

# ALLEN & OVERY

## The Criminal Finances Act

*A guide for the financial services sector*

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2017



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# Introduction

The Criminal Finances Act 2017 (the Act) represents the largest overhaul of the UK's anti-money laundering regime in more than a decade and the largest expansion of corporate criminal liability since the Bribery Act 2010. It also grants enforcement authorities significant new investigatory powers. This guide explains these and other provisions of the Act and explores their impact on the financial services sector, particularly international businesses operating in the UK, to help you ensure compliance with the Act.



## **New corporate criminal offences**

Corporate failure to prevent the facilitation of foreign or domestic tax evasion:  
How and where do they impact my firm? What must employees know?  
What is the defence and how do I benefit from it?



## **Unexplained wealth orders**

A new presumption in POCA to help recover illicit wealth:  
How do UWOs work? Why do firms need to know about a tool that targets individuals?



## **Disclosure orders**

New tools in money laundering investigations:  
How do these add to existing powers? What issues will they pose for the financial services sector?



## **Changes to the Suspicious Activity Reporting regime**

A longer moratorium period and the so-called super SAR:  
What are the challenges (and benefits) for the regulated sector?



## **Enhanced Proceeds of Crime Act Powers**

The 'Magnitsky amendment' which targets the assets of human rights abusers:  
How does it change POCA and is it more than just political symbolism?

# An Act designed to recover criminal proceeds and fight international corruption

The origins of the Criminal Finances Act are not just legislative history. They provide indicators as to how it will be used, who it will target and future developments.

The new criminal offences in the Criminal Finances Act were first proposed in the summer of 2015 in UK government consultations focusing on tax evasion. These noted the difficulty of holding commercial organisations to account for the criminal acts or omissions of their employees or agents under the identification doctrine. The approach under the Bribery Act 2010 (namely a strict liability corporate criminal offence of failure to prevent bribery) was cited favourably as being a way to address this.

The Legislation was given renewed impetus following the leak of the 'Panama Papers' in April 2016. The UK Government's Anti-Money Laundering Action Plan (released the same month) stated the intention that the Criminal Finances Bill would significantly improve the ability to recover proceeds of crime and fight international corruption.

It also included a consultation on the use of Unexplained Wealth Orders, a tool which had been keenly advocated by Transparency International.

The Act largely received cross-party support in Parliament. However, Opposition attempts to include a general offence of corporate failure to prevent financial crime were rejected (see page 28 of this guide for further information). Notably, however, an amendment to expand provisions of the Proceeds of Crime Act to those complicit in human rights abuses was successful.

The Bill narrowly made it through the Commons and Lords prior to Parliament being dissolved for the 2017 General Election. On 27 April 2017, the Bill received Royal Assent as the Criminal Finances Act 2017.

## TAX EVASION AND MONEY LAUNDERING



**GBP4.4 billion per year**

estimated loss to UK from tax evasion

**GBP100bn**

estimated amount laundered through UK banks each year (of which NCA estimates 0.2% is frozen)

## FINES



**GBP510 million**

Total fines for offences under s.7 of the Bribery Act 2010

**GBP2.5bn**

Penalties for offshore tax evasion imposed by HMRC since 2010

The Criminal Finances Act significantly modifies the Proceeds of Crime Act 2002 and a number of other Acts. The facilitation of tax evasion offences are contained in a standalone Part 3 of the Act.

Provisions of the Act have already begun to come into force and the government indicated in its most recent consultations that the remaining provisions would be phased in from Autumn 2017. How and when each section of the Act is to be implemented is broken down on the next page.

## THE CRIMINAL FINANCES ACT 2017

IN EFFECT FROM:	PROVISION OF THE ACT	HOW IT IS IMPLEMENTED
<b>PART ONE – PROCEEDS OF CRIME</b>		
<b>Chapter One – Investigations</b>		
TBC	<b>Sections 1-6:</b> Unexplained Wealth Orders (and related interim freezing orders)	New sections 362A to T of Proceeds of Crime Act 2002 (POCA)
TBC	<b>Sections 7 and 8:</b> Disclosure Orders in Money Laundering investigations	Amendments to sections 357 and 358 of POCA
27 June 2017	<b>Section 9:</b> Beneficial ownership/information sharing from UK overseas territories	New section 445A POCA
<b>Chapter Two – Money Laundering</b>		
31 October 2017	<b>Section 10:</b> Extension of the moratorium period	New section 336A to C of POCA and amendments to sections 335 and 336
31 October 2017	<b>Section 11:</b> Information sharing for SARs	New sections 339ZB to ZG of POCA
31 October 2017	<b>Section 12:</b> Further information orders	New section 339ZH to 339ZK of POCA
<b>Chapter Three – Civil Recovery</b>		
TBC	<b>Section 13:</b> Proceeds of crime and gross abuse of human rights (the ‘Magnitsky amendment’)	Amends section 241 POCA and inserts new definition at section 241A
TBC (section 15 from 31 October 2017)	<b>Sections 14-16:</b> Additional forfeiture powers (cash, moveable property, bank accounts)	Amends section 289 POCA and new sections 289(7) A to C, 303B to Z. New chapter 3B
<b>Chapter Four – Enforcement Powers</b>		
TBC (section 18 from 27 June 2017; section 17 from 31 October 2017)	<b>Sections 17-25:</b> Extension of enforcement powers and assault/obstruction offences	Amends sections 315, 378, 444, 445 POCA and new sections 356A, 453B and 453C
TBC	<b>Chapter 5 (sections 26-34):</b> Miscellaneous provisions	Numerous minor amendments to POCA
<b>PART TWO – Terrorist Property</b>		
TBC (sections 41 and 42 from 27 June 2017; sections 36, 37 and 43 from 31 October 2017)	<b>(Sections 35-43):</b> Disclosures of information; civil recovery; counter-terrorism investigators; enforcement in other parts of the UK	Various amendments to the Terrorism Act 2002
<b>PART THREE – Corporate Offences of Failure to Prevent Facilitation of Tax Evasion</b>		
30 September 2017	<b>Section 44:</b> Definition of relevant body	Standalone (ie contained within the Act itself)
	<b>Section 45:</b> UK offence; <b>Section 46:</b> Foreign offence; <b>Section 47:</b> Statutory guidance	Standalone (ie contained within the Act itself)
	<b>Section 48:</b> extra-territorial application; <b>Sections 49-52:</b> supplementary provisions	Standalone (ie contained within the Act itself)
<b>PART FOUR – General Provisions (in force)</b>		
<b>Consequential amendments, boilerplate provisions etc.</b>		

