

# The financial challenge to crime and terrorism

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# EXECUTIVE SUMMARY

The Government's first duty is to protect its citizens. It is determined to safeguard the security and prosperity of the UK from the threat of organised crime and terrorism. Organised crime causes social and economic harm estimated at £20 billion to communities in Britain each year. The UK - and British interests overseas - face an enduring terrorist menace that is historically unique in both its scale and international dimensions.

Finance is the lifeblood of these threats. Organised criminals, driven by profit, use the financial system to move money, and launder and disguise it in other types of assets. Terrorists move funds through the financial system to promote militant ideologies, train new members, pay operatives, acquire weapons, stage attacks and sometimes carry out ostensibly legitimate activities to provide a veil of legitimacy for essentially terrorist organisations.

In the same way that the financial system provides a mechanism for legitimate trade and investment, so it can be abused by organised criminals and terrorists for their own purposes. And just as globalisation has created new opportunities for legitimate business, so it has created potential new risks as criminals and terrorists can, for example, move funds internationally more easily – with an estimated £3 billion of criminal profits moved out of the UK annually. Moreover, the financial sector in the UK relies on its international reputation for integrity and fair-dealing but is itself a target for organised crime – including, for example, fraud.

However, as criminals and terrorists have come to rely on the financial system, so the financial system and the information within it now provides a new opportunity to tackle these threats. Like the use of fingerprints in the 19th century or DNA in the 20th century, financial information is now one of the most powerful investigative and intelligence tools available, the true potential of which is only now being fully understood. And the ability to deny access to the financial system to organised criminals and terrorists presents a new opportunity to weaken their networks.

For it to be successful, the financial challenge to crime and terrorism must involve law-makers, legitimate businesses in the financial sector and law enforcement agencies. Given that the financial system, organised crime and terrorism are global in their reach, so the financial challenge must also be global. Just as there must be no hiding place for criminals and terrorists, so there can be no hiding place for those who profit from organised crime or fund terrorist activities.

Based heavily on international standards and agreements therefore, the UK has a set of financial measures – from freezing assets of terror suspects to requirements to report suspicious flows of money – to:

- deter crime and terrorism;
- detect it when it happens; and
- disrupt those responsible and hold them to account for their actions.

Yet this challenge to organised criminals and terrorists using the financial system must also avoid imposing disproportionate costs on the rest of the economy and society. Our approach must therefore be:

- effective, and make maximum impact on the underlying threat;
- proportionate, so that the benefits of intervention outweigh the costs; and

- successful at engaging public and private sectors stakeholders, at home and abroad.

In addition to describing the changing nature of the criminal and terrorist threats to UK interests, this document sets out the Government's approach to these issues to date and proposes a set of future priorities. It describes important successes, such as:

- the four-fold increase in prosecutions for money-laundering since 2002;
- the strategic cooperation between business and the Government on issues such as guidance to tackle money-laundering;
- the recovery of a record £96.8 million from criminals in 2005-06;
- securing new agreements at international and EU levels; and
- the freezing of nearly 200 bank accounts linked to terrorist suspects.

The Government's proposals include:

- new steps to make financial tools a 'mainstream' part of the UK's approach to tackling crime and terrorism, including through new powers to increase their impact, a substantial increase in targets for criminal asset recovery, and steps to ensure that Companies House data is fully utilised by law enforcement agencies;
- developing further data-sharing between the public and private sectors, and pooling intelligence better between different public authorities;
- reinforced measures to tackle the abuse of money service businesses, including by replacing the current registration system with a licensing system, underpinned by a new action plan for the supervisor, HMRC;
- enhanced measures to safeguard the charitable sector from terrorist abuse, with additional funding of £1 million to ensure the Charity Commission has the resources it needs to identify and disrupt terrorist exploitation of charities and protect donor confidence;
- further steps to extend the risk-based approach, including through the creation of a new money laundering Supervisors' Forum and a commitment to ensure authoritative guidance is available in all regulated industries;
- reforms to reduce the burden of crime and security measures on business, including measures to simplify identification and due diligence checks within revised Money Laundering Regulations and a consultation on changes to the consent and tipping-off rules;
- further steps to promote the proactive use of asset freezing powers, including the creation of a dedicated Treasury Asset Freezing Unit that will increase the expertise and operational focus that the Government is able to bring to bear on asset freezing in response to advice from law enforcement and security agencies; and
- fresh action at the international level, including through the UK's Presidency of the Financial Action Task Force from July 2007, to identify and tackle the most serious financial threats to international security.

The progress and the future priorities and measures set out in this document represent the opening of a new front – a financial front – in meeting the Government's commitment to safeguarding the UK's prosperity and security for the future.

# INTRODUCTION

Britain's society and economy is one of the most open in the world. As the pace of globalisation has increased, the UK has capitalised on its historic position as a global hub of new ideas, innovative technology and international trade to rank as the fifth largest economy in the world.

In international finance, the City of London exports £19 billion of financial services more than it imports, supporting an industry that generates around 8.5 per cent of the UK economy and one million jobs. In business, of the 800 multinational headquarter relocations since 2002, 20 per cent were to the UK.

But the great opportunities of globalisation can be used to do harm as well as good. In recent decades, sophisticated criminal and terrorist networks have emerged to become every bit as entrepreneurial and international as modern businesses. These now pose a significant challenge to UK interests at home and abroad, threatening life, and our way of life.

The Government is committed to using all tools within its power to safeguard Britain's prosperity and security from these threats. As part of this commitment, it has worked with its partners to build an international framework of financial measures that now provides a critical bulwark against crime and terrorism.

