

# Sectoral Risk Assessment

## INTRODUCTION

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As an AML supervisor, CILEx Regulation is required to set out information on money laundering and terrorist financing risk that we consider is relevant to those we supervise.

We have identified and assessed the international and domestic risks of money laundering and terrorist financing to which you are subject. Alongside the National Risk Assessment, the information in this sectoral risk assessment is designed to assist our firms in carrying out their own money laundering and terrorist financing risk assessment. It reflects changes to the risks to which firms may be exposed based upon intelligence gathered from a variety of sources.

This assessment has been updated in March 2022 the light of the risks related to dealing with sanctioned persons or entities.

### Money Laundering

Money laundering is the generic term used to describe the process by which criminals disguise the original ownership and control of the proceeds of criminal conduct by making such proceeds appear to have derived from a legitimate source. The National Crime Agency (NCA) believes that serious and organised crime costs the UK £37 billion a year.

By helping to counter money laundering, we are all helping to reduce wider crime and create a safer society. Money laundering also includes money that is used to fund terrorism.

Every business in the scope of the money laundering regulations must be supervised by a supervisory authority and comply with all the requirements of the regulations.

The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (as amended) (“the money laundering regulations”) set the administrative requirements for the anti-money laundering regime within the regulated sector and outline the scope of customer due diligence. The regulations aim to limit the use of professional services for money laundering by requiring professionals to know their clients and monitor the use of their services by clients.

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## Our responsibilities

CILEx Regulation take our responsibilities very seriously to help implement a coherent and effective defence against intentional and inadvertent enablers of money laundering. This means both CILEx Regulation and our supervised firms focusing efforts where risks are highest. In that way we can best protect the integrity of the legal sector and the wider public.

We will work to build trust in the legal system, tackling professional enablers of money laundering, and helping to support our members and firms to raise standards and reduce money laundering. We want our firms to ensure that their clients and the legal system are protected and not just adopt a tick box approach to compliance with rules.

We will ask to see your firms' written risk assessment and policies, procedures and controls as part of our initial authorisation and routine supervision, but this must remain confidential and should not be disclosed to customers, or third parties.

In carrying out this sectoral risk assessment we are fulfilling our duties under Regulation 17 of The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (as amended) (the regulations). We draw upon the National Risk Assessment alongside other sources of intelligence to inform this assessment.

## Who do the regulations apply to?

The money laundering regulations place obligations on firms offering services that are most likely to be targeted by those wishing to launder money. These include independent legal professionals, tax advisers, and trust or company service providers.

You must consider whether the activities you carry out mean that you are subject to these regulations. For example, carrying out estate administrations', holding client money, providing tax advice or providing company formation services.

All firms, both regulated and unregulated, that are within scope of the money laundering regulations must take appropriate steps to identify, assess and maintain a written record of their risk of being used for money laundering or terrorist financing.

## Your own risk assessment

Where a firm falls within the scope of the Money Laundering Regulations, the regulations require that the firm must identify and assess the risks of money laundering and terrorist

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financing to which the business is subject. In carrying out the risk assessment this will help you understand the risks you face and means that you should be better prepared to counter them if your firm were to be targeted.

You must take into account:

- a) information made available to you by CILEx Regulation, including this risk assessment; and
- b) risk factors including factors relating to—
  - (i) your products and services
  - (ii) your consumers and clients
  - (iii) your transactions
  - (iv) your delivery channels; and
  - (v) the countries or geographic areas in which you operate

You must then create and maintain your own written risk assessment, as required by Regulation 18, which should be kept up to date reflecting changes in your clients, the services you offer and the risks that you may face. In deciding what actions are then necessary following the assessment, you should consider the size and nature of your business.

Ultimately by engaging fully you will be understanding the risks your firm may face, and how you can protect your firm and maintain your reputation.

## RISKS FACING THE LEGAL SECTOR

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### National Risk Assessment 2020

The UK Government periodically undertakes a National Risk Assessment pulling together risk-based information from all sectors in scope of the AML requirements, law enforcement and other sources.

