Solicitors Regulation Authority

SRA response

Economic Crime Levy Consultation

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Introduction

1. The Solicitors Regulation Authority (SRA) is the regulator of solicitors and law firms in England and Wales. We work to protect members of the public and support the rule of law and the administration of justice. We do this by overseeing all education and training requirements necessary to practise as a solicitor, licensing individuals and firms to practise, setting the standards of the profession and regulating and enforcing compliance against these standards. We are the largest regulator of legal services in England and Wales, covering around 80% of the regulated market. We oversee some 202,000 solicitors and more than 10,100 law firms (correct as of June 2020).
2. The Law Society of England and Wales is the named supervisor for relevant persons who are regulated by it in Schedule 1 of The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations (as amended) ('the regulations'). The SRA was established as an independent board of The Law Society of England and Wales to discharge its regulatory functions. The SRA exercises the Law Society's supervisory role under the money laundering regulations.
3. We are the largest legal sector Anti- Money Laundering (AML) supervisor and we have a population of 24,730 (as of June 2020) beneficial owners, officers and managers (BOOMs) that we supervise. They are spread across the 6,593 firms that have declared themselves to be in scope of the regulations. The firms we supervise for AML are a subset of our regulated population, who we authorise for the provision of legal services under our Authorisation of Firms Rules [https://upgrade.sra.org.uk/solicitors/standards-regulations/authorisation-firms-rules/] . We take a risk-based approach to our AML supervision, mixing in-depth examinations of firms' compliance (generally done on site but currently remotely due to Covid-19), with thematic reviews and desk-based reviews of risk assessments, policies, controls and procedures.

Executive Summary

4. We welcome the opportunity to respond to the Economic Crime Levy consultation. We also welcome the improvements that government is proposing to make to the UK's AML and Counter Terrorist Financing (CTF) infrastructure and resourcing. To effectively address

AML risk requires applying a greater proportion of resources where the risks are highest and this approach is embedded at the highest levels of AML work, including by the Financial Action Task Force. As a professional body supervisor, we support work to detect and prevent money laundering in line with this and believe that this proportionality needs to be embedded in the overall approach to AML.

5. We believe that a single agency collection model is preferable as it will be the most efficient overall. Collecting the levy will require significant investment in processes, systems and communications for the collector, as well as an annual cost to run each collection exercise. A supervisor-led model would mean that 25 AML supervisors would incur the cost of collecting the levy, which will be passed onto the regulated sector and ultimately consumers, whereas a single agency collector would be much more efficient as only one organisation would incur these costs. A single agency may achieve efficiencies through economies of scale and will be able to take a consistent approach to collection and enforcement.
6. We agree that the levy should be charged on a risk-based approach, where firms undertaking work with the highest risk of being used by money launderers should pay more than lower risk firms. At present however, we believe there is currently no accurate way to measure firms' risk that could be used to calculate the levy. Charging on the basis of Suspicious Activity Reports (SARs) would be particularly problematic as it could encourage firms to submit fewer reports to reduce their levy liability. We view charging on the basis of turnover or revenue, ideally only of activity that is in scope, to be the best available option at this point in time. In the future, government and supervisors should work towards a levy payment which takes into account risk, using a metric that is objective, comparable across all regulated sectors and does not incentivise undesirable behaviour.
7. A number of factors contribute to a firm’s risk profile, for example its work area, the location and type of its clients and how well the firm mitigates its risk. Any of these risk factors can apply to smaller firms, and in addition small firms may have fewer resources for compliance control systems to mitigate their risk. Criminals may specifically target small firms because of this perceived lack of systems to prevent them from being exploited by money launderers. For these reasons it would be contrary to a risk-based approach to exempt small firms from contributing to the levy, and could result in larger firms paying disproportionately higher fees.
8. Finally, as a general point, this levy will create additional costs for firms in scope of the money laundering regulations. This creates a greater incentive for firms to seek to avoid becoming regulated and approved by an AML supervisor. We expect these incentives to be particularly strong with financially vulnerable firms, which may be at greatest risk of exploitation of would-be money launderers. The higher the costs imposed for compliance, the greater the incentive will be for firms to seek to avoid it.

