Association of Accounting Technicians response to HM Treasury: Consultation on the transposition of the Fourth Money Laundering Directive

AAT is a registered charity. No. 1050724

Association of Accounting Technicians response to the consultation on the transposition of the Fourth Money Laundering Directive

1. Introduction

1.1. The Association of Accounting Technicians (AAT) is pleased to have the opportunity to respond to the consultation paper on transposition of the Fourth Money Laundering Directive (4MLD), published on 15 September 2016.

1.2. AAT is an existing supervisor under the Money Laundering Regulations 2007 (MLR).

1.3. AAT is submitting this response on behalf of our membership and for the wider public benefit of achieving sound and effective administration of the law.

1.4. AAT has added comment in order to add value or highlight aspects that need to be considered further.

1.5. AAT has focussed on the operational elements of the proposals and has provided opinion on the practicalities of implementing the measures outlined.

1.6. Furthermore, the comments reflect the potential impact that the proposed changes would have on SMEs and micro-entities, many of which employ AAT members or would be represented by AAT's 4,200 licensed accountants.

2. Executive summary

2.1. AAT presents this response in the knowledge that the UK is broadly aligned already to the requirements of 4MLD, having championed an "all crimes" approach to money laundering (ML).

2.2. The proposals being consulted upon indicate the government's commitment to a proportionate approach to ensuring that obliged entities create a hostile environment for criminals, deterring their use of the financial system to launder the proceeds of crime. This is balanced against the need to ensure that the UK does not create barriers to legitimate business growth.

2.3. AAT welcomes the proposal to increase the turnover threshold, recognising that this will benefit business. Any proposal to increase the agility with which the government can be responsive to changing market needs will promote the UK growth agenda.

2.4. AAT is open to increasing guidance on Customer Due Diligence (CDD), but advocates caution that the provision of additional guidance may have the unintended consequence of encouraging a "tick box" approach to following guidance, moving away from the risk based approach.

2.5. A number of new terms are introduced with 4MLD, including "member organisation" and "federation". These are new terms, and it is not immediately apparent what they are referencing. AAT urges caution in adding complexity to the reliance provisions. Reliance has the potential to significantly reduce the regulatory burden of the regime, but it is currently risky and costly to both the party being relied upon and the party relying upon them. Increasing the spectrum of parties who could be involved in reliance will only seek to deter further from its use.

2.6. AAT has real concerns about the potential for there to be rigidity with the introduction of thresholds for both requiring the appointment of a Compliance Officer and also the potential for imposition of the independent audit requirement. Business growth is dependent upon an organisation's ability to innovate and distinguish itself from competition. Such requirements may stifle growth. AAT considers that the regime should focus on the outcomes sought, and be mindful that the supervisory regime is in place to monitor compliance with the MLR, and take action as necessary to address identified non-compliance. An independent audit function might be a recommendation stemming from a supervisory intervention. But to set a threshold for its requirement could result in disproportionate outcomes as smaller firms would lack the resources to access independent audit, which will have been designed for larger firms.

2.7. AAT supports the proposed approach to PEPs, recognising that whilst in the UK domestic PEPs are likely to pose less of a risk, other jurisdictions may have different experiences. It is AAT's view that the definition should be restricted to those holding office, and guidance should focus on the jurisdictional risks associated with holding office, informed by FATF evaluations and the Corruption Perception Index.

2.8. AAT appreciates and welcomes the government efforts to increase transparency with the People with Significant Control (PSC) regime, and is in favour of casting the net widely to include a diverse range of entities within the scope of the regime. It is AAT's view that a failure to do this may lead to displacement of criminality, with such entities being identified as safe havens for ML activity. This argument is extended to the inclusion of company formation agents to the scope of the AML regime. As was demonstrated by the Panama papers, the risks associated with use of corporate structures to disguise the source of funds was significant. To be able to do this with no scrutiny or requirement to comply is counter-intuitive to the purpose of the regime.

2.9. As a supervisor, AAT on balance welcomes the proposals to develop the supervisory regime, particularly the powers available to supervisors and can see the merits this will bring to a robust cohesive AML regime. AAT urges the government to carefully consider how it seeks to extend the scope of fit and proper and criminality testing to ensure that it delivers a proportionate outcome which clarifies lines of accountability. There is a risk that it will be costly to implement unless the government is clear on its scope recognising that entities are diverse in their makeup.