The 2020 National Risk Assessment said: 'The risk of abuse of legal services for money laundering purposes remains high overall. Legal service providers (LSPs) offer a wide range of services and the services most at risk of exploitation by criminals and corrupt elites for money laundering purposes continue to be conveyancing, trust and company services and client accounts.'

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It further commented: 'The risk of these services being exploited by criminals increases when legal professionals fail to carry out their obligations under the MLRs or take a tick-box approach to compliance'.

Although legal services are rated high for money laundering, they are not judged to be attractive for terrorist financing, so the risk associated with the sector remains low.

The services at highest risk of exploitation remain trust and company formation, conveyancing and client account services.

However, they have highlighted that the following are now new areas of concern:

- sham litigation (i.e. fake lawsuits where the payment of damages through the courts allows money to be laundered);
- cryptocurrencies where the original ownership is hard to identify;
- crowdfunding which can make the source of funds extremely difficult to establish.

## Emerging Risks

### **Russia and sanctions (Updated March 2022)**

In response to the Russian invasion of Ukraine on 24 February 2022, the UK has implemented swiftly changing sanctions against a growing list of designated persons and entities. Firms are expected to carry out checks against the latest sanctions lists and identify any potential or actual breach of financial sanctions to OFSI

We would expect to see a firm's appetite to engage with work on behalf of designated persons or entities reflected in their own policies and risk assessment. Where a firm is considering offering legal services it will need to apply for a licence from OFSI. We would expect firms to consider very carefully the reputational implications of carrying out this work and to notify us if they do make an application.

As there may be efforts to access frozen assets, firms should check the beneficial ownership of all clients and be wary of agents acting on behalf of third parties.

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## Covid-19

The Covid-19 pandemic presented huge challenges as criminals recognised that they were able to exploit some firms, where the tolerance to risk changed because of financial pressures. In addition, the trend for firms not meeting clients face to face grew, bringing its own risks for effective identification of clients.

Having robust policies, controls and procedures (including the assessment of the risks your firm faces) will assist you in protecting you from criminals.

The use of effective electronic identification and verification tools may assist in meeting client expectations to deliver remote identification checks. With potentially a wider range of verification being provided, they may help raise the standard of the checks you are carrying out. However, the ultimate responsibility remains with you and your firm.

The Financial Action Task Force (FATF) has produced a booklet on using these services, [Guidance on Digital ID](#)

## Technology

The increased use of technology will mean opportunities for criminals to exploit any weaknesses in their design or application. For any new technology you use, you should assess the risks that they may introduce and understand effective mitigation of these risks where possible (e.g. two level passwords, firewalls etc).

We are all seeing the importance of cyber security in protecting our data and systems, so preventing cyber security breaches will help combat criminal activity. Preventing cyber-crime should be a feature of your firm's routine programme of training.

## Risks identified from our supervisory activities

In common with the other AML supervisory bodies CILEx Regulation is required to identify and monitor risks in the sector that it supervises. It does this through its own research of the market, but also through its contact of the firm's that it regulates, both in terms of annual Return assessment information and from direct contact with firms.

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This has highlighted a number of risks which are broadly consistent with those identified by other supervisory bodies. It is important that we share this information with the firms that we supervise so that they too can recognise risk. And whilst some of these risks are relatively obvious there may be others that are less so to some.

Our analysis of the risks that the firms we regulate face, breakdown in to two key areas, external and operational:

## 1. External factors

### Funds from overseas

We are aware of the continued desire of overseas individuals and companies to invest in businesses and property in the United Kingdom. And whilst this can be legitimate and therefore welcomed, firms need to remain vigilant to the exact source of the money.

It is imperative that firms remain aware of the current list of high-risk third countries and apply enhanced customer due diligence where appropriate.

And even where the country is not on the high-risk list such as in the case of Russia and China, firms need to be very careful to ensure they are not dealing with politically exposed persons and can verify that the source of the funding is legitimate.

### Funds from within the UK

Whilst some types of acquisitive crime may have reduced during the lockdown as people were forced to stay at home, both cyber-crime and other types of fraud remain a significant problem. Some criminals even used the pandemic itself to perpetrate new methods for committing fraud. As such firms need to remain vigilant to unusual payments, particularly large sums of cash, and not relax the restrictions they have in their AML policies for handling such payments.

