Money laundering risks for non-regulated businesses

Jonathan Pickworth and Jonah Anderson at White & Case, and Toby Duthie at Forensic Risk Alliance, find out how the UK's AML regime applies to businesses outside the regulated sector

Money laundering – concealing the origins of illegally obtained funds – is not new. But the focus on money laundering by governments, and therefore law enforcement, has increased dramatically over the past 20 years. So too has the perception of how funds are laundered and the scale on which it is done. Historically, the apparent focus of money laundering was on drug traffickers cleaning cash locally via car washes, nail salons or night clubs. Now it is perceived as an international crime committed by organised crime groups and corrupt public officials. It has been estimated by the United Nations Office of Drugs and Crime that 2–5% of global GDP is laundered each year.

At the same time, the apparent threat from terrorism is ever-increasing. Terrorists obtain funds from a wide variety of sources. While money laundering is retrospective in requiring a predicate crime, terrorist financing has more of a focus on the destination and purpose of the funds. However, both money launderers and terrorist groups employ similar techniques in their activities.

In the UK, the "regulated sector" consists of financial institutions, auditors and other gatekeepers to the financial system.

> But how does the money laundering regime affect those outside the regulated sector, including businesses in the UK and overseas that might unwittingly end up in receipt of the proceeds of crime?

These organisations face greater anti-money laundering (AML) and counter-financing of terrorism (CFT) burdens than those outside the regulated sector, particularly in reporting suspicions regarding money laundering.

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Money laundering in the UK is a broad offence

While businesses operating outside the regulated sector do not have the reporting obligations of regulated companies, these non-regulated businesses do face the risk of liability for a substantive money laundering or terrorist financing offence, and the duty under the Terrorism Act 2000 to report beliefs or suspicions that arise in the course of a trade, profession, business or a person's employment.

It should be noted that the concept of money laundering in the UK is not only confined to transactions involving money. Criminal property, for the purposes of the money laundering offences under the Proceeds of Crime Act 2002 (POCA), is defined as a person's benefit from criminal conduct (in whole or in part and directly or indirectly), in circumstances where the alleged offender knows or suspects that it constitutes such a benefit.

The bar regarding suspicion is low, suspicion having been defined by the courts as a possibility, which is more than fanciful, that the relevant facts exist.

The definition of criminal conduct includes conduct overseas if it would constitute an offence in the UK, a logical approach given the international nature of money laundering. This is, however, subject to an "overseas defence" discussed below.

Case study – retail

Aequitas Groceries is a premier food supplier. It sources prawns from Thailand via Feronia Shrimp Co. Feronia supplies prawns at a significant discount as compared to its competitors.

The Aequitas Groceries compliance department receives an anonymous email in broken English alleging that Feronia's fleet is substantially staffed with slaves trafficked from Cambodia and that Feronia does not have the correct fishing permits. Attached to the email is a video that appears to corroborate the use of slaves on a fishing boat in the Feronia fleet.

The prawns acquired from Feronia appear to be criminal property.

Three substantive offences under POCA can be committed by a natural person or a corporate. In practice, there can be significant overlap between these offences. The substantive offences are as follows:

- Section 327 – concealing, disguising, converting, transferring or removing criminal property from the UK;
- Section 328 – entering into or becoming concerned in an arrangement that a person knows or suspects facilitates, by whatever means, the acquisition, retention, use or control of criminal property by or on behalf of another person; and
- Section 329 – acquiring, using or possessing criminal property.

Case study – M&A

Alpha Limited is a listed pharmaceutical company headquartered in London. Alpha wishes to acquire Bravo Limited, a private company incorporated in India, which has developed a niche product used in heart surgery. During the due diligence process, Alpha discovers that Bravo has engaged in aggressive marketing of its products to healthcare professionals, which has involved lavish hospitality and shopping trips funded by prepaid credit cards.

During the acquisition process, Bravo's external legal counsel makes a joint SAR with Alpha satisfying its reporting obligation but also seeking consent for it and Alpha to proceed with the transaction.

It is a condition precedent that such conduct ceases. Alpha conducts a post-acquisition review and exits some of Bravo's employees from the business. However, Alpha must also seek consent prior to any dividend payment from Bravo to Alpha given that the revenues will continue to be tainted by the proceeds of crime, as some of the revenues generated are a result of the bribery scheme.

A firm can also avoid liability if:

- it intended to make a SAR but has a reasonable excuse for not doing so;
- regarding the section 329 offence only, the firm acquired, used or possessed the property for adequate consideration; or
- the "overseas defence" is available.

Liability may be avoided if a company submits a suspicious activity report (SAR) seeking consent to undertake activity involving property suspected of being the proceeds of crime.

> The position regarding predicate offending that occurred overseas is reasonably clear. But what is the position when the predicate offending takes place in the UK and the laundering overseas?