2.10. AAT is supportive of the proposed approach to administrative sanctions, but suggests that in order to address the long standing challenge in evidencing the proportionality of sanctions across the regulated sector, inclusion of reference to percentage of turnover or fee income is used as a metric as opposed to an unlimited financial penalty.

3. AAT response to the consultation paper

3.1. The following paragraphs outline AAT's response to the proposals outlined in the consultation paper. Only those questions where AAT has a comment to make have been listed.

Who is covered by the directive?

Question 1: Do you agree with the proposed turnover threshold of financial activity being set at £100,000 as one of the criteria to comply with an order to be exempt from the directive?

3.2. As a supervisor whose firms provide services to small to medium size enterprises, AAT very much welcomes the government's recognition that the regulatory framework in respect of incidental financial activities can stifle growth within smaller businesses.

3.3. AAT supports any move to increase flexibility in determination of thresholds as the needs of the market change, and agrees with the proposal to disaggregate the absolute turnover threshold from the VAT registration threshold for that reason.

Question 2: The government would welcome views on whether a maximum transaction threshold per customer and single transaction should remain at £836 (€1,000).

3.4. The €1,000 threshold is well established now, and AAT concurs with the government's rationale for leaving it as it is.

The due diligence requirements and reliance

Question 3: when do you think CDD measures should apply to existing customers while using a risk-based approach?

3.5. AAT advises its firms to evaluate their CDD upon receipt of any new information to fulfil the ongoing monitoring requirements as set out in paragraph 8 of the MLR. If the new information is consistent with the risk profile of the client as determined initially, then there is no need to conduct further CDD. If the information is inconsistent and indicative of an escalation of risk, then AAT would see this as a flag to undertake further CDD.

Question 4: What changes to circumstances do you think should warrant obliged entities applying CDD measures to their existing customers?

3.6. In asking question 4 the government has indicated a number of examples which may, or may not, be relevant changes in circumstances to trigger additional CDD depending on the nature of the transaction or relationship. Certainly for retail banking, such changes may indicate the need for additional CDD, but in other circumstances perhaps not. AAT advocates that providing too much guidance on this may result in a "tick box approach", or a perception of an exhaustive list, and may also result in unnecessary additional burdens. If "vocation" is used as an example, many individuals would change their job frequently, but provided that there is no material change in the behaviours, it is unlikely that this should trigger the need for additional due diligence. By comparison, a limited company's diversification into a wholly new and distinct market from that which it currently operates in should trigger the application of customer due diligence measures.

3.7. Annex 1 to 4MLD indicates a non-exhaustive list of risk variables, which offer a principle based alternative to the specific examples provided, and AAT would advocate using these as the foundation for identifying risk based triggers for additional CDD on existing clients.

3.8. AAT would suggest in addition to those categories outlined in Annex 1, the government considers including "the nature, status and behaviour of the client", which encompasses the changes prescribed, but in addition other changes such as a change in legal status, changes in jurisdictional reach, changes in behaviour and/or of business should be considered for inclusion.

Question 8: What are the money laundering and terrorist financing risks related to pooled client accounts and what mitigating actions might you take?

3.9. Pooled client accounts potentially afford criminals to operate below the radar with their funds being masked in the context of other clients' funds, resulting in a challenge to banks to potentially identify criminal proceeds. The same could apply to terrorist financing.

3.10. The consultation document at paragraph 4.18 makes reference to pooled client accounts being held generally by legal professionals and notaries. Accountancy service providers can also hold pooled client accounts, although in practice this is a rare occurrence, and considered increasingly unnecessary.

3.11. Any professional operating a pooled client account should do so in accordance with the requirements of their profession. Those requirements are in place to prevent abuse of the pooled account by both clients and professional service providers, mitigating against the risk of abuse.

Question 9: What would be the effect of removing SDD measures on pooled client accounts?

3.12. It is AAT's view that if SDD measures were removed on a pooled client account then the burden on both clients and banks would increase as the default start position would be that banks would have to undertake CDD on all clients accessing the account, or alternatively enter into reliance arrangements with regulated entities.

Question 11: What are your views on the situations described by the ESAs where SDD may be appropriate on pooled client accounts?

3.13. AAT agrees that the situations described by the ESAs indicating where SDD may be appropriate are the right indicators, and if subscribed to would provide a risk based and pragmatic approach to the ongoing use of pooled client accounts.

Question 12: Are there any other factors and types of evidence of potentially lower risk situations, aside from those listed in Annex II of the directive, that you think should be considered when deciding to apply SDD?