Suggestions from clients that they did not want to bank money because it would mean having to visit a bank should be challenged. And equally the reason they are holding larger sums of cash explored.

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There are also reports of a significant number of incidents of businesses falsely claiming grants, bounce back loans and other forms of support during the lockdown, or falsifying records to obtain more funds. As a result, there will be individuals seeking to move and hide this money. This puts conveyancing firms at a significant risk as fraudsters seek to move money into property. Remember money fraudulently obtained will be criminal money.

Above all firm's need to be vigilant in carrying out their risk assessments of clients, particularly in respect of the source of the funds and ensure that the written record is supported by evidence of the appropriate checks.

## 2. Operational Factors

### **Diversification into new areas**

The Coronavirus pandemic and the restrictions it has placed on the nation have also restricted some areas of work. As a result, some of the firms that we regulate have looked to innovate and move into the provision of new services or other areas of law.

Whilst we recognise that not all areas of law are reserved legal activities, regulated firms are required to let CILEx Regulation know if they are seeking to provide new services through their firm, so we can effectively monitor risk. An example of this was a firm seeking to offer pre-paid funeral plans, and here we were able to advise them that this would become regulated work in 2022 needing separate FCA regulation.

Whilst we would expect firms to only engage in areas of law for which their staff are suitably experienced and authorised, there is also a risk in taking on non-law related services particularly where staff are not familiar with their provision. Moving into such service provision, when not carefully planned, can distract staff from following routine procedures, with AML checks being no exception. Moreover, new providers of trust and company formation services, can be a target for money launderers.

Please ensure that you are not taking on risks that are not covered by your firm's professional indemnity insurance. Remember you are under a duty to notify them of any changes regarding the work of the firm.

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## New ways of working

The last year and the restrictions brought about by the Coronavirus have required virtually all firms to make changes to the way that they operate. Whether this be working with clients remotely rather than face to face or having staff working from home, so supervision of staff can be more challenging.

It has been pleasing to see the number of firms proactively drafting Coronavirus Response Policies, to ensure that the changes made to service delivery do not impact on the firm's compliance arrangements. But these response policies need to be reflected in firm's other policies, or implementation will be ineffective.

Again, it is important to ensure that these new ways of working do not compromise the customer due diligence checks, with the inherent risk that would have to the firm's money laundering prevention arrangements.

Be very careful to ensure that the new arrangements do not adversely impact the service that is being provided to clients. We are very aware that claims on a firm's professional indemnity insurance can make it very difficult in the current market for firms come renewal time.

## Reduced staffing

The pandemic saw reduced workloads for most firms and whilst that position has now changed for many it did result in several of the firms, we regulate furloughing staff.

Whilst furloughing staff was quite unavoidable for some firms, the number of staff furloughed needs to be carefully balanced against workloads to ensure compliance arrangements are not compromised. Staff must be brought back onstream promptly when workloads require it.

What has been noticeable in the last year, is that due in part to reduced staffing and possibly remote working, the review of policies by firms has been delayed. It is vitally important that firms take steps where need to ensure such reviews are put in place as soon as practicable. When we resume inspection visits, we will be looking to ensure that compliance and risk registers are up to date.

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### **Delayed Policy review and implementation**

This point was raised in the section on ‘Reduced staffing’, but it is very important and therefore, deserves its own section.

The country’s transition out of the European Union has resulted in range of changes to legislation. This along with significant modifications to the ways in which firms are now operating will in most cases have necessitated alterations to a firm’s policies and procedures.

So, whilst it was good to see firms had brought in standalone Coronavirus Response Policies, these were not always acknowledged by changes in the firm’s main policies, such as the Case Management Policy, or even other documents such as client care letters.

Firms need to ensure policies and their supporting documentation are kept up to date and are consistent. Failure to do so can result in staff not taking the necessary action when it comes to dealing with a client.

### **Training**

It is vitally important that staff have regular training and no more so, than on anti-money laundering. Checks on the CPD records for CILEx members who are associated with the firms that we regulate showed little specific AML training during 2020.