This document sets out the strategic priorities necessary to tackle the evolving threat in a way that is proportionate in its public impact and that safeguards the UK's position as a secure and dynamic place to do business.

**1.1** This chapter sets the context for the Government's strategy for tackling money laundering and terrorist finance by describing the serious threat to UK interests from the criminal and terrorist networks involved and the need for a new front – a financial front - in the fight against them.

**1.2** Chapter 2 sets out the framework of anti-money laundering (AML) and counter-terrorist finance (CTF) measures and the milestones that these have achieved so far in reducing the harm from crime and terrorism. It sets out new data on the financial economy of crime and terrorism and highlights the practical way in which the financial tools developed in recent years are being deployed to save lives and hold perpetrators to account. In doing so, this document identifies real successes but also long term challenges for the future.

**1.3** Chapter 3 sets out the Government's strategic priorities that will meet these challenges and build on the accomplishments of recent years. It highlights areas of significant change and the key priorities for the future. These priorities provide all stakeholders – in the private sector, law enforcement; and Government – with a strategic framework to help maximise their contribution to the fight against crime and terrorism in the years ahead.

## The criminal threat

**1.4** The prosperity and security of all countries is put at risk by complex criminal and terrorist networks that are in some cases as entrepreneurial and international as modern business.

**The cost of organised crime** 1.5 The Government's 2004 White Paper, *One Step Ahead*, described international organised crime as 'reaching into every community, ruining lives, driving other crime and instilling fear'. As it does so, it leaves a severe economic and social cost in its wake. Ordinary citizens foot the bill for this. The economy suffers, and tax revenues are lost (and sometimes stolen) because illegal activity displaces legitimate enterprise. The taxpayer pays again for increased policing, for the costs to the health services, and from the costs of crime against business that are passed on to consumers.

**The social and economic harm of crime** 1.6 Home Office research has estimated that organised crime generates over £20 billion of social and economic harm in the UK each year. This represents not just the cost of prevention and insurance, but the cost of the impact of crime (such as theft or physical harm to victims) and the costs of the response, such as running the criminal justice system. This includes:

- illicit drug use, which carries with it costs associated with premature death; drug related crime; security expenditure; drug related violence; health and social care expenditure; criminal justice costs; and social security and sickness absence. Overall, Class A drug use generates harm amounting to £12.7 billion per year in its wake;
- human smuggling and trafficking, which takes place against a backdrop of fear and intimidation. The mental and physical harm associated with people smuggling, combined with its impact on the immigration service, costs the UK some £2.1 billion per year;
- excise smuggling, which causes harm to the UK costing £3 billion each year, not only in terms of lost tax revenue but by the lost profit due to UK business from an illegal market and the law enforcement costs of stopping it; and
- bogus VAT claims (so called 'missing trader' fraud), that were estimated to amount up to £1.9 billion in 2005.

1.7 Broader new estimates of fraud are shortly to be published identifying a total of over £6 billion fraud against the private sector. Work is underway to assess the proportion of this that might be attributable to organised crime and the total underlying costs.

## Today's terrorist threat

1.8 Separate from acquisitive crime, international terrorism has developed in recent years to seriously threaten security at home and abroad.

1.9 Since 9/11, there have been further significant attacks in predominantly Muslim countries such as Pakistan, Tunisia, Morocco, Qatar, Jordan, Egypt, Saudi Arabia, Yemen and Indonesia (including the bombing of a nightclub in Bali in October 2002, in which over 190 people were killed, including 28 British citizens) and Turkey. There have also been significant attacks in India and in Europe, including multiple attacks on the Madrid train network in March 2004 and attacks in the United Kingdom in July 2005, when synchronised explosions on the Underground network and a bus in London killed 52 innocent people and injured over 700 others.

1.10 Terrorism is not a new phenomenon. For example, the UK experienced repeated domestic terrorist attacks as a result of the long-running troubles in Northern Ireland. Nevertheless, many countries now face a severe terrorist threat that is:

- genuinely international, with perpetrators making maximum use of the freedoms and possibilities of modern life – especially the ease of travel and the ease with which information and money flows across the world;
- derived from a mixture of groups, networks and individuals. These range from larger groups organised around clear hierarchic and bureaucratic structures, to much looser and smaller groups of like-minded individuals. These different elements often cooperate and assist each other, but often also pursue separate goals; and
- indiscriminate in seeking to cause mass casualties, regardless of the age, nationality, or religion of victims.

#### **Box 1.1: International terrorism and the UK**

The UK is a prominent target for international terrorist groups. There have been bomb and gun attacks on British citizens and interests in a number of countries over the last few years, as well as targets in the UK itself:

- November 2003 – Al-Qaida attacked the British Consulate and HSBC building in Istanbul, killing 27 people including three British citizens;
- September 2004 - A British national residing in Saudi Arabia was killed in a Riyadh shopping centre by Al-Qaida gunmen;
- October 2004 - British engineer Kenneth Bigley was murdered in Iraq by the Al-Qaida in Iraq group;
- March 2005 - A British teacher was killed in a car bomb explosion in Doha, Qatar; and
- July 2005 - four suicide bombers attacked the London transport system, killing themselves and 52 other passengers. A subsequent attempted attack failed, with no casualties caused.

British and foreign nationals linked to or sympathetic with Al-Qaida are known to be present within the UK. They are supporting the activities of terrorist groups in a range of way:

- providing resources for terrorist networks engaged in conflicts overseas;
- fund-raising for terrorist networks overseas and in the UK;
- acquiring and disseminating false documents for use by terrorists in the UK and overseas; and
- facilitating training in the UK and overseas in extremist ideology and terrorist techniques.

