UK Law Commission Proposes Reforms to Suspicious Activity Reports for Money Laundering

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The Law Commission has published an extensive consultation paper examining the UK's current Suspicious Activity Report ("SAR") regime for reporting suspected money laundering to the National Crime Agency ("NCA") and outlining provisional reform proposals.[1] The consultation runs until 5 October 2018, after which the Law Commission will present its final recommendations to the Government. This is the first step in a process that could result in significant changes to Part 7 of the Proceeds of Crime Act 2002 ("POCA"), affecting all organisations that deal with money laundering issues.

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We summarise below the key views expressed and changes proposed in the consultation paper, and analyse the likely practical effect if the reforms are implemented.

Current SAR Regime

There are two types of disclosures that an organisation may make:

- 'Required disclosures' –Organisations in the regulated sector (including financial services, law and accounting firms) must submit SARs where they know or suspect, or have reasonable grounds to know or suspect, that money laundering has occurred or is occurring. Failure to do so is a criminal offence for the individuals involved.

- 'Authorised disclosures' – In addition, any organisation may submit a SAR to seek consent from the NCA for engaging in money laundering activities (also referred to as a 'defence against money laundering') based on knowledge or suspicion that the property it is dealing with constitutes or represents a benefit from criminal conduct.

The current regime has long been criticised for being confusing and requiring organisations to file SARs in too wide a range of circumstances, resulting in a high number of 'defensive' reports which are of little practical intelligence value. This has created excessive compliance burdens on banks in particular, while being ineffective in combating criminal activity.

[1] Law Commission, 'Anti-Money Laundering: the SARs Regime', Consultation Paper No 236 (20 July 2018).

By way of illustration, the consultation paper notes that the NCA receives an average of 2,000 SARs per working day, of which approximately 100 include requests for consent (i.e. authorised disclosures). Between October 2015 and March 2017, the NCA received over 634,000 SARs. Consent was refused in less than six percent of the cases in which it was requested.

Law Commission Proposals

Predicate criminal offences. Money laundering is a 'parasitic' offence requiring the prior commission of a separate criminal offence (such as bribery, fraud or insider dealing) which generates property that becomes the object of a money laundering offence. Currently, any criminal offence can result in criminal property. This means that a SAR may need to be filed as a consequence of a single, relatively minor offence. The Law Commission considered a proposal to restrict the predicate offences to 'serious crimes' (defined by a list of offences or a maximum penalty), but viewed this as introducing unnecessary complexity and an undesirable barrier to prosecuting money laundering offences.

Test of suspicion. One of the most important factors leading to the high number of SARs is the very low threshold of suspicion that is required. 'Suspicion' is not defined in POCA but has been explained by the courts through various formulations, the leading one being: "*a possibility, which is more than fanciful, that the relevant facts exist*".[2] In the context of required disclosures, the meaning of 'reasonable grounds to suspect' has not been interpreted by the courts, but the Law Commission considered that this is currently an objective test that is satisfied where a reasonable person would suspect money laundering based on the information available at the time.

The consultation paper concludes that it would be undesirable and practically difficult to formulate a definition of 'suspicion' in a way which would add anything to its ordinary, natural meaning. However, the Law Commission suggested that the Government issue formal guidance under a statutory power which would provide a non-exhaustive list of the factors capable of founding a suspicion.

The centrepiece of the consultation paper is the set of provisional proposals that:

- The test for required disclosures should be changed to 'knows or has reasonable grounds to suspect'. The latter element would be defined to require both an actual suspicion of money laundering *and* that this suspicion be based on some objective grounds. This would alter the current test since a subjective suspicion alone would no longer be sufficient for a SAR to be made.

[2] *R v Da Silva* [2007] 1 WLR 303; [2006] EWCA Crim 1654 at [16]

- Statutory guidance would include a list of objective factors that may provide reasonable grounds for suspicion.