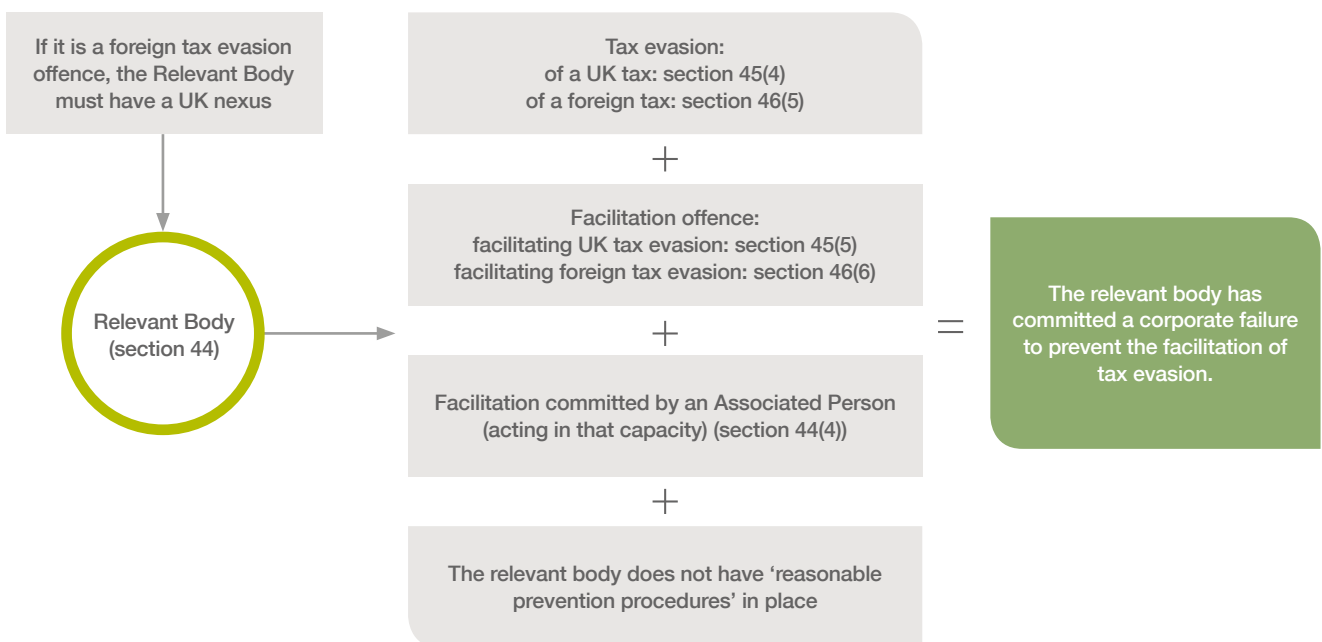


# The new corporate criminal offence

## Overview

Part 3 of the Act has inevitably caught the most attention. This creates two new criminal offences of corporate failure to prevent a tax evasion facilitation offence – either domestic or foreign. The foreign tax evasion offence carries a dual criminality requirement (i.e. the offence must also be a crime under English law). It is a defence to both offences to prove that a firm had in place ‘reasonable prevention procedures’.

### *The elements of the offences:*



## PENALTIES



### Penalties if the offences are committed

A relevant body convicted of section 45 or 46 offences faces a range of sanctions. The Act provides for an unlimited fine. In severe cases, a financial services firm could also face a loss of its regulatory licence whilst an individual director could face disqualification.

In practical terms, the 'unlimited fine' is calculated by reference to the Sentencing Council Guidelines for corporate offenders. These require a court to consider whether compensation and confiscation are required before moving on to impose the financial penalty.

The financial penalty is based on the harm inflicted subject to a multiplier applied for culpability (up to 400% in cases of very high culpability). Harm will normally be the actual or intended gross gain to the offender. However, the court may also look to the cost the relevant body has avoided by failing to put in place reasonable prevention procedures. In cases where these are difficult to calculate, the court has a general discretion to impose the fine it considers appropriate in all the circumstances.

### Is debarment an issue I need to be concerned about?

A concern which many clients have raised in relation to potential corporate convictions for financial crime is debarment. Debarment – that is, exclusion from public procurement processes – may have potentially severe consequences, particularly for businesses in sectors such as defence or infrastructure. Debarment is less likely to be of concern for financial institutions. This is because 'financial services' (which tracks the definition under MiFID) are excluded from the relevant Directive. However, some services (e.g. accountancy services, trustee services) may be caught. For this reason, the rules relating to debarment are summarised below (note other rules may apply when dealing with multilateral institutions e.g. the World Bank, development agencies):

#### **Mandatory debarment? No.**

A relevant body that: (i) commits tax evasion; (ii) is in breach of its obligations to pay tax; or (iii) assists or induces tax evasion anywhere in the EU, faces mandatory debarment. However, it will not face such action if it commits an offence under section 45 or 46 of the Act as these are not part of the exhaustive list of offences for which mandatory debarment applies under the Public Contracts Regulations 2015.

#### **Discretionary debarment? Possibly.**

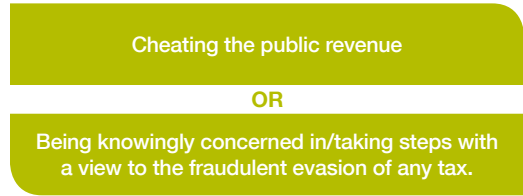
A public body has discretion to exclude companies if (amongst other reasons) it can demonstrate a firm is guilty of 'grave professional misconduct' which calls into question the firm's integrity. Dependent on the facts and severity of the case, corporate failure to prevent the facilitation of tax evasion could be such a ground. In such a case, a firm would need to demonstrate that it had complied with the self-cleaning regime in order to avoid debarment.

# Tax evasion

The Criminal Finances Act **does not** extend the existing scope of tax evasion or criminal facilitation by individuals under English Law.

However, the strict liability nature of the corporate offences (subject to one defence) means relevant bodies should carefully consider what constitutes evasion and facilitation. After all, a financial institution is unlikely to have reasonable prevention procedures in place if it does not clearly understand the limits of legitimate tax avoidance and how its associated persons may assist in illegitimate evasion.

## *UK tax evasion offence:*



## *Foreign tax evasion offence:*



### DOES THERE NEED TO BE A CRIMINAL CONVICTION FOR TAX EVASION?



No. HMRC's guidance explicitly states that an underlying conviction for tax evasion is not required for the corporate offences to be committed. The enforcement authority must, however, discharge the criminal burden of proof to show beyond reasonable doubt that evasion and facilitation have occurred.

Importantly, HMRC has a sophisticated process for encouraging individual confessions. Under Code of Practice 9, HMRC may offer individuals who admit to tax fraud a Contractual Disclosure Facility (CDF). Provided a full disclosure of their deliberate conduct to evade tax is made and applicable penalties paid, HMRC may agree not to pursue a criminal investigation into the individual's conduct.

The ability of individuals to enter into a CDF distinguishes tax evasion from the equivalent underlying offences in the Bribery Act (bribing or accepting a bribe). No such mechanism is available to settle bribery allegations and, of course, Deferred Prosecution Agreements are not available for individuals. The only option an individual has is to plead guilty in the hope of obtaining a reduced sentence.

As a result, firms should be aware of the possibility of facing (and defending) investigations where an individual has already admitted tax evasion.



# Facilitation

In addition to criminal tax evasion, the corporate offences require criminal facilitation to have been committed by a person associated with the relevant body (see the next page for more information on associated persons).

## *UK tax evasion facilitation offence:*

Being knowingly concerned in, or in taking steps with a view to, the fraudulent evasion of tax by another person

OR

Aiding, abetting, counselling or procuring the commission of a UK tax evasion offence

OR

Being involved in part in the commission of an offence consisting of being knowingly concerned in, or in taking steps with a view to, the fraudulent evasion of tax

## *Foreign tax evasion facilitation offence:*



## Focus on: *What constitutes criminal dishonesty*

The common mental element for both criminal evasion and facilitation is dishonesty. The new corporate offences have focused much attention on this requirement. For example, what might constitute dishonesty in a complex offshore financial services group which intentionally pursues aggressive tax planning for the benefit of its customers? Clients have also asked whether dishonest facilitation captures situations where an associated person turns a blind eye to evasion.