3.14. Given that Annex II is presented as a non-exhaustive list it provides sufficient information for firms to ascertain what is meant by low risk. It is AAT's view that extending the list further would be a shift towards identifying an exhaustive list of factors, which would not be helpful.

Question 13: Are there any other products, factors and types of evidence of potentially higher risk situations, aside from those listed in Annex III of the directive, which you think should be considered when assessing ML/TF risks in respect of EDD?

3.15. As stated above, Annex III is also presented as a non-exhaustive list, and therefore AAT considers this to be appropriate for the purposes of assisting firms to identify high risk situations.

Question 17: What are your views on the meaning of a "member organisation"?

3.16. In the context of reliance, AAT finds use of "member organisation" as a term unclear, risking complicating reliance provisions, unless defined appropriately.

3.17. AAT finds that reliance is seldom used by firms to discharge CDD duties, because the obligations on the entity being relied upon, coupled with the risk accepted by the entity seeking to rely upon another entity increase as opposed to decrease the burden on regulated firms.

Question 18: What are your views on the meaning of a "federation"?

3.18. In the context of reliance, AAT is unclear on the intended organisations who should be included in the definition of "federation", and to that regard, the relevance of such a party to the reliance relationship.

Question 21: Should the government set a threshold of the size and nature of the business for the appointment of a compliance officer and employee screening? If so, what should the government take into account?

3.19. It is AAT's position that government intervention in setting a threshold undermines the purpose of the risk based approach, which puts the onus on regulated entities to develop, on a risk sensitive basis, internal systems and controls. Any threshold may create unnecessary burdens because of the extent of diversity in business models which exist.

3.20. AAT suggests as an alternative that the government considers providing guidance for obliged entities on the outcomes sought in contemplation of such thresholds, allowing firms the autonomy to deliver the outcomes in a manner which is most proportionate to their business model.

3.21. It is AAT's assertion that as a supervisor, it is in a position to evaluate whether a firm is achieving the outcomes sought without the need for threshold criteria to be introduced. Therefore there is a role for all supervisors to play in determining this.

Question 22: What should be taken into account when screening an employee?

3.22. AAT suggests that employee screening should ensure that only fit and proper persons are in a position to carry out and influence regulated activities.

3.23. At the same time, AAT acknowledges that mandating employee screening increases the costs of doing business, and increases barriers of market entry. Recognising this, AAT suggests that firms are guided on *de minimis* requirements for employee screening in order to minimise the burden on small businesses.

Question 23: Should the government set a threshold for the size and nature of the business that requires an independent audit function? If so, what should the government take into account?

3.24. AAT suggests that a threshold may be arbitrary, and therefore would not support this as proposed. The need for independent audit should be commensurate to risk and non-compliance, not size or nature of business. Typically larger firms have access to more resources than smaller firms, and invest more heavily in their compliance systems and controls.

3.25. AAT suggests that the government consider this further in the context of the role of supervisors, which is to monitor firms' compliance with their obligations under the MLR and Proceeds of Crime Act (POCA). To impose additional thresholds for independent audit functions increases the degree of complexity in operation, and may also preclude smaller firms from accessing such services as required due to costs if the model builds into an independent industry which targets its activity towards larger firms which have more resources.

Question 24: What do you think constitutes an "independent audit function"?

3.26. AAT sees the use of the word "audit" in this context as distinct from statutory audit, but more as an independent systemic review of a firm's systems and controls in order to determine an outcome as to their fitness for purpose.

3.27. In order for this to be objective, AAT would advocate the development of standards against which compliance would be assessed, were a threshold to be set for an independent audit. It would also be imperative to determine the appropriate level of qualification for those delivering the audit to ensure that the evaluation is adding value to the overall regime.

Question 25: How many of the controls listed at paragraph 4.34 are [businesses] already carrying out, and what is the likely cost of these procedures?

3.28. It is AAT's position that all the factors indicated in paragraph 4.34 are currently required of firms, and therefore do not amount to a change in the regime.

Politically Exposed Persons (PEPs)

Question 50: How do you differentiate between risk management systems and risk-based procedures?

3.29. AAT considers risk based procedures to reflect the overall assessment of the firm's risk exposure, and consideration of professional activities in that context. By contrast, risk management systems represent a mechanism, or mechanisms firms use to control the risks they are exposed to.