Response to consultation questions

Question 1: Do you agree with the design principles as set out above? Should the government consider any further criteria?

9. We agree with the listed design principles.

Question 2: What do you believe the levy should fund? Are there any other activities the levy should fund in its first five years?

10. While we generally agree with the funding priorities as set out, we are of the view that reform of Companies House should be funded by the fees that Companies House charge. Unlike other proposed areas of work, this project could readily be funded by its service users.

Question 3: Do you agree with the government's approach to publish a report on an annual basis? What do you think this report should cover other than how the levy has been spent?

11. We agree with the proposed frequency of the report and that it should set out how resources have been used. We would also suggest it should include reference to key metrics for tracking development of the UK's AML regime and it could also serve as the vehicle for publishing the levy rate for the coming year.

Question 4: What are your views on what the proposed levy review should consider and when it should take place?

12. We would advise caution on making long term commitments to an untested levy collection framework. In order for hidden issues to be able to be addressed in an appropriate timeframe, we believe a review after one year would be appropriate. After this initial review and the fixing of any issues it may identify, a longer timeframe before the next review may be appropriate.
13. Also see our response to Question 6.

Question 5: Do you agree with our proposal that revenue from UK business should form the basis of the levy calculation? Please explain your reasoning.

14. Given the absence of alternative and readily available factors that would reflect firm risk in an accurate and comparable way, we generally agree with the proposal for the use of UK revenue as the core metric for calculating the levy. However, basing the levy only on revenue will limit how proportionate it can be, as the revenue of a firm does not necessarily correlate to risk. Many of the largest firms will have the resources and expertise to more effectively

guard themselves against money laundering risk, whereas smaller firms may be more exposed and present an easier prospect for criminals seeking to abuse their services.

15. There is a risk in using UK revenue, that this may invite firms to restructure to offshore revenue to external jurisdictions. We would view this to be a low risk in our sector, given the regulatory, tax and practical implications of such restructuring.

Question 6: Are there any sectors that would be disproportionately impacted if revenue is used as a metric, or where revenue would be disproportionate to level of risk?

16. In principle we believe that government should seek to apply the same levy calculation formula across sectors, wherever possible, in order to ensure fairness and to maintain the design principles.
17. If deposit taking institutions do indeed need a modified form of revenue calculation due to their different business model, as is proposed in the consultation, any deviation from the standard approach should be completely transparent.

Question 7: Do you believe other levy bases would provide a better basis for the levy calculation? These could be the ones outlined in Table 4.A or those not considered in the consultation document.

18. We believe that UK revenue is the only viable metric currently available for calculating the levy (see our answer to question 5). We do not see the inclusion of any of the other factors as providing a benefit that would outweigh their inherent limitations, drawbacks or risks. No other factors exist to our knowledge that would be worth considering for this purpose.

Question 8: Should a fixed percentage or banded approach be taken to utilising revenue as a metric? Please explain your reasoning.

19. We believe a banded approach has greater advantages as it would provide a simpler and more predictable framework for calculating the levy. A possible disadvantage is that this approach could create an incentive for firms at the bottom of a band to keep their turnovers artificially low. Despite this we would see a banded approach as having more advantages, particularly as it will be more clearly explainable to those firms falling in scope.

Question 9: What are your views on the principle of exempting small businesses from paying the levy, and on the level of a potential threshold?

20. Small firms form a significant proportion of the firms we supervise. Due to their smaller size, and more limited resources they can be vulnerable to attempts to use their services to launder money and finance terrorism, not least because money launderers may target firms that they perceive to have less sophisticated controls. Firms may have a number of factors that contribute to their risk regardless of their size, for example clients from high risk jurisdictions, offering services in high risk areas or not meeting clients face-to-face will all increase risk. The risk that small firms pose should be reflected in their contribution to the economic crime levy. For these reasons we do not believe that small firms should be exempt from paying the levy.

Question 10: What are your views on having businesses below the threshold subject to a small flat fee?

21. The smaller firms in scope of the AML regulations are a diverse group and regardless of where a threshold may be set, firms falling below the threshold will have a range of different revenues. Instead, we think there should not be a threshold, and smaller firms should be appropriately banded. See our answer to Question 9.