Historically under criminal law, the test for dishonesty was a two-stage assessment. The conduct had to be dishonest by the standards of an ordinary, reasonable individual and the evader or facilitator must know their conduct is dishonest by those standards (i.e. the test in *R v Ghosh* [1982] EWCA Crim 2). While it was a high threshold, the test had been applied without undue difficulty by juries on a daily basis, for example, in theft cases. This is unsurprising – few would argue they did not know stealing was dishonest by the standards of the ordinary individual.

However, the recent case of *Ivey v Genting Casinos* [2017] UKSC 67 overruled this test. Now, the test is the same as at civil law – albeit proven to the criminal standard. The conduct must be dishonest by the standards of the

ordinary individual (knowing the facts the evader or facilitator did). Whether or not the evader or facilitator viewed their conduct as dishonest is irrelevant. The Supreme Court's decision may heighten concerns of corporate conduct being found criminal where the public view of acceptable activities differs substantially from professional market practice.

This criminal test can of course capture situations where an employee 'buries their head in the sand' provided a jury believed their conduct was so severe it amounted to dishonesty. The severity of an employee's conduct may be impacted by whether there was a legal duty to act (for example, to submit a Suspicious Activity Report).

The key points for firms to bear in mind are that first, the question of dishonesty will be significantly less important in cases where there is a confession or a whistle-blower at the evasion or facilitation stage.

Secondly, where dishonesty is at issue, the firm does not have a special ability to see into the mind of its associated persons. That role is reserved for the court and jury who may make a different assessment of dishonesty from those involved at the time – all the more so given the Supreme Court's latest judgment.

# Associated person

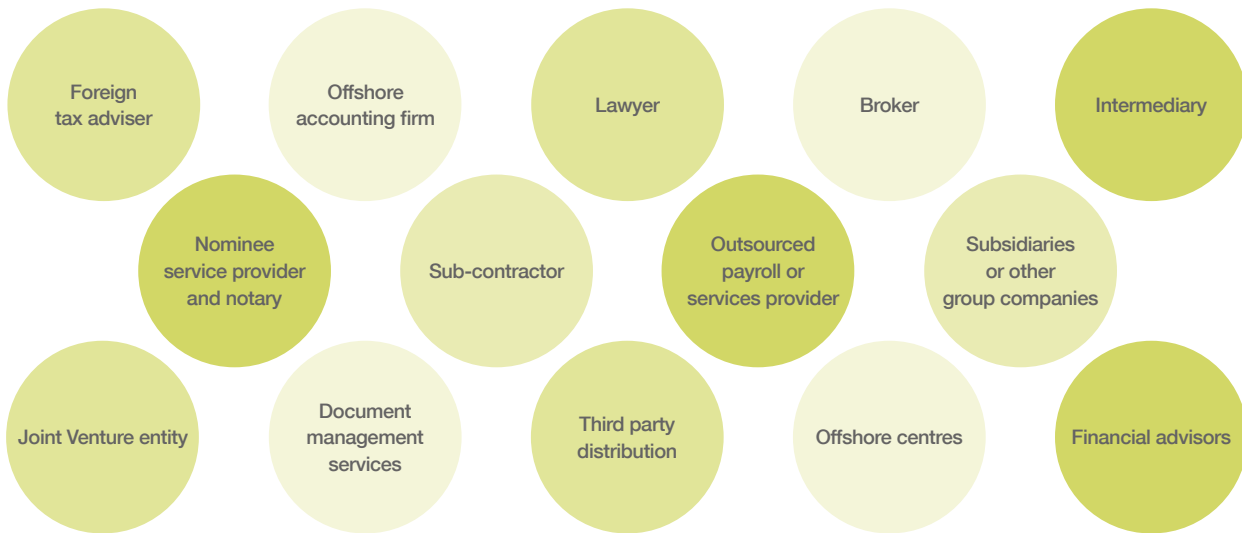
As with the Bribery Act, the Criminal Finances Act imposes liability on a firm for its failure to prevent the actions of an ‘associated person’. A person is associated with a relevant body if they provide services for or on behalf of it. Importantly, only the facilitator need be an associated person; the tax evader does not have to be. An associated person can be either an individual or a corporate.

## Who can be an associated person in practice?

The definition of associated persons means that firms can be held criminally liable not only for acts of their employees but also for those of agents and any entity providing a service for the firm or on its behalf, whether in the UK or overseas.

Given how important the meaning of associated person is in assessing the breadth of the offences, it is unfortunate that the examples given by HMRC in its guidance are rather obvious.

More difficult cases such as franchisees or referral partners (where there is a financially incentivised referral agreement) are not difficult to imagine. Firms can, however, take some comfort from the fact that the more remote the associated person, the less it will be reasonable to have had prevention procedures in place to stop them facilitating evasion. Examples of potential associated persons are set out below.



## ‘Acting in the capacity’

The requirement that the facilitator be acting in the capacity of an associated person is vital in limiting the scope of the offences. Without it, a relevant body would be liable for a failure to prevent any facilitation of tax evasion, regardless of whether the ultimate tax evader had any connection with the firm.

As confirmed in the HMRC guidance, a firm will not be liable for an associated person who facilitates tax evasion on a

‘frolic of their own’. So, for example, if a bank’s HR manager went home one evening and helped their partner falsify pay slips to evade tax, the bank would not be liable for their actions. However, if their partner was a consultant to the bank and the HR manager used the bank’s payroll software to create forged records, the bank would potentially be liable for their actions.

## Territorial scope

The UK tax evasion facilitation offence can be committed by any relevant body, whether or not it has a UK Nexus.

The foreign tax evasion facilitation offence requires a UK Nexus, although that need not be related to the commission of the underlying offence.



Relevant bodies which could be caught by the Act:

A non-UK bank with UK branches even if the facilitation is wholly outside the UK and relates to foreign tax

A UK accountancy firm that instructs a foreign tax adviser on behalf of a foreign client to give the client advice on UK or foreign tax planning

A non-UK hedge fund which does not have UK branches but a UK intermediary acting for the company assists a company client to evade tax (whether UK or foreign)

The significance of the wide territorial scope of the section 45 and 46 offences should not be underestimated. Each of the convictions and Deferred Prosecution Agreements for the section 7 Bribery Act offence has related to conduct which took place outside the UK.

While the UK nexus serves to capture the firm's global activities, this does not necessarily mean controls to prevent tax evasion should sit at the group holding company or regulated entity level. Given the liability for foreign as well as UK tax evasion, controls will be most effective if based at the operating company level.

### GUIDANCE ON UK PROSECUTORIAL DISCRETION



Whilst the preference will normally be for the jurisdiction suffering the tax loss to take the appropriate criminal or civil response, if this is not possible (for example due to lack of resources, corruption, or any other reason) the UK Government believes that it should be open to the UK to hold the relevant body to account, should it be in the public interest to do so.

Source: HMRC Guidance

## Dual criminality

The territorial scope of the foreign tax evasion offence is limited by a dual criminality requirement. Both the tax evasion and the related facilitation must be offences under both the relevant foreign law and English law.

## What does this mean in practice?

The section 46 offence will therefore not have been committed where conduct is a only a crime in the foreign jurisdiction by virtue of it having more onerous tax laws than the UK. Similarly, there cannot be a UK prosecution for conduct in a foreign country which is legal there but would have amounted to tax evasion if committed in the UK. In practice, this means that countries where reckless or negligent tax evasion is a crime will not be caught by the section 46 offence. Similarly, where the UK's facilitation laws are broader than the foreign jurisdiction, no offence will have been committed. The guidance also makes clear that where a tax evasion offence occurs in one foreign country and the act of facilitation in another, then the act of facilitation must be illegal in the country where tax is being evaded for an offence to have been committed.