Question 51: Under the terms of the directive, all PEPs are considered to be high risk. However, obliged entities may use a risk-based approach to both identification of a PEP and the depth of EDD measures that are applied to them. What risk factors do you think are relevant when deciding how to identify a PEP and adapt EDD measures to them? Would more clarity in guidance be helpful to avoid the disproportionate application of EDD measures to low-risk groups and their families?

3.30. Whilst AAT understands the rationale for inclusion of domestic PEPs, and welcomes the closure of what was a significant loophole, it does present as being potentially problematic when considered in the context of the additional resource required to be invested in ensuring the propriety of managing regulated activities.

3.31. AAT suggests that broad guidance from government on its position in respect of domestic PEPs would be welcomed by the regulated sector, and domestic PEPs alike.

3.32. AAT considers the key risk factor in determining the degree of EDD required of a PEP is reference to the jurisdiction within which they operate, and its evaluation by both FATF, and Transparency International's Corruption Perception Index. Secondary to this then, once it has been identified, is the degree of power and influence that individual has. The more power and influence held, the higher the risk of corruptibility.

Question 52: The directive specifically applies to members of parliament or of similar legislative bodies and to members of the governing bodies of political parties… There are over 400 registered political parties, of which the vast majority are very small. Should there be some form of criteria or some examples set out in guidance of the political parties to which this applies, e.g. those having elected members of Parliament, the European Parliament, or the devolved legislatures? If so, what is the reasoning behind the use of these particular criteria or examples? Would guidance on this issue assist, and if so, what should the guidance include to provide clarity?

3.33. AAT considers the definition of PEP should only extend to those holding office, and not to those with political affiliation, or motivation. This is because to extend this further requires additional resource to identify, for a disproportionate outcome given that the purpose of extending CDD is to ensure that those who hold office do not abuse their position for personal gain. Arguably those not holding office cannot abuse it.

Question 54: Does the extent of EDD on the family members of PEPs and individuals who are known to be close associates of PEPs correspond with the measures that are appropriate for PEPs themselves? Which risk factors do you think are relevant?

3.34. It is AAT's view that this entirely depends on the risk posed by the PEP.

Question 56: Is the guidance sufficiently clear about how EDD should be applied to PEPs, their family members and their known close associates? If not, what should the guidance include to provide clarity?

3.35. It is AAT's view that with the Persons of Significant Control (PSC) regime, the ability of firms to identify known close associates of domestic PEPs is greatly improved, as will be the case within Europe. The challenge continues to lie in the fact that such information is not readily and publically available in higher risk jurisdictions.

Beneficial ownership

Question 60: The government welcomes any views on the issues highlighted above, and the Persons of Significant Control (PSC) regime itself.

3.36. AAT very much welcomes the transparency brought by the PSC regime, and the reduction in burden of CDD it brings with it for small firms.

3.37. AAT considers the list of entities proposed in paragraph 10.8 to be viable entities for the purpose of money laundering, and their exclusion may result in displacement of activities towards these types of entity if they are not included.

Question 66: The government welcomes your views on clarifying, through appropriate guidance, that a one off company set up is a business relationship that has an element of duration.

3.38. AAT fully supports the fact that one-off company set up should be included within the scope of the AML/CTF regime, and that excluding it creates a significant vulnerability, given the prevalence of companies used to disguise ownership.

3.39. AAT questions whether it is appropriate to base this on the fact that the relationship has an element of duration, unless the provision of that service is incidental to one of the other Article 2 services. AAT suggests that if company formation is being undertaken by way of business, it should fall within the scope of Article 2(1)(c), and not be subject to exemption.

Reporting obligations

Question 67: The government would welcome your views on retaining documents necessary for the prevention of ML/TF for the additional five years. What do you think the advantages and disadvantages of doing so are?

3.40. AAT can see from a law enforcement perspective the merit of having data records held for a period of 10 years, which may prove useful in a prosecution.

3.41. However, AAT has a number of issues with the proposal for the additional five year period as follows:

- What are the standards against which an entity would conduct "a thorough assessment of the necessity and proportionality of such further retention"?
- The cost of the additional retention period may be disproportionate to the risk mitigated by keeping the information.
- Consideration as to whether information should be retained for the additional five years would require documenting in order to protect the firm against pursuit of a non-compliance case, increasing the burden on business.

Supervision of obliged entities

Question 68: Do you think that where registration is a requirement, the supervisor should be given an express power to refuse to register or to cancel an existing registration?