The single-criminality approach to criminal property was qualified by the introduction of an "overseas defence" intended to decrease SARs made to the UK authorities relating to suspected minor predicate crimes committed overseas. The "overseas defence" provides that a person or company will not commit a principal offence if they know or have reasonable grounds to believe that the criminal conduct occurred overseas and such conduct was not unlawful under the criminal law applying in that country or territory.

The overseas defence will not apply to overseas criminal conduct if such conduct (were it to take place in the UK) would constitute an offence carrying a maximum sentence in excess of one year imprisonment. The "overseas defence" will remain available for certain specified statutory provisions regarding gaming or contravention of financial services prohibitions even if the conduct would constitute an offence carrying a sentence of in excess of one year's imprisonment.

A deferred prosecution agreement is available regarding a substantive money laundering offence.

Extraterritoriality – UK predicate offence, overseas laundering

The position regarding predicate offending that occurred overseas is reasonably clear. But what is the position when the predicate offending takes place in the UK and the laundering overseas?

The position regarding the nexus with the UK for an offence is less clear following the 2014 Court of Appeal decision in *R v Rogers*. In *Rogers*, advance fee frauds were conducted from call centres in Spain and Turkey. The victims were consumers in the UK, who paid fees on the basis of false promises. Profits were transferred from the UK to Spain, in small tranches, into accounts controlled by the appellant, who was a UK citizen but resident in Spain. The appellant allowed the principal behind the scheme to withdraw funds from the accounts. The appellant was convicted regarding the conversion offence.

The case against the appellant therefore centred on activities undertaken in Spain regarding a Spanish bank account. The Court of Appeal found that POCA conferred jurisdiction and noted the international nature of money laundering as a crime. The reasoning was that the predicate offending took place in and impacted on victims in the UK and the laundering in Spain was directly linked to those acts.

However, some practitioners view *Rogers* as being wrongly decided and the reasoning of the Court confused. POCA was clearly intended to capture the laundering of funds within the UK that were acquired via predicate crimes conducted overseas. Rogers suggests that POCA can also cover the laundering of funds overseas when the predicate crime took place in the UK.

Existing risks

While some non-regulated businesses do have policies and procedures in place that address money laundering risks, these may not stand up to testing and responsibility for them may not be clearly defined.

The AML industry within financial institutions is very well developed and there are a large number of specialist AML professionals engaged in such work. This reflects the fact that those in the regulated sector have additional reporting obligations. In the 2015 reporting year, 381,882 SARs were filed. Those outside the regulated sector submitted less than 2% of these SARs.

There is no requirement for a non-regulated business to appoint a nominated officer (usually referred to as a money laundering reporting officer), but businesses often appoint such a person to have a focal point for the collection of money laundering concerns. An employee who makes an internal report to this nominated officer will not commit a money laundering offence.

If a nominated officer is appointed in a non-regulated business, they can face criminal liability if they receive a disclosure from within the business and fail to report knowledge or suspicion regarding money laundering, based on this disclosure, to the National Crime Agency. This is a lesser burden as compared to a nominated officer in the regulated sector, who, having received an internal notification, essentially faces a negligence test in the form of having a reporting obligation if there are reasonable grounds to know or suspect money laundering, in addition to any subjective knowledge or suspicion.

Finally, while the "tipping off" offence is confined to the regulated sector, those in a non-regulated business could commit the offence of prejudicing an investigation.

Risks – law reform

The UK government is currently consulting on reform of corporate criminal liability to avoid some difficulties in prosecuting companies. Prosecutors frequently struggle to satisfy the identification doctrine – proving that senior employees, who represent the directing mind and will of a company, are complicit in the alleged criminality. As David Green, the director of the SFO, succinctly put it in 2013, "[i]n practice, the email trail has a strange habit of drying up at middle management level."

Amongst the proposals for the new model of liability, which is expected to cover money laundering offences, are strict liability models, potentially with some sort of compliance-type defence available. The "failure to prevent" offence contained within the Bribery Act 2010, now effectively used by the SFO, is an example of a strict direct liability offence with a compliance defence.

An alternative model proposed is a "failure to prevent" offence, which requires a prosecutor to prove that not only did the offence occur, but it was the result of management failure via negligent conduct or systematic inadequacies in the mechanisms relied upon to prevent the predicate offences from occurring.

The outcome of the consultation may pave the way for heightened scrutiny of the activities of non-regulated businesses in an AML risk context as well as of the mechanisms in place to prevent non-compliance with applicable statutes.

Next steps

What should non-regulated businesses do? In preparation of the potential change in law, it may be an opportune time to:

- conduct a risk assessment regarding money laundering and terrorist financing to identify whether existing policies and procedures appropriately address any such risks;
- perform targeted transaction testing or a "books and records review" across areas identified as presenting higher money laundering or terrorist financing risk, to gauge the effectiveness or otherwise of related internal controls;
- consider how employees are trained, their understanding of money laundering risks, and whether this needs recalibrating to align with the expansion of risks faced by non-regulated businesses; and
- test payments to and from higher risk locations with consideration of a combination of bribery, sanctions, money laundering and terrorist financing compliance risks.