Question 13: How do you think money laundering risk should be accounted for in the levy calculation?

22. While we agree with the idea of using risk as a means of calculating the levy, we believe there is currently no available option to do this where the possible benefits outweigh the drawbacks and risks.
23. The national risk assessment was not created with the intention of rating activities across supervised areas in a way that is comparable. It is also written with significant input from the regulated sector, so could allow sectors to unduly influence how certain risks are rated.
24. The risk ratings firms have with their supervisors are unsuitable for this for the following reasons:
    - There is not one consistent way of risk rating firms across supervisors, all take their own approach to estimating risk and to categorising the results
    - We keep these risk ratings private as we do not want firms to attempt to game our system of risk rating to avoid our supervisory oversight and potentially to avoid detection of criminal activity. Using these ratings for calculating the levy would effectively allow firms to deduce their risk ratings.
25. In the future, government and supervisors should work towards a levy payment which takes into account risk, using a metric that is objective, comparable across all regulated sectors and does not incentivise undesirable behaviour.

Question 14: Do you believe using number of SARs reported as a metric through a banded approach would be an appropriate means of achieving this objective? Please explain your reasoning.

26. We believe the use of SARs not only risks creating a financial disincentive to report suspicious activity, but also is not a good identifier of high-risk firms. Firms that submit more SARs may be doing so in part due to the effectiveness of their internal controls and systems, rather than due to being particularly risky. The fact that a firm has submitted zero SARs may suggest that they have ineffective controls or even that they are purposefully underestimating risks and not reporting suspicions they may have.
27. The banded approach to SARs suggested in the paper (charging a higher rate where firms exceed an average number of SARs per year for two years), while likely not to impact firms we supervise due to the high threshold proposed (10,000 per year), does not reflect firms' risks in our view, only the scale of their operations. We believe revenue is a more effective indicator of this.

Question 15: Do you believe there should be a periodic or annual process for setting the levy rate? If periodic, what would an appropriate period be?

28. We think the priority here should be clarity and certainty so far as possible, particularly around the principles against which the rate is set, for the sector and the levy collector(s) from year to year. If future areas of scope are added to the levy, either as new leviable sectors or funding focuses, this should be separately consulted upon.
29. However, at this time of economic change, we believe that the levy rate should be reviewed on an annual basis, so it can reflect as accurately as possible those factors that will be used to calculate the levy eg number of firms in scope. This will also allow for adjustments to the rate where there may be a belief that a future period may be significantly different to the last (eg due to market uncertainty.)

Question 16: Would you prefer to calculate the levy based on total revenue or revenue from AML-regulated activity only? Please explain why.

30. We believe that ideally it should apply to revenue from work in scope of the money laundering regulations, however, we see significant challenges to this. The most significant of these is that many firms will struggle to separate in-scope revenue from total revenue, and to do so may require costly adjustments of their

systems. We believe that government should examine this issue in more detail across the sectors.

Question 18: Which is your preferred option for defining revenue?

31. Generally speaking, if we were asked to collect the levy, we would prefer the use of the Companies Act definition as this is closer to what we require for calculation of fees already. As a result firms will have readier access to information under this definition.
32. We should highlight here however, that we only collect turnover information based on activity undertaken at offices in England and Wales, and our regulation of a given firm may overlap with other regulators where the firm provides services in other jurisdictions eg the Law Society of Scotland. This is an unavoidable complication of a supervisor-led collection model.

Question 19: Do you agree the levy should be based on UK revenue only? How easy would it be to split out your UK revenue from your total global revenue?

33. We would query how this UK revenue approach will be defined. Much money laundering and terrorist financing risk comes from clients based overseas, so if the definition of "UK revenue" was to exclude revenue from these clients, we would not agree with its use.
34. If this will mean that all revenue generated by offices and firms in the UK will be covered by the levy, then we would generally agree with this as it would track more closely with our approach (albeit we only calculate revenue from English and Welsh offices, see our answer to Question 18).

Question 21: Do you agree that the reference period for the levy calculation should be a business's accounting period? Please explain your reasoning.

35. We agree with this, as it will prevent the need for firms to recalculate their relevant revenue with reference to a different period.