This may well have been due to remote working or even staff being furloughed, but it does present a risk. Training even if it is just refresher training is vital if staff are to remain aware and vigilant to AML related risks. So, failure to carry out regular refresher training is a risk.

### **Future updates and further support**

CILEx Regulation will continue to update this sectoral risk assessment with new information from government, law enforcement and our own regulatory regime. Any changes should prompt a review of your own written risk assessment, which should be carried out at least annually to reflect any changes in your firm and the work it carries out.

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CILEx Regulation publishes further information on preventing money laundering and terrorist financing [here](#)

## RISK FACTORS

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In looking at these risk factors, we are considering the inherent level of risk before any mitigation that you put in place. These are the ones we consider to be significant for our firms and your firm's risk assessment will need to address these.

By being present they do not mean that you should withdraw from a particular area of work or service or client; however, you must address the risk and demonstrate that you are complying with the requirements of the regulations to prevent any money laundering taking place.

Clearly there can be a single risk, or a combination of risks, that can impact on your assessment of a client or transaction.

### 1. PRODUCT AND SERVICES RISK

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Criminals will look at the services that you offer to assess whether you may be targeted for money laundering. The 2020 National Risk Assessment identified the following products and services as posing the highest risk of being used for money laundering:

#### **Trust and company formation**

The creation of trusts and companies on behalf of clients is assessed to be the legal service at greatest risk of exploitation.

Law enforcement investigations often highlight trusts and companies being used to:

- hide beneficial ownership through complex structures;
- undermine due diligence checks; and
- frustrate law enforcement investigations.

#### **Conveyancing**

Property provides the opportunity to launder large amounts of money in a single transaction, as well as often being a store of growing value.

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Often overseas companies linked to the proceeds of crime are involved in property purchases.

Overseas property investment has moved into smaller cities and towns, so the potential risk is continuing to spread.

### Client accounts

Accessing a client account can make funds appear to have a genuine source for criminals and may not attract the attention of law enforcement agencies.

A client account must never be used:

- as a banking facility; or
- to pass funds through it without a legitimate underlying legal transaction.

Firms should be aware of any attempt:

- to pay funds into a client account without a genuine reason;
- to get a refund of funds from a client account (particularly to a different account from which the original funds were paid);
- to access your client account bank details; or
- to access the client account prior to client due diligence being completed.

It is a good idea not to disclose details of your client account (for example by including them in engagement letters) except when required.

### Tax Advice

The national risk assessment addresses tax advice directly: 'The provision of tax advice and acting as an agent with HMRC on behalf of clients provides several means to launder money and poses a high risk.'

By offering tax advice there is a higher risk of encountering the proceeds of crime – if a client is seeking to evade or avoid tax.

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## 2. CONSUMER AND CLIENT RISK

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Whilst smaller practices often have a deep knowledge of their clients, long-standing relationships, and/or a primarily local focus, this may mean they sometimes do not document risks faced by their practice.

Each client should be considered separately, as each will have their own individual risk-profile. Remember to consider the risk posed by the beneficial owner, so make sure you know who you are dealing with.

General client risks can include:

- Pressuring you into a certain course of action.
- Engaging you for low-risk work, and then swapping to higher risk work to bypass more detailed checks.
- Clients onboarded in another firm which has since merged with your own.
- Clients onboarded by a third party, intermediary or agent.

Having effective ongoing monitoring of all clients is the best way to mitigate these risks.

### **Sanctioned Persons (Updated March 2022)**

Separate from Politically Exposed Persons are those designated persons and entities subject to sanctions by the Government. Details can be found on the [OFSI website](#).

Firms can only carry out paid work for them under licence, so there is the risk that a designated person may indirectly approach a firm or use an agent to conceal ultimate beneficial ownership. The risk is raised when they are seeking to access frozen assets. More information can be found at [Financial Sanctions](#).

### **Concealing identity**

For some clients, there may be good reasons why they cannot produce identification documents, for example elderly people or illegal immigrants.

But for money launderers the warning signs may include:

- seeking anonymity on behalf of themselves, a third party or beneficial owner;

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- being evasive about proving their identity;
- producing non-standard documentation; or
- acting outside their usual pattern of transactions.