# The defence

The only defence to the section 45 and 46 offences is that a relevant body had in place such prevention procedures as it was ‘reasonable in all the circumstances to expect’ it to have. Alternatively, a relevant body may argue that it would not have been reasonable for the relevant body to have had any prevention procedures in place (this is unlikely to arise often).

There is a subtle difference between the Bribery Act section 7 defence of ‘adequate procedures’ and the ‘reasonable prevention procedures’ language used in the Criminal Finances Act – however, given the similarity of the procedures outlined in the HMRC guidance, this appears to be a very minor distinction.

As with the Bribery Act, guidance sets out six guiding principles which should inform a firm’s reasonable prevention procedures:



## Risk assessment

Tax evasion risk should (to the extent it is not already) be included in a firm’s risk assessment exercises. Consider guidance by a relevant regulator. Firms however must identify risks of committing the ‘facilitation offence’. Consider country, transaction, sectoral, business opportunity, business partnership, product and customer risks. There is useful Joint Money Laundering Intelligence Task Force guidance on high and low risk factors.

### Motive, means and opportunity

The risk assessor must ‘sit at the desk’ of every employee, agent or other person who provides a service on behalf of the business, and ask, “if I were seeking to criminally facilitate tax evasion, how would I go about it and what would make succeeding more difficult?”.

## Proportionality of risk-based prevention procedures

Some level of risk assessment is likely to be needed in all circumstances, even for low risk businesses. A business may want to conduct a high level risk assessment across all business units first, before drilling down to detailed assessments in higher risk areas.



## Top level commitment

Senior management must demonstrate and lead a culture of zero-tolerance towards the facilitation of tax evasion.

Senior management must lead the risk assessment and the creation of prevention policies.

HMRC expects entities to draft and maintain a written statement setting out their position on involvement in the criminal facilitation of tax evasion, including the provision of services which pose a high risk of being misused to commit a tax evasion offence.

## Due diligence of associated persons

### Less needed:

- ✓ For the associated person who is a well-respected entity in a regulated sector; or
- ✓ where a company has good, direct control and supervision over the associated person.

### More needed where:

- ✓ the associated person operates via anonymous/complex corporate structures;
- ✓ the associated person operates in a higher risk jurisdiction;
- ✓ there are past allegations/incidents of illegality; or
- ✓ there is little supervision/control over the associated person.

## Communication

Prevention policies and procedures must be communicated, embedded and understood throughout a business and almost all those that provide services on its behalf, through internal and external communication, including training. There must be an established and confidential means for individuals to raise concerns about tax fraud.

## Monitoring and review

An organisation must review its prevention procedures and make improvements where necessary. Risks faced by a business will change over time, e.g. if a new business line is introduced, an office in a new jurisdiction is opened or new associated persons are engaged.

## Actions for firms and analysis

HMRC guidance makes clear that what is defined as reasonable preventative procedures will change the longer the Act is in force. Certain policies will take time to implement and the government has indicated that HMRC will look at both procedures that were in place and procedures that were planned at the time the facilitation of tax evasion occurred.

### TIMING



HMRC guidance states that the Government expects there to be rapid implementation of prevention procedures, focusing on the major risks and priorities, with a clear timeframe and plan from the date the offences came into force.



# Actions and analysis

## Likelihood of enforcement

There have been suggestions that the new corporate criminal offences will be rarely used in practice. The argument is that proving to a criminal standard that both evader and facilitator acted dishonestly will be a high bar for prosecutors – even if the onus is on a financial institution to show it had reasonable prevention procedures in place.

However, even the most virtuous company cannot always prevent its associated persons acting dishonestly. If and when that does occur, then the only escape from strict liability is to prove reasonable prevention procedures are in place. For that reason, the most significant impact of the Bribery Act 2010

was to bolster compliance and to tip the cost/benefit analysis in favour of having adequate anti-bribery procedures in place. The same is likely to be true here.

Secondly, the enforcement landscape for financial crime has changed significantly in the UK in the last couple of years. A crucial component of this is the existence of Deferred Prosecution Agreements (DPAs). Following their introduction by the Crime and Courts Act 2013, DPAs have become an important part of the corporate crime enforcement tool kit. The four DPAs which have been entered into so far are set out below.

## Deferred Prosecution Agreements: The story so far

Sector	Outcome	Location of misconduct	Misconduct	Fine as multiplier of gross profits	Discount (co-operation/admission)	Total penalty*	Cost ordered to be paid
Financial Services	DPA	Tanzania	Bribery	300%	33%	USD3.2m	GBP330k
Undisclosed – SME	DPA	Asia	Bribery	5.7% (low to avoid insolvency)	50%	GBP6.6m	None (to avoid insolvency)
Engineering	DPA	Asia, Africa	Bribery, corruption, false accounting	250%-325%	50%	GBP497.25m	GBP13m
Retail	DPA	UK	False accounting	Not yet disclosed	Not yet disclosed	GBP235m	Not available

\*Repayment of profits, fine, compensation not including interest

DPAs will be available for corporates looking to settle an investigation into the section 45 and 46 offences. It may be a challenge for the authorities to prove all the elements of the offences before a jury. However, in the current climate many financial institutions may be reluctant to take that risk. Firms may seek to cooperate from an early stage in order to maximise their chances of securing a DPA. Add to this the undesirability of having current or former employees cross-examined and the negative press of a long-running corporate tax evasion trial and it is easy to see why a DPA may be an

attractive alternative. Combine this with the option of individual settlements in tax evasion cases and the experience of enforcing the corporate failure to prevent model under the Bribery Act. The result, in our view, is that these offences will make their presence felt before long.

HMRC will investigate the domestic tax evasion offence and the CPS will prosecute it. The SFO or NCA will investigate the foreign tax evasion offence and the SFO or CPS will bring prosecutions. It will therefore be interesting to watch for differences in strategy between authorities.

## Actions and practical steps

The repeated message we have heard from HMRC is that there is no one size fits all approach for firms seeking to demonstrate that they have reasonable prevention procedures. While their guidance is an important starting point, the question of what procedures are reasonable is ultimately a question for a jury.

A few starting points for financial services firms to consider are set out below:



### Risk assessment

A firm which does not carry out an assessment of its tax evasion facilitation risks will struggle to benefit from the statutory defence. However, this does not need to be a brand new exercise – consider whether planned risk assessments could also address this area, at least in part.



### Money Laundering Regulations 2017

Firms will already be looking at how to implement the new and on-going requirements under these changes. Consider whether work here on client due diligence etc. could be leveraged to help show reasonable prevention procedures.



### Audit/inspection rights in third party contracts

These may be increasingly useful. For example, do your standard forms give you sufficient powers to be comfortable that you can show reasonable prevention procedures exist across high risk entities in your supply chain?



### Representations

Similarly, consider whether contracts with service providers and other associated persons adequately deal with tax evasion and facilitation. For higher risk categories of individuals or corporates, would additional warranties or representations be useful?



### High risk countries

Do you operate in countries that have not signed up to the OECD's Common Reporting Standard or which might otherwise be considered high risk? If so, what steps have you taken to be comfortable that the financial records and dealings of clients and associated persons in those jurisdictions are in accordance with international standards?



### Supporting front line staff

Many of your front line employees may deal with tax structured products and/or with offshore jurisdictions. While you cannot expect (or indeed train) them all to be tax experts, do they know who to contact if they are concerned or do not understand why a transaction or product is structured the way it is?