In some cases they have also been engaged in directly planning, or attempting to carry out, terrorist attack. Some of the terrorists have received military and specialist terrorist training in camps overseas. Relationships forged in these training camps have formed the basis of loose networks of terrorists who can operate outside structured organisation.

## CHALLENGING CRIMINAL AND TERRORIST THREATS

The Government's first duty is to protect its citizens and it will use all tools at its disposal to do so. As criminals and terrorists have come to rely on the financial system, so in turn the financial system itself, and the information within it, now provides a new opportunity to tackle these threats. So in meeting its duty, the Government has worked with its international partners to use financial measures in new ways that help deter crime and terrorism in the first place, detect it when it happens and disrupt those responsible.

**1.11** The extent of links between terrorism and organised crime varies from country to country. In general they are distinct phenomena with differing drivers. But together they pose a serious and immediate threat to the UK and other open societies. Both criminal and terrorist threats also share important common characteristics – in particular, a requirement to utilise and disguise money flows. Formulating a coordinated response to this common characteristic enables both phenomena to be tackled simultaneously using similar means.

### The criminal economy

**1.12** Money provides both the basic motivation and the opportunity for acquisitive criminals. The Government believes that the most serious forms of organised crime alone generate:

- an illicit turnover of some £15 billion per year;
- money laundering through the regulated sector of about £10 billion per year; and
- criminal 'capital formation' – that is, assets invested in a possible seizable form of about £5 billion, £3 billion of which is exported overseas. This fact emphasises that organised criminal networks involved resemble modern business enterprises in their sophistication and international reach.

### The significance of terrorist finance

**1.13** In relation to terrorism, while individual attacks can yield great damage at low financial cost, a significant financial infrastructure is required to sustain international terrorist networks and promote their goals. Funds are required to promote a militant ideology, pay operatives and their families, arrange for travel, train new members, forge documents, pay bribes, acquire weapons, and stage attacks. Often, a variety of higher-cost services, including propaganda and ostensibly legitimate 'social' activities are needed to provide a veil of legitimacy for organisations that promote their objectives through terrorism.

**1.14** For example, according to the United States Commission into 9/11, Al-Qaida was assessed to have spent some \$30 million per year prior to 9/11 on funding operations, maintaining its training and military apparatus, contributing to the Taliban and their high-level officials, and sporadically contributing to related terrorist organizations<sup>1</sup>.

<sup>1</sup> [http://www.9-11commission.gov/staff\\_statements/911\\_TerrFin\\_Monograph.pdf](http://www.9-11commission.gov/staff_statements/911_TerrFin_Monograph.pdf)

**1.15** In recent years Al-Qaida and the groups that they have inspired have attacked over 25 countries and killed thousands of people. The financing of this activity is equally international with funds very often being raised in one country, used for training in a second, for procurement in a third and for terrorist acts in a fourth - and the outcomes broadcast in propaganda across the world. The Government's strategy in tackling international terrorism therefore reflects the international nature of today's threat.

## The Government's objectives

The Government's over-riding goal is to protect its citizens and reduce the harm caused by crime and terrorism. Whilst finance is the lifeblood of criminal and terrorist networks, it is also one of their greatest vulnerabilities. The Government's objectives are to use financial measures to:

- **deter** crime and terrorism in the first place - by increasing the risk and lowering the reward faced by perpetrators;
- **detect** the criminal or terrorist abuse of the financial system; and
- **disrupt** criminal and terrorist activity – to save lives and hold the guilty to account.

In order to deliver these objectives successfully, action in this area must be underpinned by the three key organising principles that were first set out in the 2004 Anti-Money Laundering Strategy<sup>2</sup>:

- **effectiveness** – making maximum impact on the criminal and terrorist threat;
- **proportionality** - so that the benefits of intervention are justified and that they outweigh the costs; and
- **engagement** - so that all stakeholders in government and the private sector, at home and abroad, work collaboratively in partnership.

## Objective 1: Deter

**Preventing crime and terrorism** **1.16** Financial measures deter crime and terrorism by increasing the risk to perpetrators of being caught and decreasing the reward they might expect to gain. For example:

- asset-recovery powers strip criminals and terrorists of funds and property so that they jeopardise not just their liberty but their financial lifeline as well. Recovered funds are *turned against* the criminal – by being used to fund further action against money laundering and by compensating victims;
- specific legal penalties exist to punish those who handle illicit funds. This opens up new avenues for prosecution and targets the wider facilitation networks that make crime and terrorism possible;
- “know your customer checks” and record keeping requirements on firms in key areas make it harder for perpetrators to disguise the financial audit trails they leave behind; and

<sup>2</sup> Anti Money Laundering Strategy, 2004, HM Treasury, Home Office, FCO.

- firms that act as a gateway to the financial system (such as accountants, lawyers or banks) are required to stay vigilant against signs of suspicious financial activity and report these to the Serious Organised Crime Agency's Financial Intelligence Unit for assessment – further increasing the likelihood of detection.

**1.17** Taken together, these measures and many others like them create a hostile environment for criminals and terrorists and limit the funds available to them.

## Objective 2: Detect

**1.18** Like the use of fingerprints in the 19th century, or DNA analysis in the 20th, financial information has come to be one of the most powerful investigative and intelligence tools available. As money moves through the financial system, it leaves a verifiable trail that can indicate illicit activity, identify those responsible, and locate the proceeds of criminality that can then be recovered. As financial institutions and other firms have taken steps to 'know their customer' and keep records, the importance of financial investigation has increased dramatically in recent years.

