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## **Executive Summary**

- Evidence suggests that regulated industries – this submission concentrates on the banking and real estate industries – fail to properly implement the risk based approach mandated in the anti-money laundering regulations in relation to high risk clients, especially politically exposed people (PEP). This is predominantly a failure of compliance, most likely due to a lack of effective enforcement, although the anti-money laundering regulations could be improved to address the issue of PEPs from corruption hotspots or ‘kleptocracies’.
- The FinCEN files suggest that banks are the most likely regulated industry to file ‘defensive’ Suspicious Activity Reports (SARs) in order to escape legal liability, rather than blocking the transaction (or further transactions) and closing the client’s account. Meanwhile, real estate agents and conveyancers are not incentivized to file SARs, whose numbers in these sectors remain low.
- Until professionals in regulated industries are prosecuted or sanctioned for failing to report suspicions or knowledge of money laundering, compliance will remain low. The same can be said for those submitting false information to Companies House. Although plans are afoot to grant Companies House more powers to investigate such individuals, the reforms lack a clear timeline, as do the proposed tightening of the regulations regarding Limited Partnerships, which have been identified as a common vehicle for money laundering.
- The use of Unexplained Wealth Orders (UWOs) in targeting PEPs whose sources of wealth are unclear is already in jeopardy, after one such UWO was dismissed, when the judge failed to take into account the corrupt political economy of the PEP’s country of origin. The judge’s reliance on enforcement actions from the PEP’s country of origin appears to undermine the very point of UWOs in the case of foreign

PEPs: the order's aim is surely to counteract, and not reinforce, claims of legitimate wealth by those in power in corruption hotspots.

## **Introduction and Background**

1. We are a group of researchers from the universities of Exeter, Cambridge, Oxford and Columbia (New York) who have worked together on research on money laundering and the use of anonymous companies by political figures from Central Asia and Africa. We submitted evidence to the Treasury Committee in 2018 regarding investment in London property by politically-exposed persons from Central Asia.<sup>1</sup> One member of the team, Professor John Heathershaw, also presented both oral and written evidence to the Foreign Affairs Committee in summer 2019 regarding the inquiry into autocracies and UK foreign policy.<sup>2</sup> A second member, Dr Tena Prelec, submitted written evidence on UK-Western Balkans relations to the House of Lords and oral evidence to the House of Commons in 2018, including on the rule of law and influence of authoritarian countries.<sup>3</sup>
2. Since January 2019, we have been part of the Global Integrity Anti-Corruption Evidence (GI-ACE) programme, which was funded by the UK Department of International Development - now the Foreign, Commonwealth and Development Office. Our particular research project is entitled *Testing and evidencing compliance with beneficial ownership checks*, which encompasses several different threads: namely, an investigation into the checks on politically exposed people (PEPs) in regard to real estate transactions in the United Kingdom, the checks that banks perform on corporate entities based when faced with clients who display various degrees of risk, and the wider topic of 'reputation laundering' through philanthropic donations and other means. In this submission, we will be drawing both on our

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<sup>1</sup> <http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/treasury-committee/economic-crime/written/82400.html>

<sup>2</sup> Written evidence from Dr John Heathershaw (AFP0029) to the Foreign Affairs Committee (2019): <http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/foreign-affairs-committee/autocracies-and-uk-foreign-policy/written/105181.h>

<sup>3</sup> <https://committees.parliament.uk/committee/78/foreign-affairs-committee/news/103318/prospects-for-eu-enlargement-in-western-balkans-examined/>

research conducted under the GI-ACE project, and also our personal research as academics and researchers.

3. A major part of our GI-ACE funded research has been an analysis of UK laws and legislation concerning money laundering, especially in relation to the purchase of property within the United Kingdom. We began this research by creating a database of real estate purchases by PEPs from a range of countries. This database now contains over 60 examples.
4. The passing into UK law of the Unexplained Wealth Order (UWO) in 2018 and the subsequent issuing of two UWOs against figures from Eurasia has provided us with a great deal of information from court documents and related material. We have also obtained a wealth of company records and court documents related to money laundering activities by African (and, in particular, Nigerian) elites in the UK, and complemented our findings by conducting interviews with a wide range of experts, including with professionals from the real estate industry, in order to assess what they consider to be the strengths and weaknesses of current AML legislation. This allows us to suggest ways in which both AML and UWO legislation could be improved.

### **The problem of PEPs from kleptocracies**

5. *The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017* (from here on “MLR 2017”) stipulate that enhanced due diligence must be carried out on clients from high-risk jurisdictions, as defined by the EU’s list of high risk third countries. This list includes countries who are home to major terrorist organisations (for example, Yemen, Iraq, Syria) and those countries who are considered deficient in their AML controls (Guyana, Vanuatu, Trinidad & Tobago). However, as a recent report (co-written by a member of our team, Professor Jason Sharman) on anti-corruption measures by Financial Accountability, Transparency and Integrity (FACTI) recently pointed out: “Jurisdictions end up on these lists for failing to implement a set of international standards, not necessarily because they pose actual money laundering or tax evasion/avoidance threats. As a

result, there is a tenuous relationship between actual risk and the propensity to end up on such lists.”<sup>4</sup>