3.42. As an existing supervisor under the MLR, AAT has the power to refuse to register, or cancel registration of a firm using other non-statutory regulatory mechanisms, underpinned by the governance framework of the organisation. These powers are in place to explicitly address the fit and proper status of members and firms more broadly, but in having a power to refuse to register, or cancel existing registration, AAT is confident in the fit and proper status of its members and firms.

3.43. AAT's robust framework is undermined by the fact that HMRC, as the default supervisor for the accountancy sector has no such power available. This means that despite AAT taking steps to ensure that firms identified as either unsuitable to be licensed to deliver services within the regulated sector, or alternatively found to lack the systems and controls required to reduce the risk of services being used to launder the proceeds of crime; such firms are still able to operate under the guise of HMRC registration.

3.44. On this basis, AAT would very much welcome the introduction of an express power for all supervisors to be able to refuse to register, or to cancel an existing registration.

Question 69: The government welcomes views on the reasons for a supervisor to refuse a registration or to cancel an existing registration. Are there any other reasons you think should be captured? Do you foresee any problems with the conditions identified?

3.45. AAT agrees that the broad reasons captured for refusal to register, or cancellation of registration are adequate.

3.46. The reference to "cancellation" implies a degree of immediacy. Supervisors are already required under the MLR to take action to ensure compliance of supervised firms, and most are in a position to ultimately prevent firms not demonstrating compliance from continuing to practice. HMRC do not have such a power owing to the lack of fit and proper test, and therefore the immediacy of the term cancellation might be appropriate for their purposes, and a welcome addition. AAT is of the view that given the gravity of such a step, its use must be proportionate.

3.47. AAT notes the use of terminology changes from "entity" to "business" to "member", and invites careful consideration of the implications of all these scenarios in the context of registration. Supervisors will need a mechanism supported in the revised regulations which adequately links the conduct of individual controlling interests within an entity, employees of the entity, and also the makeup of the entity itself, as well as the implications of any "network arrangements" to any registration decision taken. Network arrangements would include an individual with a controlling interest in that specific entity having controlling interests in others, or alternatively known links across the regulated sector, which would in actual fact increase the potential for successful layering from the perspective of the criminal.

3.48. In addition to the examples given, AAT would suggest that the government also considers including a power to refuse where an entity (or member) has been refused registration (or had registration cancelled) by another supervisor, provided such a decision has been made, and the applicant given access to an appeal procedure. It is AAT's view that the latter step in such a circumstance precludes firms and individuals from moving between supervisors, because if an appeal has concluded that the decision taken by the first instance supervisory body was sound, then there should be no avenue for a firm found to be deficient by a supervisor to have a second opportunity to be included within the regulated sector. This would create a level playing field, and reduce

the supervisory burden of conducting fit and proper tests on firms where evidence is available to indicate a lack of suitability for the regulated sector.

Question 70: The government welcomes views on whether a supervisor should have the power to add conditions to a registration or whether they should have the power to suspend an existing registration.

3.49. AAT has powers to both suspend a licence to practice, including part suspension where issues are limited to a very specific area of practice, and also add conditions to a licence by virtue of its own regulatory framework. Such powers are of benefit in being able to safeguard the public from the risk of harm caused by deficient firms, but also act as a deterrent to firms who may seek to avoid taking steps to bring the firm into compliance.

3.50. The challenge for AAT is that a non-compliant firm may seek to continue to practice regardless of a period of suspension, and there is no legal basis to preclude this. On this basis, AAT would very much welcome a legally based power to suspend practice for the reasons of anti-money laundering compliance concerns, which oftentimes is the issue at stake which results in the suspension of the licence.

3.51. A further benefit of the power to suspend is that it prevents a firm from practising whilst an investigation is ongoing, which has been an issue and a frustration for all stakeholders in pursuit of a responsive AML/CTF regime.

Question 71: The government welcomes views on the test that should be applied by a supervisor when seeking to refuse to register, cancel an existing registration, add conditions to a registration or suspend an existing registration (see 12.8).

3.52. AAT advocates that the test applied should be risk based, and therefore the concepts of knowledge, suspicion and belief can all be relevant depending on the specific circumstances being considered.

3.53. AAT has always found the “reasonable and informed third party test” helpful in objectively determining the propriety of a decision taken, and considers this would assist decision makers in determining whether and how the public interest is served by the decision taken.

Question 72: Where there is more than one supervisor, we welcome views on preventing the resubmission of an application for registration with another supervisor.