### The value of financial investigation

**1.19** Financial information is now routinely used as part of the evidential case to hold criminals and terrorists to account. It also has a key intelligence role - for example by allowing law enforcement to:

- **look backwards**, by piecing together how a criminal or terrorist conspiracy was developed and the timelines involved;
- **look sideways**, by identifying or confirming associations between individuals and activities linked to conspiracies, even if overseas – often opening up new avenues for enquiry; and
- **look forward**, by identifying the warning signs of criminal or terrorist activity in preparation.

**1.20** Financial intelligence is particularly suited to these tasks in that it is relatively unambiguous, can be processed easily by computing technology, has low perishability and can be accessed easily with little intrusion on the provider.

**1.21** Criminals and terrorist networks can go to great lengths to disguise their financial audit trails. Key sections of the private sector are therefore required to watch out for, and report, the warning signs of suspicious financial activity. As shown in chapter 2, these reports are a critical aid to law enforcement efforts to combat specific cases of crime and terrorism as well as build up the general intelligence picture of the criminal economy.

## Objective 3: Disrupt

### Thwarting crime and terrorism

**1.22** Financial measures decrease the rewards and increase the risks faced by criminals and terrorists. Money laundering and terrorist finance measures create new avenues for prosecution and investigation and introduce powers to deprive criminals and terrorists of their assets.

**1.23** The disruptive impact of measures against illicit funds is wide ranging and can frustrate criminals' and terrorists' ability to operate in a variety of ways, for example by inducing:

- denial of opportunity – for example, by dismantling permissive financial institutions on which they rely;
- financial stress, for example by freezing or reclaiming illicit funds - limiting their ability to sustain their operations;
- attacks to morale; leadership and legitimacy within a network; and
- forcing targets to shift activity into areas where they are more vulnerable that they would otherwise avoid.

**1.24** Financial measures allow law enforcement agencies to go beyond the stark choice between prosecution or no action when dealing with serious crime and terrorist threats. Fundamentally, they alter the incentive structure of criminals and terrorists by frustrating their ability to raise, move and use funds - driving their expected reward downwards and their likelihood of detection up.

## PRINCIPLES FOR SUCCESS

The UK operates within a comprehensive international framework that deters financial crime and terrorism in the first place; detects it when it happens and disrupts the activities of those responsible.

These objectives will only be delivered successfully if the interventions of all those involved are driven by the three key principles of effectiveness, proportionality and engagement. These organising principles were set out in the Government's 2004 Anti-Money Laundering strategy document and remain as relevant as ever in tackling crime and terrorism in a way that safeguards the UK's prosperity, security and liberty.

### Effectiveness

**1.25** Money laundering and terrorist finance measures should be implemented in a way that makes maximum impact on the underlying threat. This basic principle has important implications for how money laundering and terrorist finance measures are applied in practice. It means that:

- **our understanding of the underlying threat should be increased continually and should direct action to mitigate it.** Recent developments to help do this include the creation of the Joint Terrorist Analysis Centre, the UK's centre for the analysis of international terrorism, and the annual "Threat Assessment" of organised crime, produced by the Serious Organised Crime Agency (SOCA);
- **institutional barriers cannot be allowed to stand in the way of an effective response to the threat.** Roles and responsibilities have been reformed in recent years in support of this. For example, the Government is legislating to merge the Assets Recovery Agency and SOCA in order to make further inroads into the criminal economy. SOCA itself has been designed with powerful legal gateways to allow it share information and collaborate with others; and

- systems should be designed to maximise their practical impact – and then assessed to ensure that they do. The Government’s 2004 Anti-Money Laundering Strategy stated that the Government would “continue to monitor the effectiveness of the anti-money laundering regime, and once the new controls have been properly tested, will consider whether changes are necessary to improve their effectiveness”.

#### Box 1.2: Assessing the effectiveness of the AML/CTF system

The Government has maintained high levels of scrutiny of its systems for tackling criminal and terrorist finance, including:

- comprehensive assessments of the UK’s AML/CTF system, including the IMF Financial Assessment Programme report<sup>3</sup>; the 2004 Anti-Money Laundering Strategy document and the FATF evaluation of the UK, which will be published later this year;
- sector-specific assessments to review existing approaches in areas of particular vulnerability. Chapter 3 gives recent examples in relation to charities and Money Service Businesses;
- reviews of key Government processes, such as Sir Stephen Lander’s review on the system of suspicious activity reports; and
- consultation and assessment of regulatory impact such as that on the third EU Money Laundering Directive.

### An effective international architecture

**1.26** Crime and terrorism are global threats. Money launderers and terrorist financiers abuse the increasingly global financial system to hide funds across borders in order to disguise their true nature and put them beyond the reach of authorities. To tackle these activities effectively, other countries need to have measures in place to prevent the exploitation of their financial system and cooperate effectively with international partners.

### Supporting the international response

**1.27** The UK is therefore a strong supporter of the development of an international framework to fight money laundering and terrorist financing. The UK was instrumental in creating the Financial Action Task Force (FATF ) to develop a set of international AML/CTF standards to be applied consistently by all countries. To build capacity in this area world-wide, the UK acts as an Observer to six of the eight FATF regional bodies around the world.

**1.28** As shown in chapter 2, the UK also plays an important role on the UN Security Council and in the European Union. This is essential not only to help steer an international challenge to crime and terrorism but to do so on the basis of a level playing field across countries that supports the competitiveness of UK firms.

<sup>3</sup> The IMF concluded that the “UK has a comprehensive legal, institutional, and supervisory regime for AML / CTF”.

## Proportionality

**1.29** The fight against crime and terrorism imposes costs on Government, business and taxpayers. It is essential, therefore, that the benefits of this effort should outweigh its burdens; that action is targeted wherever possible on specific areas of risk and vulnerability; and the right balance is struck between the need to safeguard the security of the public and their privacy and liberty.