6. Indeed, absent from the list are many corruption hotspots, including those countries that could be considered ‘kleptocracies’ – where the ruling elite profit from the country’s natural resources and control the major business at the expense of wealth creation for the general populace. Notable countries from Eurasia and Africa that could be described as kleptocracies but who do not feature on the high-risk list include Angola, Azerbaijan, the Democratic Republic of Congo, Kazakhstan, Turkmenistan, and Uzbekistan. Our team’s prior research has established how such kleptocracies are kept afloat by transnational financial networks that allow money to be siphoned from these countries to Western democracies.
7. Guidance from the National Crime Agency (NCA) does include specific risk factors which may lead an individual to conduct enhanced due diligence (EDD) on certain clients. The country specific risk factors form an excellent definition of what constitutes a kleptocracy.<sup>5</sup> As such, the guidance is clearly advising EDD to be performed on any client from countries that fit this risk profile. However, this ‘risk-based approach’ is in danger of being subject to the eye of the beholder or being ignored altogether. Upcoming but as yet unpublished research from Professor Jason Sharman regarding banks suggests that “contrary to the risk-based approach, the central regulatory principle of international banking... we find that banks are remarkably insensitive to risk.”<sup>6</sup>
8. As stipulated by MLR 2017, all politically exposed people (including domestic PEPs) and their close relatives (spouses, siblings, parents, children) must undergo EDD

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<sup>4</sup> FACTI, 2020, *Anti-Corruption Measures*, [https://assets-global.website-files.com/5e0bd9edab846816e263d633/5f15bdfd2d5bdd2c58a76854\\_FACTI%20BP5%20-%20Anti%20corruption%20measures.pdf](https://assets-global.website-files.com/5e0bd9edab846816e263d633/5f15bdfd2d5bdd2c58a76854_FACTI%20BP5%20-%20Anti%20corruption%20measures.pdf), p14. Accessed 3 December 2020.

<sup>5</sup> See for example Financial Conduct Authority, 2017, *Finalised guidance: FG 17/6 The treatment of politically exposed persons for anti-money laundering purposes*, <https://www.fca.org.uk/publication/finalised-guidance/fg17-06.pdf>, pp10-11. Accessed 3 December 2020.

<sup>6</sup> Upcoming research paper, Findley, Nielson, Sharman; 2021, *Behavioral Institutionalism: How Organizational Scripts Constrain the Gatekeepers of Global Finance*

when conducting a transaction in a regulated industry, such as real estate or banking. Evidence suggests that PEP status, as well as country of origin, is being overlooked. According to the FACTI report, most major instances of non-compliance by financial institutions, especially with regards to foreign PEPs, are a problem of complicity or negligence, rather than lack of capacity, citing a 2011 survey of UK banks by the British regulator: “It found that roughly one third of banks were willing to accept clients despite a very high money-laundering risk, and that these banks dismissed serious allegations about clients without further investigation. Over half failed to conduct the required enhanced due diligence for high-risk customers, and more than three-quarters failed to establish the legality of their clients’ wealth.”<sup>7</sup>

9. As highlighted in our 2018 submission to the Treasury Committee, this also appears to be true in real estate. Transparency International’s research using open-source data found over £4.4 billion worth of properties bought across the UK with suspicious wealth linked to at least 160 properties. Those purchasing the properties are “high-corruption risk individuals”, including those who have been charged and convicted with corruption offences.<sup>8</sup>
  
10. One weakness of MLR 2017 is that it stipulates that EDD no longer has to be performed on a close relative of a PEP as soon as the PEP leaves office. This means the very next day after a sitting president dies or leave office, his/her spouse or child can buy a property in the UK without undergoing EDD, so long as they themselves have not held office. Financial Conduct Authority (FCA) guidance on the treatment of politically exposed persons (PEPs) adds a caveat – that EDD need not be done on a PEP’s relative in these circumstances “unless this is justified by the firm’s assessment of other risks posed by that customer.”<sup>9</sup> Yet this again suggests a risk-based approach which may be ignored, as it based on subjective assessment of risk. This weakness also fails to take into account the fact that PEPs and their relatives may look to

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<sup>7</sup> FACTI, 2020, op. cit, p21.

<sup>8</sup> Transparency International, 2017, *Faulty Towers: Understanding the Impact of Overseas Corruption on the London Property Market*, [https://www.transparency.org.uk/sites/default/files/pdf/publications/TIUK\\_Faulty\\_Towers\\_August\\_24.pdf](https://www.transparency.org.uk/sites/default/files/pdf/publications/TIUK_Faulty_Towers_August_24.pdf), pp4-5. Accessed 3 December 2020.

<sup>9</sup> Financial Conduct Authority, 2017, op. cit, p8.

launder the profit obtained from graft while in office some time – even years – after they have left the political scene.<sup>10</sup>

### **Unexplained Wealth Orders already in jeopardy**

11. So far out of the four Unexplained Wealth Orders that have been issued (all by the National Crime Agency, NCA) and made public, two have been against PEPs from Eurasia. The fact that one of these (issued against properties owned by Zamira and Jahangir Hajiyeve, an Azerbaijani banker) was upheld and the second (issued against properties owned by Dariga Nazarbayeva and Nurali Aliyev, the daughter and grandson respectively, of Kazakhstan's first president, Nursultan Nazarbayev) dismissed allows us to compare and contrast the two cases. In short, the Hajiyeve case was successful because she could not provide documentation that traced the funds directly from their source into the respective properties, whereas Nazarbayeva/Aliyev could, although the NCA's approach in the second case was also criticised by the court.