3.54. As an existing supervisor, AAT is committed to continuing to work collaboratively with other supervisors to ensure that only appropriate entities and individuals are able to work in the regulated sector.

3.55. As stated in paragraph 3.27.4 above, AAT suggests that if the supervisor is given a power to refuse on the basis that another supervisor has already done so, this would preclude the consideration of a further application by a firm not considered appropriate to work within the regulated sector.

3.56. Information pertaining to such applications could either be published by supervisors, for referencing by others in contemplation of a new application, or alternatively stored on a centrally hosted information sharing hub, such as SIS or FINNET, provided that the provision of such a centrally hosted hub was accessible by all supervisors in order to not undermine the veracity of the data stored.

Question 73: Do you agree with the government's approach to a "person who holds a management function" in paragraph 12.13- namely those who make decisions about a significant part of the entity's activities or the actual managing or organising of a significant part of those activities? Do you think it will encompass all individuals that should be subject to a fit and proper test?

3.57. The proposal to extend this definition to include "making decisions about how a significant part of an entity's activities are to be managed or organised", or "the actual managing or organising of a significant part of those activities" immediately raises questions about how "significance" could be determined in a meaningful and comparative way to make such a determination in a standardised manner across a diverse range of entities.

3.58. AAT urges caution in the proposed approach to defining "management positions", and the potential regulatory burden this may place on businesses, particularly small to medium size firms who may experience a higher throughput of staff, or alternatively capture more staff within the entity by the definition due to less defined organisational structure. This risks placing disproportionate burdens on smaller firms than larger firms, and may therefore increase costs to small business.

3.59. AAT suggests that in order to extend the scope of "management function" beyond that of "the exercise of functions undertaken by senior management during the course of business" may have the unintended consequence of casting the net too widely.

3.60. Supervisors have detailed knowledge of and power over their individual members, but not their employees, who under existing supervisory regimes would be held to account through the firm, and those with a controlling interest, who would inevitably be members of those supervisory bodies.

3.61. It should be for employers to ensure the fit and proper status of their employees, and employees to have to demonstrate this. It is unreasonable for supervisors to be involved in the determination of the status of those in roles which are not clearly defined, and by virtue of the proposed broad definition of a management function could arguably include anybody.

3.62. It would create additional challenges in terms of policing, given that in the absence of a centralised licensing scheme for those seeking to work in the regulated sector in any function, there would be delays to recruitment as fit and proper checks would need to be carried out on those who might not be subject to them through a professional body, or statutory licensing regime. This would create high barriers for small businesses, which may stifle the UK growth agenda disproportionately to the risk posed, and alternative means of controlling the entity exist with senior management accountability.

3.63. AAT would suggest that the onus is placed on "senior management" to ensure that all staff working for the entity (regardless of their seniority) are fit and proper, to affirm the fit and proper status of their staff to their supervisor, and acknowledge their accountability to that regard as a more proportionate way of achieving the outcome sought.

Question 75: What are your views on the meaning of "criminal convicted in relevant areas"?

3.64. AAT agrees with the subsets identified by the government in respect of "relevant areas" for the purposes of ML/TF.

3.65. In its own existing definition, AAT has extended the subsets identified to include predicate offences with a known link to money laundering. On this basis, AAT currently includes (in addition to the list proposed by government) as relevant:

- Serious organised crime, including drug offences, human trafficking and immigration offences, and/or offences under the Terrorism Act 2000

- Offences of dishonesty
- Offences involving abuse of position.[1]

3.66. The rationale for extending the definition of "relevant areas" beyond those proffered by the government in this proposal is that AAT correlates the risk of corruptibility to involvement with predicate offences. By giving an individual found guilty of involvement in serious organised crime access to the regulated sector (and indeed the skills they would need to avoid the regulated sector in order to launder the proceeds of crime), is counter intuitive to the overall purpose of the AML regime.

3.67. Paragraph 12.22 invites respondents to give a view on whether the directive should be extended to include not only criminals convicted in relevant areas, but those being investigated for, or charged with a crime in the relevant area. AAT would very much welcome this proposal. Currently there are significant challenges on two levels in respect of criminal investigations, and charges. The first is the challenge associated with information sharing between law enforcement and supervisors, with law enforcement being cautious to provide information to supervisors which can be used to trigger a supervisory response, but providing sufficient indication of a concern to leave a supervisor in a predicament as to the appropriate action to take when a firm's risk profile has been escalated by virtue of law enforcement interest. Such an extension would provide a gateway for information sharing. Coupled with the ability to "suspend registration" as is discussed under the response to question 70 above, this would provide for a responsive risk appropriate outcome.