**1.30** A proportionate challenge to crime and terrorism is one that is unremittingly “risk-based”. Under this principle, all parties – law enforcement, Government departments, regulators and industry - focus their resources on the areas where the likelihood and impact of abuse is greatest.

### The risk-based approach

**1.31** Criminal and terrorist finance threats change constantly, and vary greatly across customers, jurisdictions, products, delivery channels, as well as over time. This means that the response to crime and terrorism needs to be as supple as the criminals and terrorists themselves. A prescriptive “tick-box” approach would miss its target and fail to deliver benefits that outweighed the costs of intervention.

**1.32** Proportionality therefore demands that:

- **industry and Government understand where risks of financial abuse are particularly high and have the flexibility to adapt their approach to their particular circumstances.** Risk-based principles are hard-wired throughout the AML / CTF system described in this document. Chapter 3 sets out new proposals to enhance it further by developing a better understanding of high risk areas; sharing this with industry; and giving firms greater scope to tailor their approach to the particular risks that they face;
- **the best possible balance is struck between the need to protect citizens’ privacy and fundamental rights on the one hand and to ensure their ongoing security on the other.** For example, access to, and use of, financial data by law enforcement to support their enquiries is subject to a framework of robust legal controls to ensure that it remains at all times proportionate and warranted. Chapter 2 explains how this principle is being promoted further in relation to ‘closed source’ evidence used in terrorist asset freezing cases; and
- **where administrative burdens fall to the public and to businesses in the public interest, these should be as low as possible.** Because criminals and terrorists are opportunistic in exploiting loopholes, some financial controls must be applied across the whole financial system. This means that the response to crime and terrorism creates some burdens on all citizens and business – for example, in relation to verifying identity. Chapter 3 describes how the Government intends to further minimise these costs going forward.

## Engagement

**1.33** The Government’s 2004 Anti-Money Laundering Strategy Document set out a commitment to collaborate closely with stakeholders, emphasising the need for a “closer partnership between all stakeholders... as part of the process of continually improving the system for the benefit of all”.

**I.34** No attempt to root-out criminal and terrorist finance will succeed unless the public and private sectors work together and that within Government, policy makers work closely with operational colleagues and international partners.

**I.35** In the UK, this principle of engagement means that:

- **the Government must listen carefully to the views of those affected by the measures it introduces.** Formal and informal consultation is therefore an integral part of the Government's *modus operandi* for policy making on AML/CTF issues;
- **feedback and information sharing between Government and the regulated sector should be increased.** The 2006 Lander Review of the Suspicious Activity Reports system set out the key role of feedback, which applies across the AML / CTF system. It builds trust and assures those complying with their responsibilities that their contribution is used and valued. It helps industry understand the risks to their business from laundered money and terrorist financiers, and it provides an aid to continuous improvement – both of the quality of private-sector reports of suspicious activity and also in the use that is made of them;
- **stakeholders should have clear roles, but must also work coherently together across departments and sectors.** The UK AML/CTF system requires strong coordination across institutional lines if it is to tackle threats that respect no such barriers. The structures linked to Government's strategy on terrorism, known as CONTEST, and the Money Laundering Advisory Committee, which provides strategic direction in this area are two examples where collaboration delivers strategic direction across a broad agenda; and
- **engagement with international partners needs to be robust, advancing operational and policy goals alike.** In an operational setting, the ability to work closely with international partners, subject to appropriate safeguards and controls, is essential in order to prevent national boundaries standing in the way of justice. UK engagement also needs to raise financial standards in priority areas overseas – using the full toolkit of traditional diplomatic negotiation; bilateral lobbying and multilateral discussions, backed up by in-country law enforcement co-operation and technical assistance.

**Box 1.3: Engaging partners overseas****Tackling financial crime across borders**

UK authorities have been equipped with a suite of powers, subject to proper safeguards, enabling strong collaboration with sister-agencies overseas. In 2005, the UK's Financial Intelligence Unit handled 366 requests for information from other countries. The FSA's enforcement division handled 282 requests for assistance from overseas regulators.

**Capacity building in priority countries**

Working with FATF partners, the UK has been a strong advocate of effective mechanisms to focus international pressure on those jurisdictions that fail to match up to their responsibility to deliver similar cooperation.

UK crime and security goals rely on our overseas partners having the capacity to tackle criminal and terrorist finance. Recent exercises in priority countries include:

- **mock Trials on money laundering.** Training has been provided to police, prosecutors and judges in a major cocaine producing country with little experience of prosecuting cases related to the laundering of profits from drug trafficking;
- **assistance to Financial Intelligence Unit and drafting of a Proceeds of Crime Act.** Computer equipment and training was provided to help establish the Financial Intelligence Unit of one Caribbean jurisdiction. At the same time a legal expert was provided to draft a new consolidated Proceeds of Crime Act and associated regulations; and
- **building Financial Intelligence Units.** The UK Financial Intelligence Unit (FIU) based in the Serious Organised Crime Agency (SOCA) has hosted a series of visits from sister agencies overseas to spread best practice on intelligence handling, IT systems and architecture, relationships with the reporting sectors, quality control and operational procedures.

**Summary**

**1.36** As part of its commitment to tackle crime and terrorism, the Government has worked with its international partners and the private sector to build a solid framework of financial measures to deter, detect and disrupt criminal and terrorist finance.