12. However, what was both surprising and disappointing – and potentially catastrophic for the future of the UWO legislation – was the willingness of the judge in the second case to accept as reliable evidence information from Kazakhstan, despite the fact that its judiciary and investigative bodies lack independence, and the individuals subject to the UWO were close relations of the country's then president. For example, the judge claimed that the fact that the Kazakh prosecutor had ruled that Nazarbayeva's assets were legitimate was a 'powerful' argument.<sup>11</sup> These fails to take into account the rather obvious point that in a kleptocracy, enforcement agencies and law courts work to legitimise power and money on behalf of those in power.

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<sup>10</sup> For example, Dan Etete, a former Minister of Petroleum of Nigeria held on to a licence he awarded while in office to a company he himself controlled before selling it for \$1.1 billion thirteen years later. See Para 19 below, and Global Witness, 2019, *Timeline: The corporate corruption trial of the century*. <https://www.globalwitness.org/en/blog/timeline-corporate-corruption-trial-century/>. Accessed 3 December 2020

<sup>11</sup> High Court of Justice, 2020, *Approved Judgement: National Crime Agency (Applicant) V (1) Andrew J Baker (2) Villa Magna Foundation, (3) Manrick Private Foundation, (4) Alderton Investments Limited (5) Tropicana Assets Foundation*, <https://www.judiciary.uk/wp-content/uploads/2020/04/Approved-Judgment-NCA-v-Baker-Ors.pdf>, Para 77. Accessed 3 December 2020.

13. This sets an unfortunate precedent for the future of UWOs: that PEPs need only to appeal to their home country's legal system for 'legitimization' of their assets in order for the UWO to be defeated. Thus the legislation appears more likely to fail when PEPs who enjoy continued favour in their home countries are targeted – which is the very opposite of what the legislation was designed to do. It is extremely worrying that this belief seems to have filtered through to the NCA, as a recent article suggested: “NCA financial investigators have privately told the MoS [Mail on Sunday] that they believe targeting corrupt businessmen with access to ‘expensive QCs and claims of private wealth’ is a ‘waste of time’.”<sup>12</sup>
14. Crucially, the judge in the Nazarbayeva/Aliyev case argued that there was a “need for caution in treating complexity of property holding through corporate structures as grounds for suspicion”.<sup>13</sup> Yet the ruling by the Court of Appeal in the Hajiyeva case states that “the process by which an acquisition is made may be a legitimate starting point.”<sup>14</sup> The judge's statement is also in contradiction to the FCA who say that “situations that present a higher money laundering risk” might include “customers who have unnecessarily complex or opaque beneficial ownership structures” and “transactions which are unusual, lack an obvious economic or lawful purpose, are complex or large or might lend themselves to anonymity.”<sup>15</sup> It is unfortunate that the UWO High Court ruling may have undermined key advice from the UK's financial regulatory body regarding the use of such structures.
15. Vital to this particular UWO should have been, not just an assessment of the validity of the complexity of the structures used to hold the properties, but an assessment of the validity of the complexity of the business dealings *behind* such property dealings.

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<sup>12</sup> Mail on Sunday, 2020, *Britain's FBI takes down the 'McMafia' millionaires*, <https://www.dailymail.co.uk/news/article-8973527/Britains-FBI-targets-people-smuggling-kingpins-threatens-seize-McMafia-property-portfolios.html>. Accessed 3 December 2020.

<sup>13</sup> High Court of Justice, 2020, Approved Judgement, op cit. Para 96.

<sup>14</sup> Court of Appeal (Civil Division), 2020, *Between Zamira Hajiyeva (Appellant) And National Crime Agency*, <https://www.bailii.org/ew/cases/EWCA/Civ/2020/108.html>, Para 41. Accessed 3 December 2020.

<sup>15</sup> Financial Conduct Authority, 2018, *High-risk customers, including politically exposed persons*, <https://www.fca.org.uk/firms/money-laundering-terrorist-financing/high-risk-customers-politically-exposed-persons>, Accessed 3 December 2020

For example, to buy one of the properties, Nurali Aliyev received a \$65 million loan from a Kazakh bank, Nurbank, through a company which itself then made a further loan to another entity. Nurali Aliyev was the ultimate owner of all these structures, but his ownership was obscured through the use of several layers of shell companies.<sup>16</sup> At the time of the loan he himself was the chairman of Nurbank, and his mother, Dariga, was its main shareholder.<sup>17</sup> It is unclear whether Aliyev ever paid the loan back or whether the loan agreement was presented as evidence to the court. The arrangement raised many questions: if the loan was legitimate why had significant efforts been made to hide its beneficiary and make it appear as if the loan was being sent onward to a third party? Who exactly at the bank approved the loan, and on what terms? Yet Nurbank – now no longer owned by Dariga Nazarbayeva, but by the sister of an associate of her ex-husband<sup>18</sup> – said that the loan was legitimate.<sup>19</sup> It is unclear on what evidence this conclusion was based, and if whoever made this claim had the full facts at their disposal. Even if the full information was known, this example again highlights the problem of a British court relying on information from any institution based in a kleptocracy.

