largest risk in the UK according to available data ¹² Therefore, based on the scale of risk, it would be sensible that the financial sector should be involved in countering the system-wide fraud risk.

Question 36: What mechanism would you recommend in order to collect additional funding?

As we have stated above, any additional funding should be borne by UK Government revenue, or only by those sectors posing the biggest risk and will therefore benefit the most.

¹² FRAUD - THE FACTS 2020 The definitive overview of payment industry fraud: <https://www.ukfinance.org.uk/system/files/Fraud-The-Facts-2020-FINAL-ONLINE-11-June.pdf>



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