**1.37** Taken together, these raise the costs and significantly increase the risks faced by perpetrators and at the same time, help safeguard the integrity of the international financial system. To meet its objectives successfully, the Government is committed to three organising principles to drive its approach. These principles of effectiveness, proportionality and engagement aim to maximise the impact of efforts against the underlying threats; ensure that the benefits of these outweigh the costs and entrench strong collaboration based on clear responsibilities between stakeholders.



# 2

## THE FRAMEWORK FOR ACTION

The Government and its international partners use financial tools to deter crime and terrorism in the first place; detect it when it happens and disrupt the activities of those responsible.

The international framework necessary to do this has developed significantly in recent years as capital movements have become more fluid and the threats more sophisticated. The UK has been a significant architect of key international financial standards that have opened up a new front in the fight against crime and terrorism.

In matching up to its international responsibilities, and reducing the harm caused by crime and terrorism at home, the Government has sought to implement these measures in a way that is effective, proportionate and engages all those whose cooperation is essential to drive success.

### KEY FEATURES OF A SUCCESSFUL AML / CTF REGIME

**2.1** Chapter One described the serious threat posed by crime and terrorism and the important role that financial tools can play in protecting the public. This chapter sets out the comprehensive framework of measures that the Government has developed to do this, working with its partners internationally and in industry.

**2.2** A comprehensive package of measures is now in place that combines:

- solid legal foundations that outlaw the financing of terrorism and money laundering;
- financial safeguards applied by industry - backed-up by law; supervision and guidance that help identify and trace illicit funds;
- measures to maximise the investigative and intelligence value of the financial information generated by criminals and terrorists as they move through the financial system; and
- an armoury of measures to disrupt the flow of criminal or terrorist assets and hold those responsible to account.

### Legal foundations

#### The “All Crimes” approach

**2.3** The Proceeds of Crime Act (POCA) applies international standards in a way that delivers one of the world’s most powerful legal tools against money laundering. It provides for a single set of money laundering offences, applicable throughout the UK to the proceeds of all crimes. Unlike earlier legislation targeting drugs trafficking<sup>4</sup>, POCA means that law enforcement agencies no longer need to show that illicit money was derived from one particular kind of crime.

<sup>4</sup> Chiefly, the Drugs Trafficking Act 1994.

**Box 2.1: The value of an all-crime approach.**

An 'all-crimes' approach allows money laundering legislation to be hard-wired into the Government's fight against *all* crime, making it as flexible and dynamic as the criminals themselves. In Northern Ireland money laundering prosecutions have been brought in cases where the predicate offence is, or is suspected to be, armed robbery, drug dealing and trafficking, kidnapping, fuel and cigarette smuggling, tax evasion, fraud, motor vehicle theft, dishonesty and deception. As a result, a single piece of legislation has attacked criminal profits associated with an enormous range of crimes.

**Targeting criminal property** 2.4 POCA not only targets "conventional" money laundering (that is, making criminal funds appear to be legitimate), but the actual possession of criminal property. If assets have been acquired through crime, in whole or in part or represent the proceeds of a criminal lifestyle, they can now be recovered by law enforcement agencies as an integral part of their strategies to break-up criminal networks<sup>5</sup>.

2.5 The Act therefore opens up new legal avenues to prosecute those associated with criminal finance and to deprive them of any benefit they might enjoy from criminal assets.

**The Terrorism Act** 2.6 UK authorities have strong legal powers to prosecute the financial supporters of terrorism and to disrupt funds that either have been, or may be, used in connection to terrorism.

**Targeting terrorist funds** 2.7 Part 3 of the Terrorism Act creates the offence of fundraising for terrorist purposes and criminalises the use or possession of any asset where the perpetrator "intends that it should be used, or has reasonable cause to suspect that it may be used, for the purposes of terrorism". The legislation also establishes a requirement to disclose any suspicion "that another person has committed an offence [of terrorist financing]" where the suspicion is based "on information which comes to his attention in the course of a trade, profession, business [other than a business in the regulated sector] or employment."

2.8 This clear legal prohibition brings the UK into line with key international agreements reached in the United Nations and the Financial Action Task Force, most notably UN Security Council Resolution 1373 (2001) which requires all countries to criminalise and disrupt terrorist funding.

**Terrorist finance penalties** 2.9 In order to maximise the deterrent effect of existing legal measures against the financing of terrorism, and reflect the severity of the offence, the Government is considering the case for increasing the severity of these penalties up to life imprisonment and to extending and for expanding the scope of asset forfeiture powers to cover all terrorist offences – not just terrorist finance ones.

<sup>5</sup> Sections 327-329 of POCA makes it an offence to (i) "conceal, disguise, covert, transfer, or remove from the jurisdiction criminal property"; "enter into or become involved in an arrangement which the person knows or suspects facilitates the acquisition, retention, use or control of criminal property" or "acquire, use or have possession of criminal property".

**2.10** In line with international obligations, the UK has also introduced legislation, backed by a pro-active targeting programme, to prohibit funds being made available to those suspected of facilitating terrorism. The UK's asset freezing regime is described in more detail below.

**Box 2.2: The international framework for action**

Criminal and terrorist finance is a global challenge, requiring a global response. National boundaries therefore cannot be allowed to undermine action to tackle criminals and terrorists who work across them.

The UK has been instrumental in building the international architecture of financial standards and applies these in practice in its domestic AML/CTF system.

The UK's approach is strongly influenced by the recommendations of the **Financial Action Task Force**. This is the key international standard setting body in this area which also plays an important role in identifying global trends and vulnerabilities and promoting strong compliance with standards through in-depth peer-review. The UK's compliance with FATF Recommendations is currently undergoing an evaluation, the outcome of which will be published in summer 2007.