The risk posed by your client also extends to the risk posed by the beneficial owner, if applicable.

### **Politically exposed persons (PEPs)**

The money laundering regulations require:

- a firm to be able to clearly identify a PEP; and
- for firms to undertake enhanced due diligence on them.

The definition of PEPs includes individuals from the UK or abroad, as well as their family members and associates. You always should consider whether an existing client now meets the definition of a PEP.

PEPs will often have access to public funds or significant public influence, so extra checks to mitigate the risks of corruption are required.

### **Cash-intensive or high-risk sectors**

Those that present a greater risk to you may include those:

- handling large volumes of cash (take-aways and nail salons);
- linked to a higher risk of corruption or being used for money laundering i.e. arms trade or casinos.

You should have a policy on what amount of cash, if any, you will accept, and in what circumstances.

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### Friends and family and close contact clients

You should make sure that these types of clients are subject to the same level of checks as any other client. There will be an expectation to see the same risk assessments and due diligence on file for these types of clients.

Employees can be able to avoid controls and checks for themselves or for their associates, thus putting the firm in risk.

### 3. TRANSACTION RISK

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Identifying the risks involved in a transaction is helped by being alert for unusual activity or requests that don't make commercial sense.

Understanding the source of funds and the source of wealth will help you to manage the risk from a transaction. For the avoidance of doubt, for a source of funds check you should be checking where the customer got the funds from, not just ensuring the funds came from a bank account at a regulated UK financial institution.

### Size and value of the transaction

Criminals will want to see how much money they can launder. Sometimes a small seemingly innocent transaction can be followed by a much larger or high-value one.

You should be investigating:

- unusually large transactions;
- those that are not consistent with your client (i.e. suddenly buying a high value property when previously only associated with low value properties); or
- why a client is seeking to make several linked transactions, as this may present a higher risk.

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### Payment type

Whilst there may be legitimate reasons for a client's choice, anonymity and money laundering can be made easier by using:

- cash as it may not have passed through the banking system and is often untraceable; or
- cryptocurrencies as the origin of funding is likely to be obscured.

You should have a policy on what amount of cash, if any, you will accept, and in what circumstances.

### New products or technologies

Criminals are always seeking new ways to launder funds as old ways become too risky and loopholes are closed. They may also seek out firms unexperienced in new areas.

Think about new or previously identified risks if your firm:

- moves into a new business area;
- provides a new delivery channel for services;
- starts a brand-new pattern of transactions; or
- is using a new innovative technology.

You should risk assess any such new products, delivery mechanisms or technologies before using them.

### Complex transactions or products that facilitate anonymity

Increased simplicity and transparency reduce the risk of money laundering, so criminals can use complexity as a way of obscuring the source of funds or their ownership.

Make sure that:

- you do not proceed with a transaction until you fully understand the purpose and nature of the transaction you are being asked to undertake;

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- you make further enquiries or seek expertise if unsure;
- the complexity of a transaction or corporate structure is not hiding the beneficial owners.

By having accurate and up-to-date information on beneficial owners can be a key factor in preventing financial crime and tracing criminals who try to hide their identity behind corporate structures.

### Transactions that do not fit with your firm or client's normal pattern

Consider the risks of being asked for:

- transactions or services that you don't offer;
- an unconnected transaction or service for no reason;
- a service out of line with the original customer due diligence; or
- a service out of the normal pattern of transactions, without a good reason.

When doing your initial client due diligence consider what services your client might want in the future.

## 4. DELIVERY CHANNEL RISK

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The way that services are delivered can increase or reduce risk to the firm. Whilst complexity can increase risk, by maintaining strong transparency can help to reduce risk.

Newly qualified members may lack understanding and experience, and may not identify higher risk situations, though in some instances this risk is managed when members are required to undertake substantial training and work experience prior to providing services.

### Remote clients

Whilst your firm might be delivering services countrywide, you need to be mindful of the increased risk of identity fraud through not meeting a client face-to-face and how you may mitigate these risks through robust identity verification.