16. Dariga Nazarbayeva claimed she funded the purchase of one of the properties subject to the UWO by selling shares in a sugar company she owned<sup>20</sup> to an entity registered in Kazakhstan. Investigative journalism group Source Material has published evidence to suggest that Nazarbayeva seems to have controlled the Kazakh entity herself, which would mean that Nazarbayeva “was simply moving money from one of her assets to another in imitation of a genuine sale—and that details of the transaction would shed no light on the real origin of the funds.”<sup>21</sup> As UWOs require clear

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<sup>16</sup> High Court of Justice, 2020, *Between National Crime Agency (NCA) And Andrew Baker, Villa Magna Foundation, Manrick Private Foundation, Alderton Investments Limited, Tropicana Assets Foundation (Respondents): Respondents’ Skeleton Argument*, Para 177-178.

<sup>17</sup> High Court of Justice, 2020, *Approved Judgement*, op. cit, Paras 179, 182.

<sup>18</sup> Respondents’ Skeleton Argument (op. cit), Para 110(i) establishes that the banks shares were sold to a woman called S.T. Sarsenova. This is Sofya Sarsenova, sister of Rashid Sarsenov, described by *Eurasianet* as a former “business partner” of Rakhat Aliyev, Dariga Nazarbayev’s ex-husband. See *Eurasianet*, 2012, *Kazakhstan: Counting the Fat Cats’ Millions*, <https://eurasianet.org/kazakhstan-counting-the-fat-cats-millions>. Accessed 3 December 2020.

<sup>19</sup> High Court of Justice, 2020, *Respondents’ Skeleton Argument*, op. cit, Para 110(ii)

<sup>20</sup> High Court of Justice, 2020, *Judgment*, op. cit, Para 73, sub para 4.18.

<sup>21</sup> Source Material, 2020, *Sherlock Holmes and the Mystery of the Kazakh Millions*, <https://www.source-material.org/blog/sherlock-holmes-and-the-mystery-of-the-kazakh-millions>. Accessed 3 December 2020.

evidence of the origin of funds, Dariga Nazarbayeva may have misled the High Court by claiming that this share sale was the origin. Nazarbayeva's lawyers have denied these allegations.

### **FinCEN files show that banks keep the money flowing regardless of risk**

17. The FinCEN files provide us with crucial insight as to how banks deal with risk. They suggest that, when faced with suspicious activity, rather than refusing to fulfil the transactions and close the suspect client's account, many banks prefer to fulfil the transaction and file a Suspicious Activity Report (SAR), thus avoiding legal liability but still accruing banking fees. Although the FinCEN files relate to SARs filed in the United States, there is every indication that this kind of 'defensive' reporting of SARs also holds sway in the United Kingdom, where over 80% of the 478,437 SARs filed in the UK in 2019 were issued by banks and financial institutions.<sup>22</sup> According to *Finance Uncovered*, the NCA's Financial Intelligence Unit (FIU) only has 118 employees to scrutinise these near half million SARs.<sup>23</sup> The SARs regime has been identified by the UK government as an area of concern, and efforts are underway to overhaul the system.

18. The FinCEN files also highlighted examples where SARs were only filed after media reports highlighted an individual or company's suspicious activity. While banks could argue that they were proactively reacting to new information, these incidents cast doubt on the initial and ongoing due diligence performed by the banks on these clients, and again suggest the SARs were filed only to avoid potential legal liability, while still allowing the money to flow onward. These cases suggest that banks are not acting as responsible gatekeepers: instead of preventing the onward flow of corrupt funds by closing accounts, they appear happy to facilitate suspicious flows.

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<sup>22</sup> National Crime Agency, 2019, *UK Financial Intelligence Unit: Suspicious Activity Reports Annual Report 2019*, <https://www.nationalcrimeagency.gov.uk/who-we-are/publications/390-sars-annual-report-2019/file>, p8. Accessed 3 December 2020.

<sup>23</sup> Finance Uncovered, 2020, op. cit.

19. For example, recently published FinCEN documents reveal that the London branch of JP Morgan received tacit consent from the UK's Financial Intelligence Unit (FIU) to wire \$875 million whose beneficiary was suspected to be a former Nigerian oil minister, Dan Etete, who had been convicted for money laundering in France in 2007.<sup>24</sup> Etete awarded himself a lucrative licence for Nigerian oil field OPL245 while he was the country's oil minister in 1998.<sup>25</sup> Then in 2011 ENI and Shell acquired the OPL245 licence from the Etete-controlled company in a highly controversial deal which saw \$1.1 billion first transferred to the Nigerian government and then on to Etete. Between 2011 and 2013, JP Morgan filed nine SARs regarding large payment orders from the Nigerian government to a company connected to Etete. JP Morgan finalised two transfers of \$400 million in 2011 and one of just over \$74 million in 2013. During ongoing legal proceedings in London, JP Morgan stated that its compliance unit had flagged the requests, indicating that the money may constitute criminal property and informing UK authorities that the reception of these funds had already been denied by Swiss and Lebanese banks. In all the SARs filed in this case, JP Morgan named Dan Etete as the main suspected beneficiary of the funds, noting that the money was probably connected with the OPL245 deal – which resulted in a grand corruption trial in Milan.<sup>26</sup> However, the transactions were not stopped by the FIU despite the fact that, at the time of JP Morgan's SARs, information about the suspect deal and Dan Etete was already in the public domain.<sup>27</sup> This was likely caused by FIU understaffing. It was also noteworthy that, regarding OPL245, Italian prosecuting authorities were able to launch legal proceedings before the UK authorities – another possible example of under-resourced institutions, or a lack of political will to tackle money laundering by foreign PEPs in the UK.