FATF Recommendations, while not legally binding, incorporate elements of some treaties and conventions that are. Binding **UN agreements** are integral to the international framework of action and include obligations in relation to:

- drugs and crime, such as the 1988 Vienna Convention Against Drug Trafficking, which targeted drugs-related money laundering; and
- terrorist finance, including the UN Convention for the Suppression of Terrorist Financing (1999) (which provides a framework for tackling the financing of terrorism); UNSCR 1373 (which set out a comprehensive package of prohibitions against the financing of terrorism); and UNSCR 1267 (which established a global asset freeze against Al-Qaida and the Taliban).

In many areas, UN and FATF requirements are implemented through **European Union legislation** to ensure a level playing field between Member States. The UK used its 2005 EU Presidency to secure substantial progress in delivering international standards across the EU:

- the 3rd Money Laundering Directive, described below, was agreed and will come into effect in December 2007;
- agreement was reached on how financial transactions made using wire transfers should include information on the identity of the sender – building effective audit trails across borders;
- a regulation on the cross-border movement of cash, requiring substantial cash transfers to be declared, was agreed in line with FATF standards and will come into effect in 2007; and
- Member States endorsed the need to strengthen capacity to identify and freeze assets both at the national and the EU level.

## Financial controls applied by industry

### The Money Laundering regulations

**2.11** International standards reflect the fact that businesses that provide a gateway to the financial system play a key role in building a hostile environment against criminals and terrorists. The UK Money Laundering Regulations, which enshrine many of these standards, exist to ensure that these firms apply effective controls that help identify and forestall attempts to move illicit funds through the financial system. These controls must include measures to:

- **verify the identity of customers.** By knowing that customers are who they say they are, and by understanding the nature of their business, institutions can thwart attempts to disguise financial audit trails and help assess the risk of money laundering in the first place;
- **keep proper financial records for five years.** Allowing robust audit trails to be established across the international financial system;
- **train staff.** The Regulations require that relevant staff are trained to identify the warning signs of money laundering and the key legal requirements to prevent it (such as customer due diligence; record keeping and reporting suspicious transactions); and
- **ensure that suspicious activities are reported.** This requirement, discussed more fully below, has provided a key source of financial intelligence on suspicious activity since 2002.

### Extending the hostile environment

**2.12** As countries' understanding of financial risks has developed, and the nature of the threat itself has evolved, these key safeguards have been applied to a wider number of firms in order to close loopholes and to leave criminal and terrorist finance increasingly isolated.

**Table 2.1: financial guardians: sectors subject to money laundering controls**

• the traditional financial sector	• high value dealers in cash	• accountants and auditors
• bureaux de change	• casinos,	• company and trust formation agents
• cheque cashiers	• estate agents,	
• money transmitters	• lawyers involved in financial and property transactions	

### The role of supervision

**2.13** These high-level regulatory requirements are enforced by supervisors, such as the Financial Services Authority, in a risk-based way. These bodies require firms to have suitable systems and controls in place that reduce the opportunities for financial abuse. Significant penalties can be applied in cases where these are lacking – reflecting the opportunities that such failure provides for criminal and terrorist exploitation of the financial system as a whole.

**2.14** The UK puts a significant emphasis on the role of practical and enforceable guidance, authored by industry and endorsed by the Treasury, in delivering an effective challenge to criminal and terrorist finance. In particular, the guidance issued by the

Joint Money Laundering Steering Group, a private sector body, provides an authoritative account of how the high-level requirements of the Money Laundering Regulations can be best applied in specific sectors.

### Box 2.3: The Third EU Money Laundering Directive

Following an extensive consultation period in late 2006, the Treasury published draft Money Laundering Regulations for further consultation in January 2007. The Regulations implement the Third EU Money Laundering Directive, agreed under the UK's EU Presidency in 2005, and introduce tough and targeted new measures to tackle money laundering. The proposals include:

- extended supervision so that all businesses in the regulated sector comply with money laundering requirements, including estate agents, trust and company service providers and unsecured lenders;
- strict tests to ensure people running money services businesses and those who help set up trusts and companies are fit and proper;
- extra checks on customers identified by firms as posing a high risk of money laundering;
- a requirement to establish the source of wealth of customers who are high ranking public officials overseas; and
- a strengthened and risk-based regime in casinos, in line with, but stricter than, international standards.

In addition to taking tough action where the risks require it, the Regulations reduce regulatory burdens in low risk areas. For example:

- firms will be able to make fewer checks in low risk situations, such as employer led pension funds and child trust fund administration;
- the number of identity checks will be reduced with firms being able to rely upon checks of other firms in certain situations; and
- greater flexibility will be introduced to record keeping rules so that firms can keep important details rather than whole documents.

## Investigative and intelligence tools for law enforcement

**2.15** Money laundering and terrorist finance measures turn the financial fingerprints left behind by criminals and terrorists into a powerful intelligence and investigative tool.

### Legal tools to access financial intelligence

**2.16** POCA and the Terrorism Act enhanced previous powers in order to ensure that criminals cannot exploit the confidentiality of the financial system to disguise their activity. These include:

- production orders, which require a person or institution holding material either to produce it or give access to it. This might include documents such as bank statements;

- customer information orders<sup>5</sup>, requiring banks or other financial institutions to identify any account held by a person connected to an investigation;
- account monitoring orders, requiring banks or other financial institutions to provide transaction information on a suspect account for a specified period; and
- disclosure orders, which can be made by the Director of the Assets Recovery Agency (ARA) to require a person to answer questions; provide information or to produce documents throughout an ARA investigation. Whilst other orders must be applied for separately on each occasion, a disclosure order gives the Director continuing powers for the purposes of the investigation. These powers will be assumed by SOCA as part of a reorganisation of business in this area.