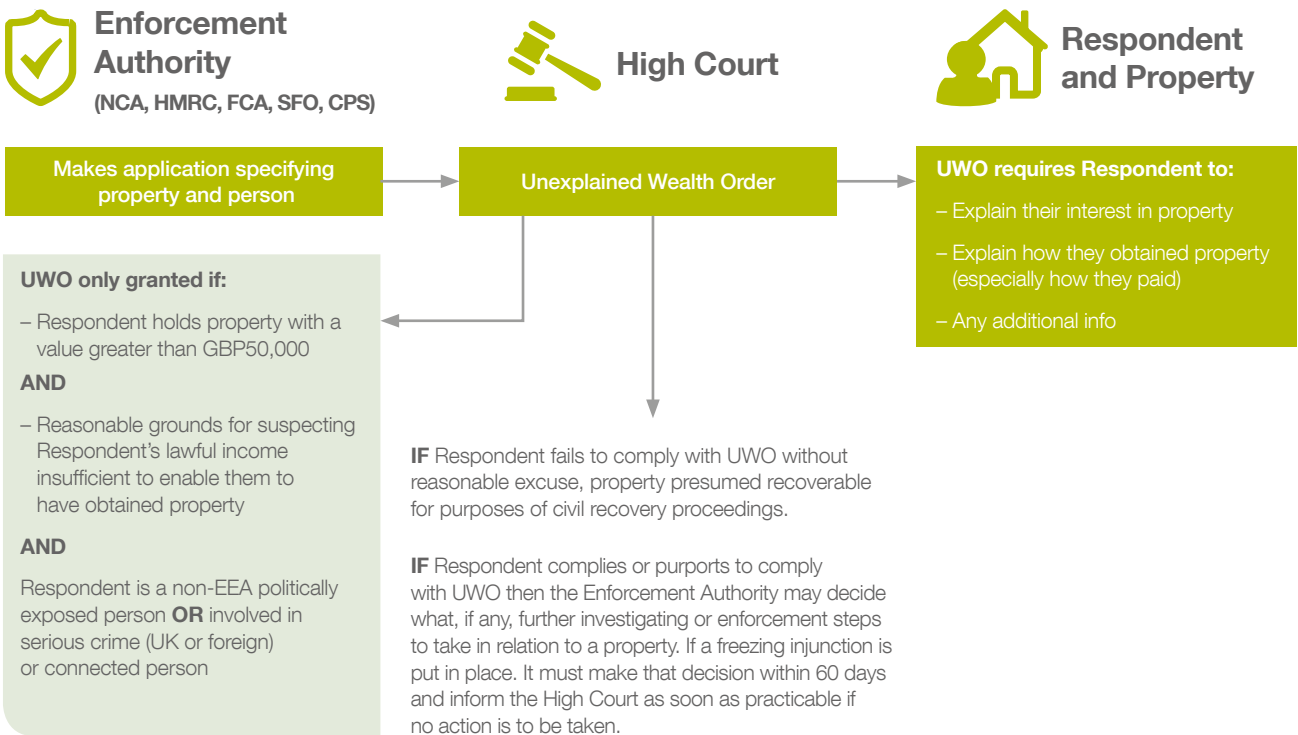


# Unexplained Wealth Orders

The Act introduces Unexplained Wealth Orders (UWOs) as a new tool to recover property using the civil recovery proceedings under Part 5 of POCA.

A UWO is an order, granted by the High Court at the request of an enforcement authority, relating to specific property. A UWO requires the respondent to provide a statement setting out the nature and extent of their interest in the property and how they obtained the property (in particular

how it was paid for). A UWO may only be granted where the court is satisfied that there are “reasonable grounds for suspecting that the known sources of the respondent’s lawfully obtained income would have been insufficient” to allow the respondent to obtain the specified property.



**CRIMINAL OFFENCE**

Criminal offence if a Respondent knowingly or recklessly makes a false or misleading statement replying to a UWO. (up to two years imprisonment).



## INTERIM FREEZING ORDERS



At the same time as applying for an Unexplained Wealth Order, an enforcement authority may also apply for an interim freezing order in relation to the same property. This will be granted if the court views it as necessary to prevent the risk of any subsequent attempts to recover the property as the proceeds of crime being frustrated.

The freezing order can remain in place while the respondent replies to the UWO. In cases where the Respondent complies or purports to comply with the UWO, it can also remain in place until the 60-day period that the enforcement authority has to decide what further steps to take in relation to the property has expired.

## How will they be used in practice?

UWOs are likely to be used primarily as a tool to expose and recover illicit wealth. However, the Act provides that information obtained via a UWO may be used in “any legal proceedings”. The sole restriction is that such information cannot be used in criminal proceedings against the Respondent (with very limited exceptions in cases of perjury etc.). Information obtained via a UWO may be kept for an indefinite period and shared with other enforcement agencies. There is therefore considerable scope for them to be used as a broader investigative tool in cases of financial crime.

In this vein, it is interesting to note that the FCA (along with the SFO, HMRC and NCA), has been granted the power to apply for UWOs. What appetite the FCA will have to use its new powers is hard to predict. That being said, the Act’s protection against self-incrimination only applies to criminal proceedings against the individual. Information supplied in response to a UWO could therefore be used against the individual or their employer in regulatory/enforcement proceedings.

A number of commentators have speculated that UWOs may run into trouble in the courts on the basis that the reversed burden of proof infringes human rights relating to privacy and property. In straightforward cases where a Respondent has been linked to serious crime, the likelihood of a UWO application being rejected or struck down for these reasons appears remote (and the European Court of Human Rights has upheld similar presumptions in the past).

However, in cases with weaker links to criminality, for example where a UWO is sought simply because a Respondent is a politically exposed person and there is an unexplained disparity in their income and assets, such arguments may well impact whether a UWO is made.

### NOTE



The legislation has retrospective effect in that UWOs can be issued in respect of property acquired before the Criminal Finances Act came into force.

## Extra-territorial effect of UWOs

The international reach of UWOs is striking. A Respondent does not need to reside in the UK. Their property does not need to be located in the UK (POCA applies to property located outside the UK). If they are a politically exposed person then they must be located outside the EU to be caught by the Act. If connected to serious crime, it does not matter where the crime occurred (provided it would amount to an offence in the UK).

As a result, the limits on the territorial scope of UWOs will be more practical than legal. UK enforcement authorities are unlikely to expend resources seeking UWOs where neither the Respondent nor the property has a UK nexus.

They will, however, be a particularly useful tool for investigating individuals with a very limited UK footprint but who choose to hold their wealth in the country given the ability to seek a supporting freezing injunction.

A UK enforcement authority may seek assistance from foreign authorities to enforce a UWO (and an interim freezing order). The willingness of foreign authorities to assist in enforcing this novel tool will also be a key factor in the geographical reach of UWOs in practice. State immunity for foreign officials may also blunt their impact in many jurisdictions.

## Impact of UWOs on financial services firms

UWOs will principally be of significance to a firm's private clients. However, the Government's draft Code of Practice issued under section 377 of POCA makes clear that UWOs can be issued against an individual or a company (provided the latter can satisfy the requirements detailed earlier).

A bank or wealth manager with significant numbers of foreign clients will want to ensure that it understands the legislation in detail and is in a position to explain the legal position to customers who are affected.

Financial institutions should also consider (and be prepared to seek professional advice) if a customer, or the institution itself, is made subject to a UWO or related information gathering powers. The lack of carve outs in the legislation means that firms may find themselves placed in a difficult position with regards to disclosing client confidential information or banking secrecy.