## UK LLPs, SLPs and Companies House

20. Two further scandals regarding Africa from the FinCEN files reveal how UK Limited Liability Partnership (LLP) companies can be used for illicit financial flows:

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<sup>24</sup> Finance Uncovered, 2020, *The Evidence: Classified files shed light on JP Morgan role in 'corrupt' oil deal payout*, <https://www.financeuncovered.org/uncategorized/jp-morgan-opl245-dan-etete-suspicious-activity-reports-nca-fiu-fincen-nigeria/>. Accessed 3 December 2020

<sup>25</sup> Global Witness, 2019, op. cit.

<sup>26</sup> Finance Uncovered, 2020, op. cit.

<sup>27</sup> Finance Uncovered, 2020, op. cit.

- a. As revealed by *Le Monde Afrique*, the Russian consulate in Cameroon received thousands of dollars from a Birmingham-based shell company called Armut Services LLP. The funds were transferred in 2006 to the Cameroonian subsidiary of the French bank Société Générale to pay for “consulting services”, with another large sum wired on the same day to the Société Générale account of the Guinean company Ets Export Drev Prom EDP.<sup>28</sup> Armut Services LLP was also involved in the alleged siphoning of funds paid by hedge fund Hermitage Capital Management to the Russian treasury, a case that resulted in the death in jail of Russian lawyer Sergei Magnitsky.<sup>29</sup>
- b. In Niger, a large-scale military procurement scandal was recently linked, thanks to FinCEN files, to the UK registered company Halltown Business LLP. The firm was established in 2011 and dissolved in 2016, according to Companies House. It was supposed to transfer commissions totalling \$2,000,000 relating to the purchase of two SU-25 fighter jets. The ‘legal basis’ for this transfer was contained in an addendum to the contract (signed in July 2012 in Kiev) that was kept under wraps. Deutsche Bank in July 2012 reported the suspicious nature of the arms purchase contract with Niger when it received a transfer of \$30,900 in its bank accounts in Latvia, allegedly linked to a “textiles” contract.<sup>30</sup>

21. It is unsurprising that the FinCEN files also highlighted the continued use of Scottish Limited Partnerships (SLPs) to move dubious funds.<sup>31</sup> Other recent investigations have highlighted how criminal money from Russia has passed through the accounts of SLPs (and UK LLPs, as described above in Para 20(a)).<sup>32</sup> Although the UK

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<sup>28</sup> Le Monde, 2020, *Au Cameroun, le consulat de Russie au cœur d’une étrange affaire politico-financière*, [https://www.lemonde.fr/afrique/article/2020/09/23/au-cameroun-le-consulat-de-russie-au-c-ur-d-une-etrange-affaire-politico-financiere\\_6053363\\_3212.html](https://www.lemonde.fr/afrique/article/2020/09/23/au-cameroun-le-consulat-de-russie-au-c-ur-d-une-etrange-affaire-politico-financiere_6053363_3212.html). Accessed 3 December 2020.

<sup>29</sup> *Ibid.*

<sup>30</sup> L’Événement Niger, 2020, *Niger – Malversations au Ministère de la Défense : 71,8 milliards de fcfa captés par des seigneurs du faux*, <https://levenementniger.com/niger-malversations-au-ministere-de-la-defense-718-milliards-de-fcfa-captés-par-des-seigneurs-du-faux/>. Accessed 3 December 2020

<sup>31</sup> ICIJ, 2020, *Unchecked by global banks, dirty cash destroys dreams and lives*, <https://www.icij.org/investigations/fincen-files/unchecked-by-global-banks-dirty-cash-destroys-dreams-and-lives/>. Accessed 3 December 2020

<sup>32</sup> Times, 2018, *Crackdown after Scottish firms used to launder Russian crime cash*, <https://www.thetimes.co.uk/article/crackdown-after-scottish-firms-used-to-launder-russian-crime-cash-s6zpb2kv>, Accessed 3 December 2020; Times, 2019, *Criminals used Scottish Limited Partnerships’ loophole to*

government has proposed reforms for LPs and SLPs – resulting in a decrease in the number of formation of SLPs – one report suggests that the lack of indication from the government on when these reforms will be fully implemented has resulted in further suspicious activity, and the creation of a further 14,000 new SLPs.<sup>33</sup> The establishment of a timeline is crucial.