Question 22: Do you agree that the levy should apply to activity carried out from the date from which the activity is regulated? Please explain your reasoning.

36. We believe that the levy should either apply for the first full year after the firm has registered as being in scope of the levy, or should be applied on a pro rata basis for the first year.
37. This will avoid incentivising registrations to come through at a certain time of the year, creating operational peaks which a levy

collection agency may struggle with.

Question 23: Do you believe levy liability should be calculated and invoiced at entity or group level? Please explain your reasoning.

38. Currently we handle fee liability at an entity level though we may provide some support information to firms including for example a breakdown of the fee liability of each entity in the group structure, so that this is clear for the firm(s). Should we be asked to collect the levy, we would prefer an approach consistent with our existing ways of working as much as possible.

Question 24: Do you agree limited partnerships should pay the levy at partnership level? Do you have any other views on how partnerships should be treated for the purposes of the economic crime levy?

39. We agree with treating limited partnerships as firms and this aligns with our approach.

Question 25: Do you think the agency should issue a notice to file or that businesses should be required to submit a return proactively? Please explain your reasoning.

40. We do not see a clear advantage for requiring the agency to issue a notice to file to all firms that may be in scope, before requiring firms to report their turnover proactively to the collection agent. This adds unnecessary administrative burden.

Question 26: Do you think all businesses should report their levy liability to the agency? If not, do you think small businesses should report a nil declaration or nothing at all?

41. Assuming there will be a threshold, we do not believe there is an advantage to requiring firms which will be outside of the scope of the levy to make a zero or under-threshold declaration, as this will create an extra administrative burden for these firms and for the collection agency. For context, we supervise approximately 6500 firms under the money laundering regulations and only a low single digit percentage of these are likely to be above a £10.2 million revenue threshold.

Question 27: Do you agree with the proposed approach for calculating the levy rate, invoicing, and payment of the levy? If not, please explain why.

42. We agree with the outlined approach.

Question 29: Do you agree that supervisors should be able to determine the frequency of reporting and payment, provided they transfer levy payments to the government a maximum of a year after the end of a business' accounting period?

43. We agree that supervisors should be able to determine the frequency of reporting and payment in a supervisor-led model, but we think this should be considered in the context of Question 30. Where a supervisor cannot collect the fees within a year, we do not think it is appropriate for the supervisor to pay on behalf of the supervised party and undertake civil action to recoup the funds. This could create a significant resource burden for supervisors, and without some clear mechanism to recover costs incurred for the collection of this levy, it will strongly disadvantage supervisors.

Question 30: What are your views on the supervisor carrying out compliance activity as set out above?

44. Supervisors cannot be assumed to have either the experience, resources or legal powers to undertake this action. While supervisors will generally have some kind of fee collection infrastructure, these processes may not be readily adapted to the collection of the levy. Effectively this undermines the "advantage" of using existing structures (listed in Table 6.B), as existing structures may not be easily adapted to this new purpose.
45. In order to be able to expect supervisors to effectively collect the levy, there will need to be a clear legal duty for supervisors to do so and legal enforcement tools to help them to successfully complete the task. We would need to set up new systems to implement these new powers.
46. Though we have powers to take disciplinary action against firms where they do not comply with our directions, it is a lengthy, case specific and time-consuming process. The administrative powers we have around collection of our practising fees, include our summary powers to revoke rights of practice on failure to pay, would not apply to collection of the levy. For a supervisor-led collection model to function, we would need bespoke powers, including potentially the power to remove firm's right to conduct activities in scope of the AML regulations.
47. One other point is that proposals in the paper around recovering of unpaid levy from firms as civil debt are a very challenging prospect. If supervisors were appointed to collect the levy, we believe recovery proceedings could best be handled by a single centralised body on behalf of supervisors.

Question 31: Which model do you prefer? Please explain why. Do you have suggestions for any other models that could be used?