Finally, to support the UWO regime, a court may grant interim freezing orders in respect of property subject to a UWO. Undoubtedly, financial services firms will be on the receiving end of such injunctions. Moreover, given the extensive extra-territorial scope of UWOs, clients with little or no UK connection may be surprised to find themselves and their property frozen pursuant to such an order. Firms will also need to be mindful of allegations contained in the wording of a UWO raising potential Suspicious Activity Report or other regulatory reporting obligations.





## Changes to the SAR regime

The Criminal Finances Act has introduced changes to the money laundering reporting regime, which was previously set out in the Proceeds of Crime Act 2002 (POCA). These changes came into force on 31 October 2017.

POCA required firms operating in the regulated sector (including financial services firms) to disclose knowledge or suspicion of money laundering to the National Crime Agency (the NCA). These disclosures were made by way of Suspicious Activity Reports (SARs). Two key changes have been made to the requirements relating to the submission of SARs under the Criminal Finances Act.



95.78% of all SARs filed between October 2015 and March 2017 were filed by financial services firms

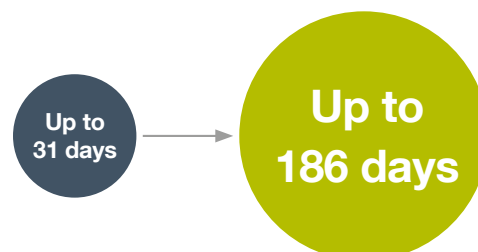


## Extended moratorium period

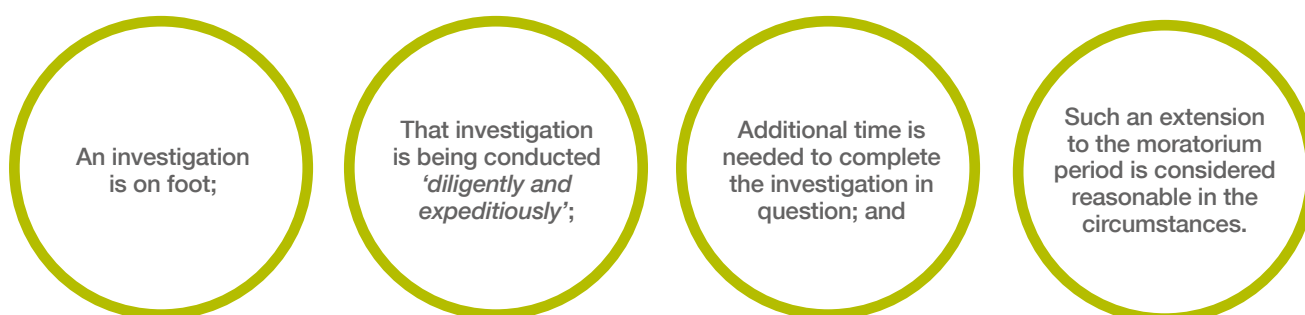
Under POCA, a firm that submitted a SAR to the NCA was deemed to have received the NCA's consent to engage in activity relating to property that it suspected to constitute the proceeds of crime if: (a) after seven working days, the NCA did not notify the firm that consent had been refused, or (b) the NCA notified the firm within seven working days that it had refused consent, but had taken no further action in relation to the matter after a further 31 calendar days. This period of 31 days was referred to as the 'moratorium period'.

As the Criminal Finances Bill was drafted, there had been talk of ending the consent-based regime relating to SARs. However, the Government expressly stated when it published the Criminal Finances Bill in 2016 that it intended to retain the consent regime.

As a result, the consent regime under POCA outlined above has survived and exists in the Criminal Finances Act. However, under the Criminal Finances Act, the NCA (as well as other authorities, such as the Serious Fraud Office and the Financial Conduct Authority) can apply to the Crown Court to extend the moratorium period for 31 days on up to six occasions. As a result, under the new requirements relating to SARs, a moratorium period could last for up to 186 days (or six months).



The Crown Court can only grant an extension to the moratorium period where:



Applications made to the Crown Court will typically be made on notice to the firm that submitted the SAR in question, unless there are reasonable grounds to believe that evidence of an offence would be interfered with, the process of gathering evidence would be interfered with, persons would be harmed, the recovery of property would be hindered and/or national security would be put at risk.

Fundamentally, the test for submitting a SAR has not changed. However, a potential six-fold increase in the moratorium period for SARs should cause firms to pause and give careful thought as to whether the test for filing a SAR has been met. In particular, the ability of the NCA (or other authorities) to extend the moratorium periods may cause

significant issues in relation to large and/or time-critical transactions. The potential for a long moratorium period may mean that control functions are more routinely challenged by front line staff as to whether submitting a SAR is absolutely necessary in a given situation.



634,113 SARs were filed between October 2015 and March 2017

The true impact of the potential for extended moratorium periods will very much depend on whether refusal of consent by the NCA remains the exception rather than the norm, as well as the extent to which the NCA (or other interested authorities) have an appetite for seeking (and the Crown Court for granting) significant extensions to moratorium periods.



## Information sharing

A frustration felt by a number of financial services firms over the past few years has been the lack of any formal mechanism which would allow them to share information about suspected money laundering with other firms. However, following a successful pilot run by the NCA and financial sector's Joint Money Laundering Intelligence Task Force, the voluntary sharing of information between regulated firms (including financial services firms) in connection with suspected money laundering has been given a statutory basis in the Criminal Finances Act.

The Criminal Finances Act allows for information sharing between firms where there is a suspicion of money laundering; either on the firms' own initiative or at the request of the NCA. It also sets out the requirements for such an information sharing request (including that the NCA grants permission) and provides for a joint Suspicious Activity Report to be submitted following information sharing that would fulfil both firms' reporting obligations. Firms which share information under these provisions are also protected from civil liability for breach of any confidentiality obligations or other disclosure restrictions, provided that any information shared is shared in good faith.

In order to take advantage of the information sharing provisions of the Criminal Finances Act, a firm must have grounds to suspect that another individual or entity has engaged in money laundering. As a result, the firm in question would still need to satisfy itself that the threshold for suspicion in this context has been met.

While well-intended, and requested by some firms, in reality there may be little appetite on the part of firms to share or request information relating to suspected money laundering from each other. In principle, the power could be useful where firms' interests align. However, on the other hand, the decision to submit a SAR is often finely balanced – MLROs from different firms may wish to take different approaches to an issue and one firm may feel it is in practice obliged to submit a SAR simply because the other is intending to. Firms are also likely to be reluctant to share client confidential information with each other, even if doing so will not attract the risk of civil liability for breaching confidentiality obligations. The same applies for data that constitutes personal data for the purposes of the Data Protection Act 1998.

Confidentiality and personal data aside, the financial services industry's heightened sensitivity to anti-trust issues may also mean that there is little appetite for information sharing under the Criminal Finances Act. To the extent that SARs need to be filed in connection with anti-trust matters, firms will be very reluctant to do anything which may jeopardise any applications for leniency or immunity. In addition, some firms have expressed concerns that sharing information with other firms under the Criminal Finances Act may itself fall foul of anti-trust laws in certain circumstances.

Between May 2016 and March 2017, the Joint Money Laundering Intelligence Task Force contributed to the following operational outcomes:



**63 arrests of individuals suspected of money laundering.**



**The instigation of more than 1000 bank-led investigations into customers suspected of money laundering.**



**The recovery of £7 million of suspected criminal funds.**



**The closure of more than 450 bank accounts suspected of being used for the purposes of money laundering.**



# Additional changes to POCA

## The Act also includes a range of amendments to POCA.

The Criminal Finances Act provides for disclosure orders to be used in money laundering investigations. Such orders are already available in confiscation and fraud proceedings. A disclosure order may be served on a third party (such as a bank) to compel the disclosure of relevant information. Information supplied by an individual or firm pursuant to a disclosure order cannot be used against them in criminal proceedings.