Question 76: What are your views on the meaning of "associates"?

3.68. It is AAT's view that the definition of "associates" should be modelled on the definitions used in the context of PEPs as articulated in Article 3(11). This is for two reasons. Firstly, the proximity argument which justifies the definitions for PEPs is equally relevant, if not more so within the regulated sector whereby a single rogue individual can prove to be a significant lever to financial crime. Secondly, the more convergence used in definitions, the more likely it is that they will be appropriately understood and implemented correctly.

3.69. AAT accepts the point raised at paragraph 12.21 which highlights the challenges in achieving distance from a familial associate, but does not consider this to be a barrier if there is the opportunity for supervisors to adopt a risk based approach to determining the resultant impact. It would be wholly disproportionate to debar an individual from the regulated sector because of a familial but estranged tie to a prolific criminal in few if any "relevant areas". It would also be wholly inappropriate to disregard familial ties which may enable a close family member of a prolific criminal into the regulated sector with the ability to have unfettered access to layering capability.

3.70. By including "reason to believe" within the realms of the test as discussed in question 71 above, AAT considers there to be adequate means for supervisors to take a risk based approach to this as a key area of supervisory judgment.

Question 78: What are your views on spent convictions and cautions being taken into account for those new sectors in paragraph 12.18, in particular estate agents, lettings agents, accountants and, if there is to be an extension, HVDs? How would disclosure of spent convictions and cautions maintain public protection and mitigate against risks to the public?

3.71. AAT urges the government to ensure an even playing field in respect of decisions taken to extend the exemptions to the Rehabilitation of Offenders Act 1974 through the Exemptions Order. The drivers for those professions and bodies covered by the Exemptions Order are not presently ML/TF related drivers. That being said, access to such information will inevitably influence supervisory activity, with the consequent

[1] Paragraph 13, AAT Criminal Convictions policy https://www.aat.org.uk/prod/s3fs-public/assets/Criminal_Convictions.pdf

potential for skewing the risk profile of the regulated sector between those who do hold exemptions and can access relevant information, and those who do not.

3.72. AAT's view is that the risk from a supervisory perspective of not knowing such matters is the risk of corruptibility on the part of the applicant, should the information be known by a former associate and used to exploit the individual. Whilst the likelihood of this is low, the impact could potentially be high.

3.73. Cases have also been identified where information has been brought to supervisors indicating concern about current practice, and reference to previous spent convictions or cautions. The absence of an exemption makes corroborating this information difficult, and provides no avenue for supervisors to establish whether a pattern of behaviour might exist.

Question 79: Are there any specific offences you consider relevant in relation to the risk of money laundering and terrorist financing?

3.74. AAT does not consider it necessary for absolute exemptions to be given to all supervisors, recognising the wider value the Rehabilitation of Offenders Act 1974 has brought to society. AAT considers that access to records of spent convictions and cautions in "relevant areas" (as ultimately defined) would be helpful information to inform both the criminality test, but also any wider risk assessment of a firm.

Question 80: Should the government extend the criminality test to other entities covered by the directive? Please provide evidence to support your response.

3.75. On the basis of the government's representations in paragraph 12.24 on the use of High Value Dealers (HVDs) and dealerships, AAT cannot see how the government could sustain an exemption from a criminality test for this group.

3.76. AAT is firmly of the view that all entities covered by the directive should be subject to the criminality test. Under 4MLD it is proposed that Trust and Company Services Providers who are not covered by another sector would be exempted from the test. It is AAT's view that this cannot be right.

3.77. The National Risk Assessment of Money Laundering and Terrorist Financing (NRA) published in 2015 assessed Trust or Company Service Providers as having a medium risk overall[2]. Subsequent to this, the "Panama papers" were released, highlighting the use of off shore trusts and companies for legitimate and illegitimate reasons, the illegitimate reasons including tax evasion, and money laundering as was highlighted by Global Witness[3]. To enhance the robustness of fit and proper testing with the inclusion of a criminality test across the regulated sector, but omit a sector which has since been identified as higher risk than the NRA had assessed creates even more of a vulnerability to the sector than existed prior to the contemplation of criminality tests.

Question 81: Do you think that a transitional period is needed to complete the criminality tests?

3.78. A transitional period will be imperative in order to complete the criminality tests, particularly if the decision is taken to extend such tests beyond those with a controlling interest in a firm.