22. In our last submission to this enquiry, we highlighted the introduction of the Persons of Significant Control (PSC) Register as a positive but commented: “legislation is only as strong as its enforcement.” This comment still holds true today. A 2019 article in the *Guardian* by Oliver Bullough, author of *Moneyland*, highlighted examples of clearly false names (“Xxx Stalin”) submitted as persons of significant control.<sup>34</sup> The government’s recently announced intention to introduce reforms to Companies House to clamp down on fraud and false information is welcome, but the timeline is again worryingly vague, with changes enacted “when Parliamentary time allows”.<sup>35</sup>
23. The proposed reforms will give Companies House greater powers to query, investigate and remove false information. Although this is welcomed, law enforcement agencies need to be given the mandate and funding to investigate those directors who sign off on fraudulent accounts, or are otherwise in violation of the UK Companies Act. Offenders need to be prosecuted (and prevented from directing UK companies in the future) in order to foster higher standards within the trust and company service provider (TCSPs) industry.

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*launder billions*, <https://www.thetimes.co.uk/article/criminals-used-scottish-limited-partnerships-loophole-to-launder-billions-nj0r9ql57>. Accessed 3 December 2020

<sup>33</sup> Bellingcat, 2019, *Smash and Grab - The UK's Money Laundering Machine*, <https://www.bellingcat.com/news/uk-and-europe/2019/10/01/smash-and-grab-the-uks-money-laundering-machine/>. Accessed 3 December 2020

<sup>34</sup> Guardian, 2019, *How Britain can help you get away with stealing millions: a five-step guide*, <https://www.theguardian.com/world/2019/jul/05/how-britain-can-help-you-get-away-with-stealing-millions-a-five-step-guide>. Accessed 3 December 2020.

<sup>35</sup> Gov.UK, 2020, *Reforms to Companies House to clamp down on fraud and give businesses greater confidence in transactions*, <https://www.gov.uk/government/news/reforms-to-companies-house-to-clamp-down-on-fraud-and-give-businesses-greater-confidence-in-transactions>. Accessed 3 December 2020.

24. The reform could be taken one step further. TCSPs who are neither British citizens nor residents in the United Kingdom have little to fear even if found guilty of breaching the UK Companies Act: UK law enforcement has little incentive to pursue these individuals extra-territorially. However, if at least one officer of any UK legal entity was either a British citizen or a permanent resident of the UK (and thus face the genuine possibility of criminal sanction), the sense of accountability for the filings made by the company would be enhanced.
25. These reforms to Companies House need to be borne in mind especially in light of the upcoming Register of Beneficial Owners of Overseas Entities legislation which in effect will require those who own UK property through an overseas company to disclose its beneficial owners. The government has said it will ensure that Companies House will be given adequate resources to deal with additional filings under this new register, but controls must be vigilant. If data is not verified, and offenders left unsanctioned, there is a danger that this new legislation will be another example (as is the PSC register currently) of ‘zombie transparency’ – where the information revealed is of little or no use due to its lack of accuracy.
26. Analysis should also be made on how serial offenders of transparency may be avoiding disclosure by working around the rules. As discussed in our last submission, when then-prime minister David Cameron outlined his government’s plans to crack down on suspicious funds being invested in UK property in 2015, he referred specifically to a property portfolio valued at over £130 million that featured a large building located on Baker Street.<sup>36</sup> A UK registered company features in the ownership structure of this building, yet the company has declared no PSC to date. Research by Source Material suggests that this may be because the ultimate ownership has been split into five different parts. It may have been structured in this way because only PSCs owning 25% or more of company shares have to be declared. There is a certain irony that when the building’s 2015 owners were finally revealed by Source Material in 2020 to be Dariga Nazarbayeva and Nurali Aliyev, this was only

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<sup>36</sup> Gov.Uk, 2015, *Tackling corruption: PM speech in Singapore*, <https://www.gov.uk/government/speeches/tackling-corruption-pm-speech-in-singapore>. Accessed 3 December 2020.

because this information had been discovered through a document leak.<sup>37</sup> This property was not part of the above mentioned Unexplained Wealth Order.

### **SARs and real estate transactions**

27. In contrast to the situation with an abundance (possibly overabundance) of SARs in the banking industry, our research suggests that not enough SARs are being filed in the real estate and property conveyancing industries when professionals encounter suspicious activity. It is worth highlighting some aspects specific to this sector that may have contributed to this low number, based on a number of interviews with conveyancers, property solicitors and other professionals:

- 1) As stipulated by Section 330 of the Proceeds of Crime Act 2002, conveyancers and solicitors involved in property transactions who have suspicion or knowledge of money laundering regarding their client need to alert law enforcement. They do this by filing a Defence Against Money Laundering SAR (DAML SAR). These differ from regular SARs as, rather than just being purely informational, they require ‘appropriate consent’ from the NCA before the transaction can proceed. Permission to proceed is granted by default if the NCA has not been in contact to stop the transaction within seven working days. The average response time for responses to reporters for all DAML SARs, according to the NCA’s 2019 SARs report, is 5.12 days (up 0.8 days on 2018).<sup>38</sup> However, several conveyancers reported, when interviewed as part of the GI-ACE project, that they were almost always only receiving consent by default after seven days. Although the number of interviews conducted was not statistically significant to cast doubt on the NCA’s figure, it suggests that certain professionals are missing direct feedback from the NCA.
- 2) The same conveyancers reported that DAML SARs were rarely refused (i.e. consent to continue the transaction was not granted due to NCA concerns that the suspicions were great enough to launch an investigation). This is borne out by the

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<sup>37</sup> Source Material, op. cit.