- For authorised disclosures, the test would remain the subjective 'knows or suspects' test. However, those in the regulated sector would be able to rely on a defence to committing money laundering if they did not have reasonable grounds to suspect that the relevant property was criminal property, so a SAR would effectively be required only where the 'knows or has reasonable grounds to suspect' test explained above was met.

- Those outside the regulated sector would continue to make authorised disclosures seeking consent where they intend to deal with property that they actually know or suspect to be the proceeds of crime.

Mixing criminal and legitimate property. An important aspect of the way the money laundering regime operates is that when suspected criminal property is mixed with property obtained from legitimate sources, all of the property becomes tainted. Consent from the NCA is therefore required to avoid the risk of a money laundering offence when dealing with such property.

To reduce the number of authorised disclosures, the Law Commission has proposed that employees of credit institutions who suspect that only part of the relevant funds constitute criminal property should have a defence to committing money laundering if they transfer that amount to a separate account to ringfence it, or allow money to be withdrawn so long as the balance does not fall below the amount of the suspected funds. However, a required disclosure would still need to be filed. No changes to the existing rules have been suggested for other organisations.

SARs providing minimal intelligence value. While the SAR regime allows a defence of 'reasonable excuse' for failing to make a required disclosure or an authorised disclosure, there is no definitive guidance as to how this term should be interpreted. The Law Commission has proposed that statutory guidance be issued to provide examples of reasonable excuses not to file a SAR, particularly where it is clear from the circumstances that the intelligence value of the SAR will be low.

- Low value transactions: the Law Commission considered, but rejected, proposing a minimum financial threshold below which no reporting obligations would apply.

- Internal movement of funds: internal transfers of criminal funds with the intention of preserving them would amount to a reasonable excuse for not submitting a SAR.

- Duplicate reporting obligations: a SAR would not need to be filed where the same facts had already been notified to another law enforcement agency.

- Public information: a short-form report would be submitted where the relevant information was already in the public domain.

- Historical crime: the guidance would address situations where minor offences were committed many years ago, making it difficult to ascertain the facts or identify the criminal property.

- No UK nexus: the guidance would clarify that where a transaction has no UK nexus apart from being reported to a UK employee and investigated, a SAR would not need to be filed.

Corporate criminal liability. The consultation paper also examines the potential for more fundamental changes, such as abolishing the consent regime, without supporting them at present. Notably, the Law Commission has asked whether a new corporate criminal offence should be introduced, making commercial organisations liable for their employees' or associates' failure to report suspicions of money laundering. Like the corporate failure to prevent bribery and failure to prevent tax evasion offences, this would be subject to a defence if the organisation could demonstrate that it had taken reasonable measures to ensure appropriate reporting.

Analysis

The Law Commission's consultation paper provides a valuable insight into the future direction of the SAR regime, which should slightly ease the compliance burden on banks that routinely file a large number of SARs. The ability to deal with mixed criminal and legitimate property, and to avoid filing SARs in some situations where they are extremely unlikely to be useful, will be welcome. However, it is not obvious that the proposed reforms will have a major effect on how the regulated sector handles SARs, and there is little in the consultation paper for organisations outside the regulated sector.

By leaving in place the full range of predicate offences for money laundering, the very low threshold for suspicion and the lack of any exemption for low value transactions, the proposals fail to address the key causes of the high number of inconsequential SARs that are submitted. The balance that the Law Commission has sought to strike between over-reporting and under-reporting of potential money laundering still firmly favours over-reporting. Consequently, the opportunity for fundamental reform of the SAR regime has largely not been grasped.

While it will be interesting to see how any statutory guidance on the proposed 'knows or has reasonable grounds to suspect' test is formulated, it is not clear that this test will lead to any significant change in practice. Although under the current test a SAR must be filed whenever there is an actual suspicion, in reality, this would almost always be based on some objectively-identifiable factors such that a reasonable person would also hold the suspicion. If not, one may need to reconsider whether that subjective suspicion even meets the low threshold required to satisfy the test of suspicion.

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