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Consider:

- Sometimes not meeting a client face-to-face may make sense as we have seen during the Covid-19 pandemic, so then adopting other ways to identify that client protects you and your firm.
- Clients who are not keen on meeting in person might be a cause for concern and you need to recognise this increases the risk of identity fraud.

### Combining services

You should always remain alert to:

- how a client is making use of the services that your firm offers;
- whether what appear unconnected services are being used to conceal a transaction that is risky;
- a company formed for one purpose some time ago is now being used with you for another;
- separate firms being used for various parts of what appears a connected transaction.

### Payments to or from third parties

The involvement of third parties in a transaction is often a reason for suspicion.

Consider:

- Why a third party or associate is required in a transaction.
- Whether they disguise where funds and assets are coming from or going to.
- Unexpected transactions including payments in error.
- By returning the funds without query, this can effectively launder criminal money.
- Why you are being required to make any third-party payment, rather than the client.
- Litigation settlements out to a client are in scope.

You should always make sure you identify the source of funds and source of wealth. Consider how far back you should go on identifying sources to be certain of where the money comes from.

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## 5. GEOGRAPHICAL RISK

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You should consider the geographical risk at all stages of a transaction:

- which services are required;
- where the client is based;
- the jurisdiction in which services will be delivered;
- where the beneficial owners are based; and
- the source and destination of funds.

For those working primarily with local clients, consider the reasons for distant clients deciding to make use of your services.

### Dealing with overseas jurisdictions

Countries with anti-money laundering and counter-terrorist financing regimes which are equivalent to the UK may be considered lower risk, but you should always remain alert.

However, for some overseas jurisdictions, the risks of money laundering are more common and therefore a higher risk, for example locations where the production of drugs, drugs trafficking, terrorism, corruption, people trafficking or illegal arms dealing more commonly occur.

Firms are required to have in place enhanced due diligence measures in dealing with countries that have not implemented FATF recommendations or have significant levels of corruption or other criminal activity, such as terrorism.

A list of high-risk jurisdictions is available [here](#)

Transparency International produces an annual corruption index available [here](#)

### Countries that do not have equivalent AML standards to the UK

In 2020, it became [a regulatory requirement](#) for clients or counterparties based in the countries on the European Commission's list of high-risk third countries, to be subject to a specified form of enhanced due diligence. The EU Commission list is to be replaced by UK recognition of the FATF [grey](#)' and [black](#)' lists for this purpose.

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However, these lists are not an exhaustive list of all high-risk countries, and other higher risk jurisdictions are listed by sources such as the [Basel Institute of Governance](#). You may also find other sources helpful, such as [Know Your Country](#).

If you have any doubts about a country's status, you should consider treating it as higher risk and carry out enhanced due diligence.

### **Sanctions (updated March 2022)**

The Russian invasion of Ukraine has brought the understanding of sanctions and how to comply with them under greater focus. The Office of Financial Sanctions Implementation maintains a list of all those [countries subject to financial sanctions](#). You can subscribe to an email alerting you to any changes.

Enhanced due diligence measures are required when dealing with countries subject to sanctions, embargos or similar measures. Licences are required from OFSI to provide paid for legal services and we would expect to be notified of any application for one. Firms need to consider the reputational impact of any involvement with a sanctioned person or entity and whether they have the necessary controls and processes to work under a licence.

We are required to collect information on sanctions breaches, so care must be exercised in dealing with overseas countries and individuals.

There is also the risk that a sanctioned person or firm will seek to employ an agent to act on their behalf in a transaction and conceal the true ownership of an asset.

### **Local restrictions on moving money**

For some clients, their country may have significant restrictions on its citizens investing or moving capital abroad, for example China. This has led to some people to use alternative shadow banking networks to move wealth out of a country.

You should recognise that these networks will have a dual purpose of:

- cleaning illicit funds for criminals; and
- facilitating people to sidestep local capital controls.

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The funds that pass through these networks therefore will generally be the proceeds of crime, even if the client is not themselves a criminal. So your source of funds checks are very important where there is a risk that money has passed through one of these networks.

The NCA has provided an explanation on how [Chinese Underground Banking](#) operates.

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