3.79. AAT has a concern about the extent of any supervisor's ability to undertake criminality testing beyond the UK legal system, and therefore, in the interests of capturing the totality of relevant information, whether this would be achievable.

[2] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/468210/UK_NRA_October_2015_final_web.pdf page 12.
[3] https://www.globalwitness.org/en-gb/press-releases/call-tax-havens-open-after-offshore-expose/?gclid=CITt942XktACFQ2ZGwoddBwMaw

Question 82: Do you think a transitional period of two years affords sufficient time to complete the criminality test on the appropriate existing persons who are already on supervisors' registers?

3.80. Subject to identifying an appropriate partner service to deliver on criminality testing, and that testing being undertaken on only those individuals within a firm who are members of AAT, two years would be an appropriate time to deliver criminality tests.

3.81. Extending the test beyond AAT members only may take longer, as AAT (and other supervisors in the same position) would need to establish jurisdiction over individuals who are not members, but employed by a supervised firm, which would currently not occur, then this would require engagement with these individuals, and development of processes to support this new, alternative method of monitoring firms.

Question 83: What are the expected transitioning and ongoing costs in your sector/business for applying a criminality test?

3.82. Inevitably the introduction of criminality testing will increase the costs across the accountancy sector.

3.83. In terms of transitional costs, depending on the nature of the ultimate proposals, these could include:

- The costs of amending the regulatory framework to accommodate new individuals not personally held to account by the organisation;
- The costs of developing systems to support the introduction of criminality testing beyond the existing membership;
- The costs of identifying and communicating with "relevant" non-member employees on a bilateral basis;
- Additional costs of holding individuals to account as well as firms
- Development of a mechanism to communicate outcomes across the regulated sectors as employees would typically be a more transient workforce than senior management, or beneficial owners.

3.84. The latter three costs would translate into ongoing costs. In terms of quantum, AAT has made preliminary enquiries into the actual testing process, but is not in a position to provide an evidence based view of costs due to commercial sensitivity. AAT can say that it estimates that the proposal will require increased staff time, and therefore headcount to deliver.

Administrative sanctions

Question 84: What are your views on there being no upper limit on the imposition of an administrative pecuniary sanction?

3.85. AAT currently does set an upper limit on the imposition of pecuniary sanctions, which is considered to be sufficient to be effective, proportionate and dissuasive.

3.86. That being said, it is a matter for any committee or tribunal determining the sanction to on a case by case basis make a determination as to the level of financial sanction, so by having no upper limit, the same end should be achieved. On this basis, AAT would have no issue if government was minded to remove the upper limit on a financial sanction.

3.87. AAT can foresee such an action manifesting de-risking behaviours within the regulated sector, but more likely an issue in the financial services sector, where significant fines have been seen to drive de-risking behaviours within financial institutions.

3.88. In order to mitigate against this manifesting as an issue, the government may wish to look at administrative sanctions being defined in terms of a percentage of annual turnover/fee income. This would also address the challenge on variation of sanctions

which has frequently been highlighted, to create an environment whereby differences in level of sanction can be justified across the sector.

3.89. This may be challenging to achieve in the case of sole traders and partnerships where such information may not be accessible, so if government was minded to pursue this, then it would need to be supported by a statutory supervisory power to compel production of information.

Question 85: Should the government consider whether additional sanctions and measures should be made available to those set out in 13.4 and 13.5?

3.90. AAT would welcome the addition of the sanctions proposed to the suite of regulatory tools all supervisors should have access to. As is discussed above at paragraph 3.27.2, HMRC's default supervisory position, and inability to de-register firms significantly undermines the overall effectiveness of the AML regime.

4. About AAT

4.1. AAT is a professional accountancy body with approximately 50,000 full and fellow members and 80,000 student and affiliate members worldwide. Of the full and fellow members, there are over 4,200 licensed accountants who provide accountancy and taxation services to individuals, not-for-profit organisations and the full range of business types.

4.2. AAT is a registered charity whose objectives are to advance public education and promote the study of the practice, theory and techniques of accountancy and the prevention of crime and promotion of the sound administration of the law.

5. Further information

If you have any questions or would like to discuss any of the points in more detail then please contact Aleem Islan, AAT Technical Consultation Manager, at:

E-mail: consultation@aat.org.uk Telephone: 020 7397 3088

Association of Accounting Technicians
140 Aldersgate Street
London
EC1A 4HY