<sup>38</sup> NCA, op. cit, p5.

figures from the NCA: of 34,151 DAML SARs filed in 2019 only 1,315 were refused (including those where the decision was not reversed after the initial moratorium period).<sup>39</sup> This amounts to a rather paltry 3.85%. In other words, only once in approximately every 26 times did the NCA prevent a transaction from continuing when suspicions or knowledge of money laundering were flagged by regulated professionals in 2019. Whether this hit rate accurately reflects instances of actual money laundering as opposed to suspected money laundering is open to debate. But we cannot escape the possibility that, given the sheer number of SARs received from the banking industry, the NCA's limited resources are stretched and therefore it only investigates the most egregious cases. If this is true, it means that many cases of actual money laundering through real estate may be slipping through the net.

- 3) There may be a further consequence: when regulated professionals' suspicions are not leading to the stopping of transactions, it may give the impression – irrespective of whether this is the case in reality – that filing a DAML SAR is of little value, a feeling likely to be exacerbated if consent to proceed is only given by default, as explained above. One would imagine that the NCA would be making every effort to counteract this perception, especially in light of the messaging coming from parliamentary and government bodies. A 2019 Treasury Committee report on money laundering identified real estate agents as a “weak link” in the anti-money laundering regime,<sup>40</sup> and in oral evidence, a director of the NCA, Donald Toon, added that the role of solicitors should not be ignored.<sup>41</sup> However, conveyancers reported in interviews that, having received a DAML SAR, the NCA sometimes requests more information, which in effect acts as a refusal to accept the DAML SAR. This is sometimes attributed to a lack of knowledge on the conveyancer's side of how to file a DAML SAR with the required information. But in these particular examples (again, gathered in interviews as part of the GI-ACE research) the SARs were filed by senior company managers with years of experience. Not only does this undermine the

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<sup>39</sup> NCA, *op. cit.*, p4.

<sup>40</sup> Parliament.uk, 2019, *UK's fragmented anti-money laundering system needs re-ordering, warns Treasury Committee*, <https://old.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/news-parliament-2017/report-published-economic-crime-17-19/>. Accessed 3 December 2020.

<sup>41</sup> The Negotiator, 2019, *Estate agents heavily criticised by MPs within parliamentary report on AML* <https://thenegotiator.co.uk/aml-money-laundering-mps-report/>. Accessed 3 December 2020.

conveyancer's judgement of what constitutes a 'suspicion of money laundering', it also often means that the real estate transaction can neither continue, nor be investigated: from the conveyancer's point of view, s/he believes there is enough suspicion of money laundering, but has not received consent to proceed with the transaction and is therefore still legally liable, yet from the NCA's point of view the activity is not suspicious enough for them to log the DAML SAR. Should the conveyancer stop the transaction, the client is free to approach another solicitor, with his/her activity left unrecorded by the NCA.

- 4) This is linked to another issue cited by respondents in interviews – that what constitutes a 'suspicion' of money laundering is not defined in law. One attempt at an encapsulation by a judge in an often cited legal case (*Da Silva V Regina* 2006) is that suspicion is "a possibility which is more than fanciful, that the relevant facts exist. A vague feeling of unease would not suffice."<sup>42</sup> This still gives considerable room for interpretation, and results in vastly differing thresholds for what constitutes a suspicion large enough to file a SAR.
- 5) If the NCA wants to see a change in the culture of solicitors in the filing of SARs, it should not only endeavour to investigate and prosecute more of their clients who are the subject of a DAML SAR, but also those solicitors who fail to issue a SAR when they have formed a suspicion or knowledge of money laundering. As the FACTI paper highlights: "It is almost unheard of for key enabler professions (law, accountancy, real estate, shell company providers) to face meaningful sanctions even when there is strong evidence of their complicity in laundering suspect funds."<sup>43</sup> Indeed, research from a legal firm suggests that there have only ever been three prosecutions under Section 330(2)(a) (failure to disclose when a person knows or suspects money laundering) in all regulated sectors, and no reported case of anyone convicted under subsection 330(2)(b) (failure to disclose when a person has reasonable grounds for knowing or suspecting money laundering).<sup>44</sup> These three prosecutions cover all regulated industries since 2002: banks and credit institutions; stock brokers and investment firms; insurance

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<sup>42</sup> Casemine, 2006, *Da Silva V Regina*, <https://www.casemine.com/judgement/uk/5a8ff7ab60d03e7f57eb10fb>. Accessed 3 December 2020.

<sup>43</sup> FACTI, op. cit, pp18-19.

<sup>44</sup> Corker Binning, 2018, *Failure to disclose does not equate to negligence*, <https://www.corkerbinning.com/failure-to-disclose-does-not-equate-to-negligence/>. Accessed 3 December 2020.

companies and intermediaries; auditors, accountants, book-keepers, tax advisers; property dealers and estate agents; trust or company formation and management; legal services; trading in goods for cash over a certain value; casinos, and auction platforms. More research needs to be done to ascertain whether prosecutions are low because of a lack of NCA enforcement. If this is not the issue, then the law should be reviewed as this would indicate that it is too difficult to enforce.