Again, the impact of these new powers will depend on how enthusiastically enforcement agencies seek disclosure orders. One can imagine that UK regulated financial services firms will be viewed as a comparatively easy source of information in money laundering investigations (compared to non-UK based individuals who may be harder to locate and compel disclosure from).

The Act also creates new civil powers to seize and forfeit monies stored in bank accounts and various types of property such as jewellery, bullion and betting receipts.

The Act also expands the civil recovery powers under POCA. These allow authorities to recover assets which have been obtained through unlawful conduct. Crucially, a criminal conviction is not required – it is only necessary to show on the balance of probabilities that the property has been obtained through unlawful conduct. The Act extends these powers to the FCA and HMRC (previously these were reserved for the

SFO, NCA and CPS).

The Act extends the full ambit of investigative powers in POCA to SFO staff (previously they had to work in conjunction with the NCA or CPS).

The Act makes it a criminal offence to obstruct/assault a law enforcement officer exercising powers under POCA. Existing offences of obstruction or assault did not fully cover all officers.

In addition, the following powers in POCA have been extended to apply to investigations in relation to terrorist property and terrorist financing under the Terrorism Act 2003:

- the powers to enhance the SARs regime;
- information sharing;
- seizure and forfeiture powers – for bank accounts and mobile stores of value; and
- disclosure orders.







# The Magnitsky Amendment

Under POCA, civil recovery proceedings may be brought in relation to property obtained through unlawful conduct.

During its passage through Parliament, the Criminal Finances Bill was amended to incorporate the so-called Magnitsky amendment into POCA which targets illicit wealth linked to human rights abuses. The nickname for the amendment refers to the death of Sergei Magnitsky, a civil rights lawyer who died in custody in Russia having been jailed while investigating corruption. A similar piece of legislation was introduced in the U.S. in 2012.

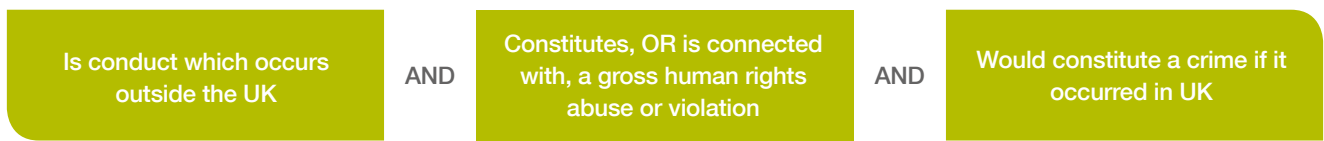
**BACKGROUND TO THE AMENDMENT**



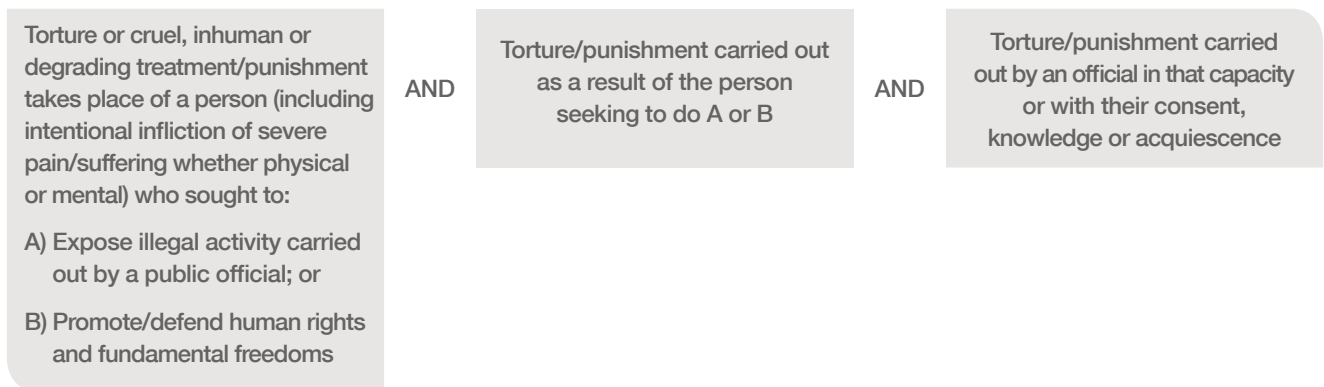
“We are campaigning for a so-called Magnitsky clause that would address weaknesses in our asset-freezing regime. First, it would create a clear legal basis for freezing the funds of anyone known to be involved in or profiting from gross human rights abuses. The power would enable British authorities (or a third party with sufficient evidence) to secure an order from the High Court. It would also establish a public register of those subject to such an order ... Ultimately it will target those profiting from the persecution of whistleblowers, journalists or dissidents — and strengthen the onus on British law enforcement authorities to act.”

**Dominic Raab (Minister for Justice and co-sponsor of amendment)**

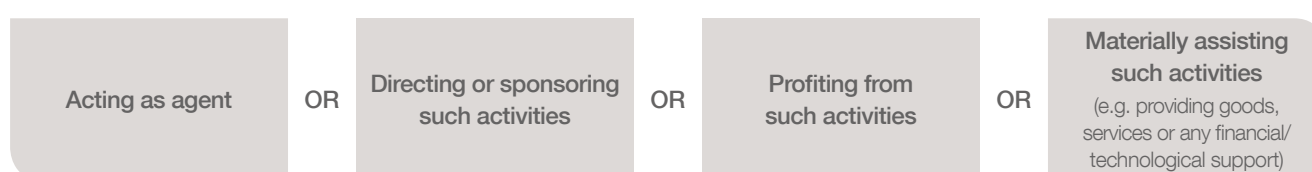
The amendment adds a new definition of unlawful conduct to POCA as follows. Conduct is unlawful if it:



The conduct constitutes a Gross Human Rights abuse/violation if:



An individual is connected with a Gross Human Rights abuse if they are:



#### RETROSPECTIVE EFFECT



If the gross human rights abuse involves torture, then the changes to POCA apply to conduct occurring both before and after the provisions are in force (likewise with property obtained before the provisions were in force). If the gross human rights abuse relates to inhuman/degrading treatment, then it only applies to conduct occurring after the section is in force.

#### NOTE



A limitation period of 20 years (from date of conduct) applies to any proceedings brought in respect of property obtained through this type of unlawful conduct.

The Magnitsky amendment was inserted less than two months before the Criminal Finances Act was passed. It has therefore not received the same scrutiny as other parts of the Act.

Clearly, the main focus of the amendment is to help target the assets of foreign officials complicit in human rights abuses. In this respect, it is difficult to see how the Act adds materially to existing law. Under POCA's broad existing definition of unlawful conduct, the profits of direct torture are already almost always likely to be recoverable – save for the unlikely situation where the gross abuse of human rights did not amount to an offence in the country where it was carried out. Critics might therefore view it as a politically symbolic change.

Where the amendment potentially breaks new ground – and the risk area for financial services firms – is in its focus on conduct 'connected with a gross abuse of human rights'. This includes providing material assistance (such as financial support).

This could capture, for example, a bank which provides lending facilities to a public official who then uses some of that money in connection with a gross human rights abuse. The key limit on a firm's liability would be that the financial support given would need to constitute a criminal offence in the UK (and therefore a firm would need to have provided support with the mental element necessary to have committed a criminal offence).