48. We prefer the single agency model, as it prevents the duplication of effort across 25 different organisations and avoids the need for multiple organisations including ourselves to take on a new and untested duty (ie tax collection) with little understanding of whether our systems are suited to it eg disciplinary structures and rules.
49. In terms of the two advantages of the supervisor led model, as related in Table 6.B in the paper: The first is that it "could leverage existing structures." We would also argue that this "advantage" is as true of the single agency model in that a single agency could be appointed as an existing body eg HMRC. Also see our points in response to Question 30 relating to a lack of an effective power to enforce for non-payment.
50. The other suggested advantage is that "supervisors will have closer relationships with businesses allowing them to potentially better ensure compliance." While we do have a close relationship with our regulated sector, our powers are, as described in our answer to question 30, not designed to enforce compliance with collection of the levy. A single agency, with clear powers set out in statute, could be more effective in enforcing their decisions against law firms on the narrow basis of levy collection than we would, unless legislative change extended our powers.
51. A single agency model may retain some of the perceived advantages of a supervisor-led model. This can be done by allowing supervisors to report firm turnover and other supporting information to the single agency, facilitating a more straightforward and streamlined levy collection process.

Question 32: If you are a supervisor, what do you estimate your costs would be in each model?

52. For the single agency model, we would foresee our costs to be minimal. We would estimate about two days of staff resource per annum to extract information from our systems and engage with the single agency about the data.
53. For a supervisor led model, we cannot provide an accurate estimate of cost as there remain so many unknowns, but we can say it will be very significant. For us to take on this duty, we would need to draw on resource from across the organisation including:
    - Finance – to take payments
    - Business Intelligence – to draw out information on firms
    - AML Team – to co-ordinate and feed into communications
    - Communications – to undertake significant communication with affected firms and more widely
    - Enforcement – working to collect civil debt and pursuing regulatory action against non-compliant firms (see answer to question 30)
    - Legal – ensuring we go about our work in a way compliant with the legislation.

Question 33: How much did your organisation spend on countering fraud in 2019? What are these funds spent on, in high level terms?

54. We are active in ensuring those we supervise are not victims of, or unknowing facilitators of fraud. We have undertaken investigations into individuals and firms in their involvement in possible fraudulent activities, we have engaged in information sharing with law enforcement and other regulators and we have issued guidance to the profession about how to meet our expectations and protect their clients and themselves. We undertake these activities as a part of our wider regulatory work and do not draw on a specific budget for counter-fraud work.

Question 34: What additional financial contribution should the private sector contribute towards improving fraud outcomes?

55. We believe that fraud is a fundamentally different issue to money laundering and it should not be included in the scope of this levy (as set out in our response to Question 35).

Question 35: Which sectors do you think should be involved in countering the system-wide fraud risk? Please explain

56. Firstly, we welcome this potentially different approach to fraud as distinct from the approach to money laundering and similar financial crimes. Fraud is very different to money laundering, particularly when it comes to legal services. Solicitors are much less likely to create a passive fraud risk when compared to other in scope businesses (eg financial institutions) as legal practices do not provide account or banking services. They are prohibited by our accounts rules from holding client money without providing relevant legal services. For fraud, solicitors are as vulnerable as any other business, and while some firms are advanced multi-nationals, many more are small firms or sole practitioners.
57. Our involvement on fraud has generally focused on investment fraud. Solicitor's firms may be used, often unwittingly to add a veneer of respectability to dubious schemes and may help manage the flow of funds via their client account. We have been working on this issue over the past few years, making our expectations clear to the profession and enforcing our expectations where we identify problems. See here [https://upgrade.sra.org.uk/solicitors/guidance/investment-schemes-including-conveyancing/] our warning notice to firms addressing this issue.
58. Generally speaking, solicitors are more frequently victims of fraud than perpetrators of it. This is increasingly a concern with regards cybercrime. Ransomware and data breaches are a growing area of interest for us. But in these instances, our emphasis is on using

guidance to ensure firms act responsibly and are not endangering their practices or their clients.

59. For these reasons, compared with money laundering, fraud is a much lower risk than it is for other in scope sectors, particularly insurance and financial services. We would however be happy to be a part of the ongoing conversation and efforts to fight fraud across the regulated sectors, and would highlight that there should be an examination of whether those sectors in scope of AML regulation are the same as those that need to be involved in the conversation on fraud, and whether the net for fraud should be wider.

Question 36: What mechanism would you recommend in order to collect additional funding?

60. See our response to Question 34.
61. We would welcome an opportunity to explore any of the issues mentioned in this response in more detail.