- 6) There also appears to be a loophole regarding Section 333A(1) which makes “tipping off” a criminal offence – where a professional in a regulated sector discloses that a SAR has been filed. One respondent, a compliance officer, stated that it was acceptable to inform a client that a DAML SAR would have to be filed (but was as yet unissued). Although this would appear to be legal, it is completely against the spirit of the law, as the client would obviously know that any delay caused in the transaction would be as a result of the SAR and a possible investigation instigated by the NCA. This practice is a clear example of ‘enabling’ behaviour, because it would allow a criminal client, prior to the issuing of the SAR, to stop the transaction and approach another solicitor. The initial solicitor could still file a regular SAR, rather than a DAML SAR, but the practice would have the same effect (of ‘tipping off’) as what the law is trying to prevent. The law should be amended, or guidance issued, to outlaw this practice.

### **Implications and Recommendations**

28. Our research, coupled with what we have learnt from the FinCEN files, suggests that the risk-based approach to money-laundering is not working in regard to transactions in financial institutions and real estate. A feeling of impunity reigns in regulated industries with no meaningful sanction against those laundering funds or turning a blind eye to suspicions of money laundering.
29. This seems true especially in regard to politically exposed people. It may be that PEP status, for some professionals, confers on the client an appearance of safety (as the person is ‘protected’ in their home country by their position), rather than one of danger (as there is a higher risk posed by the PEP’s ability to funnel corrupt funds)..

30. The implications of the failure of a recent UWO issued against property owned by PEPs from Central Asia should also be examined. Although it is obviously too early to draw conclusions from just two UWOs focussed on PEPs, it is noticeable that the UWO was successful when it was directed against a figure who was already removed from power (indeed, in jail) in his home country, and failed in the second UWO when the property was owned by two individuals who are still in favour (belonging, indeed, to the most powerful family in the whole of the country).
31. In light of the above, we recommend the following policy measures for the UK government:
- a. *Mandatory reporting to a state agency of transactions over a certain monetary value.* If the NCA is not investigating most SARs (and even on occasion sending DAML SARs back for more information) it may be prudent for the UK government to set up a different kind of reporting system. This would require certain transactions over a defined amount to be reported to a state agency, thereby removing the need for professionals to assess ‘suspicion of money laundering’, and the immediate need for the NCA to investigate. Such reporting has had a beneficial effect in the United States in regard to real estate transactions.<sup>45</sup> New legislation could mandate that purchase of a property over a certain value or a financial transaction of a certain amount would trigger reporting requirements to a state body. An additional option would be to lower these values for PEPs in recognition of the greater risk they pose for money laundering.
  - b. *UK registered companies should be required to have at least one UK citizen/resident as one of their officers.* As argued above, abuse of UK companies could be reduced if one of the company’s officers had to be a British citizen or permanent resident. There is little, if any, incentive for service providers based overseas to ensure that the companies they represent are filing accurate accounts. This reform has been proposed by other anti-money laundering experts.<sup>46</sup>

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<sup>45</sup> FINcen has introduced Geographic Targeting Orders (GTOs) which require U.S. title insurance companies to identify the natural persons behind shell companies used in all-cash purchases of residential real estate over a certain value in certain areas of the United States. Cash transactions in GTO areas have been reduced, suggesting that it acts as a deterrent to those looking to launder funds.

<sup>46</sup> ICIJ, 2020, *6 money laundering reforms that experts say need to happen right now*,

- c. *Investigation of, and penalties for, those who submit fraudulent information to Companies House.* The proposed reforms to Companies House cannot come soon enough. Regard must be paid to monitoring compliance in those submitting information to Companies House, especially with the upcoming introduction of the Registration of Beneficial Owners of Overseas Entities legislation. Fines should be imposed for non-compliance, and those individuals prevented from acting as company officers in the future.
- d. *Clear mandate and better funding of the NCA to investigate and prosecute enablers of money laundering.* The creation of OPBAS has led to more scrutiny of anti-money laundering controls in place in each sector. While fines against non-compliant *companies* are to be welcomed, fines against non-compliant *individuals* also need to be also levied to effect real change. Government agencies flag the low numbers of SARs in certain regulated industries, but these numbers will never be raised if the perception amongst the wrongdoers is that detection is unlikely and prosecution even less so.
- e. *Re-examination of anti-money laundering legislation and Unexplained Wealth Orders in relation to politically exposed people.* Following Brexit, the United Kingdom has pledged it will remain in compliance with the EU Money Laundering Directives. But the UK can go further and tighten these regulations even more, especially in regard to the greater risk posed by politically exposed people. For example, the UK may want to consider reducing the disclosure threshold for PSCs to Companies House to 15% or even 10%, and add a requirement for all PEPs who are PSCs to be placed on record no matter what percentage stake they hold. The legislation regarding Unexplained Wealth Orders and PEPs can also be re-examined in light of the recent failure of one such order: efforts should include greater examination of evidence from the PEP's country of origin, given the increased likelihood that this evidence is unreliable.

*December 2020*

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