It remains to be seen whether the amendment is well-intentioned but largely symbolic. In practice, it is likely to place yet more emphasis on firms to review and monitor their relationships with foreign PEPs and public officials. Firms should have particular regard to allegations of conduct which falls short of torture but is captured within the inhuman or degrading treatment/punishment limb of the amendment – for example the aggressive suppression of press freedom or the right to protest.



## What next

While financial services firms now have an even greater compliance burden to manage, the Criminal Finances Act could have gone much further. Opposition attempts to insert a general offence of failure to prevent economic crime into the Act were defeated.

However, the concept of a general “corporate failure to prevent” offence that would cover conduct such as money laundering and fraud is not dead. At the beginning of this year, the Government published a call for evidence on corporate liability for economic crime. The strict liability ‘failure to prevent’ model was only one of the options under consideration. However, indications are that it is the favoured option. It is likely to remain on the agenda whether or not the tax evasion offences are viewed as being a success. If the new criminal offences are little used, it may fuel calls for a broader offence to be introduced. Equally though, if there are a number of convictions or DPAs under the Act, this may also encourage the introduction of wider criminal liability for failure to prevent financial crime.

The impact of many of the remaining parts of the Criminal Finances Act will depend on authorities’ appetite for utilising their new powers. Nonetheless, firms should prepare themselves and their clients for dealing with enforcement authorities’ ever-expanding investigative toolkit.

## How Allen & Overy can help

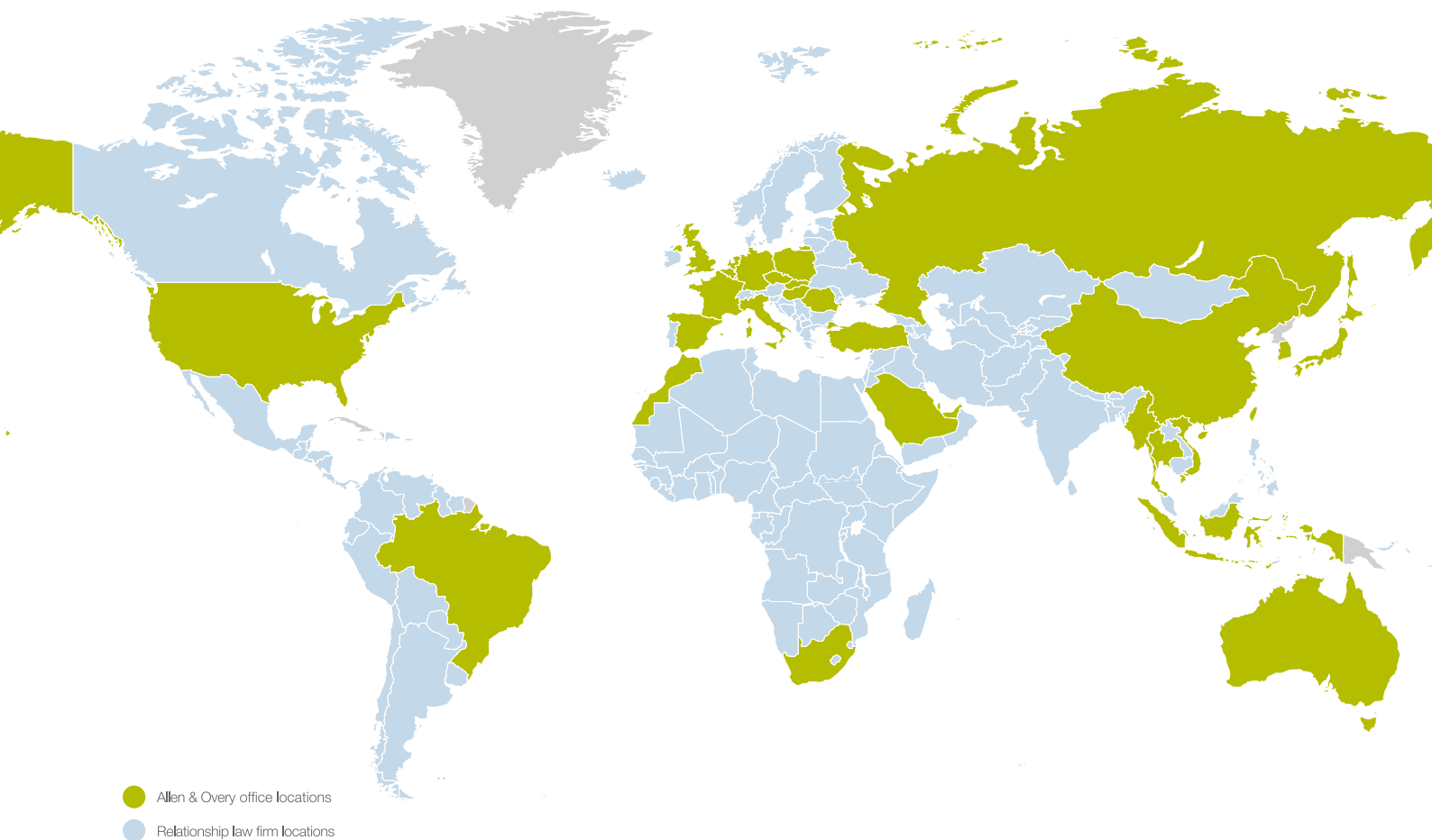
Our Criminal Finances Act Working Group comprises lawyers from our market-leading contentious regulatory, financial crime and tax teams (please see Key Contacts for more details).

Our general experience of advising on risk assessments and prevention procedures, coupled with our global tax capability, means that we can guide global businesses through the necessary steps to manage the risk posed by the new tax offences. We can provide clients with advice on compliance with the Act, including conducting full risk assessments of their businesses, devising and delivering suitable programme training for both staff and associated persons and reviewing contracts and other arrangements with third party service providers.

More broadly, Allen & Overy LLP’s global investigations practice advises clients on a wide range of high-profile criminal and regulatory investigations, with a particular focus on cross-border matters. We routinely advise clients on difficult issues arising from FCA and SFO investigations, Suspicious Transaction Reporting and the Proceeds of Crime Act generally.



## About our practice



Allen & Overy is one of the largest and most connected law firms in our peer group – our global network spans 44 offices in 31 countries and is complemented by strong ties with relationship law firms in more than 100 countries where we do not have a presence. We operate at the heart of the world’s banking and financial markets, enabling us to provide expert advice on the full range of a financial institution’s operations.

We are highly experienced in advising on the full range of financial crime issues affecting clients in the financial sector,

ranging from major regulatory investigations to high profile disputes. The depth of product and market knowledge that comes with our position as the leading international banking and finance law firm sets us apart from our competitors. As well as having extensive experience in handling financial service regulatory investigations, and associated employee issues, we have leading financial services criminal defence capability covering anti-corruption and bribery, anti-money laundering, fraud (financial and tax), antitrust, sanctions and insider dealing.



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*“Allen & Overy LLP is ‘absolutely outstanding’ at representing clients throughout the continuum of contentious issues, from internal investigations through to enforcement actions (where it is ‘able to deliver its outstanding banking and bank regulatory expertise, through contentious lawyers working seamlessly with the firm’s subject matter experts’) and any private litigation flowing out of that.”*

The Legal 500 UK 2017, Financial Services Contentious Regulatory – Tier 1

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## GLOBAL PRESENCE

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Barcelona	Dubai	Johannesburg	Perth	Tokyo
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