**2.17** In addition, new Financial Reporting Orders were introduced in the Serious Organised Crime and Police Act 2005 to create a new financial tool for the lifetime management of serious and organised criminals. Following conviction for a listed offence, a court may make a Financial Reporting Order (FRO) that requires the ongoing disclosure of the individuals financial records to a person specified by the Court - provided that the risk of the offender committing another listed offence is “sufficiently high”.

#### **Box 2.4: Financial Reporting Orders in practice**

The first Financial Reporting Order was placed on notorious drugs baron Abdullah Baybasin, following his conviction in London earlier this year and 22-year jail sentence. For the next fifteen years he must send reports of his finances to SOCA, enabling law enforcement to keep a permanent eye on his affairs and making it difficult for him to continue to operate. If there is any activity or assets that are recoverable which he does not wish SOCA to know about, he will have to take extra steps to hide them and will be committing another offence just by doing so.

**Suspicious Activity Reports** **2.18** These powers to identify and follow criminal and terrorist funds are supported by the private sector identifying and reporting the warning signs of financial abuse.

**2.19** The Proceeds of Crime Act requires that a firm’s suspicions of money laundering are reported to the UK’s Financial Intelligence Unit (housed within SOCA) and to reinforce this, the Money Laundering Regulations require these to have the necessary internal controls to ensure that suspicious transactions are identified and reported to a nominated officer.

**The Financial Intelligence Unit** **2.20** The FIU, which includes a specialist Terrorist Finance Team, provides critical analytical capacity to help exploit the financial intelligence provided by the private sector. Reports are both assessed in order to develop intelligence packages against possible crime and terrorism, cross-referred to other datasets, and made directly available to law enforcement agencies to support ongoing enquiries.

<sup>5</sup> Known as ‘Financial Information Orders’ under the Terrorism Act

### Specialist capacity for financial investigation

**2.21** In order to help build the specialist skills that can be required in complex financial investigation, the Assets Recovery Agency (which the Government is legislating to merge with SOCA in 2008) was given a statutory responsibility in POCA to train and accredit Financial Investigators. The Agency's Annual Report 2005-06 noted that "the demand for training in financial investigation across the whole law enforcement community ... continued to grow" and by March 2006, a total of 2,745 active Financial Investigators were registered as accredited, an increase of 82 per cent since the training programme began in 2003.

**2.22** All terrorist investigations have a significant financial component. To support this, the National Terrorist Finance Investigation Unit in Scotland Yard acts as a lead force for the financial investigation of terrorist cases.

#### Box 2.5: Case study: The role of financial investigation

An individual in the UK suspected of involvement with Al-Qaida used multiple accounts held in multiple identities to fund the supply of bomb components for use in another country. The conspiracy was revealed through extensive and forensic financial investigation which allowed law enforcement to establish that:

- purchases, made using different accounts, had been made over the internet from suppliers overseas. Liaison with international counterparts confirmed that these were for high-resolution maps of a third country;
- travel patterns, criss-crossing multiple jurisdictions to disguise their ultimate destination, all ultimately arrived at the same target country;
- small items, ostensibly innocent components for improvised explosives were sent to the same country by international courier over many months; and
- multiple transactions had been made to accounts which, on inspection, were controlled by an associate of the suspect - pointing to a wider conspiracy.

The new suspect's financial affairs were deliberately structured to hide the audit trail. Transaction by transaction, it was established that this new target had been operating in close concert with the first, by sending money to the same third country, through third parties in multiple countries.

The growing intelligence package now pointed to both suspect components and funds being moved to the same country. In partnership with law enforcement agencies overseas, the original suspect was arrested in a third country in a makeshift bomb factory.

## Disrupting criminal finance

### Taking the profit out of crime

**2.23** Criminals' and terrorists' reliance on finance is one their greatest vulnerabilities. Funds provide a target in their own right and the legislation outlined above has created new opportunities to arrest and prosecute those involved in the financial aspects of crime.

**2.24** In order to take more of the profit out of crime – and dislocate criminal networks in so doing - the Proceeds of Crime Act (POCA) in 2002 reformed and enhanced powers to target criminal funds in four key areas:

- **Confiscation following a criminal conviction.** In these cases, a Confiscation Order requires an offender to pay back the value of the benefit from a given crime (“the proceeds”). Restraint Orders can also be made to prevent the disposal or disappearance of property that may ultimately need to be sold to satisfy a confiscation order.

Under POCA, it is not necessary to link a particular crime with a particular benefit. There is also the option of “general criminal conduct confiscation”: this allows a court to assume that all of the defendant’s properties held over the previous six years are the proceeds of crime.

- **Civil recovery.** POCA includes a civil recovery scheme. This has been run by the Assets Recovery Agency (ARA) since 2003 and the Government is now proposing to make it available to prosecutors such as the Crown Prosecution Service, the Revenue and Customs Prosecutions Office and the Serious Fraud Office. This scheme empowers the Agency to sue by way of a civil proceedings (with a lower standard of proof than criminal proceedings) to recover the proceeds of unlawful conduct.

This scheme is only used if there has not been a successful confiscation after a conviction or where it was not otherwise possible to bring criminal proceedings. Cases are then referred to the ARA by the law enforcement authorities.

- **Taxation.** The Director of the ARA has the power to tax the proceeds of crime. This measure, which is an alternative to civil recovery, may be used when there are reasonable grounds to suspect that a person has received income or profit from criminal conduct. In such cases, POCA enables the Director of ARA to exercise the functions of the UK’s tax authority to assess a person’s income and tax. The Government is now considering the future application of these powers as part of a reorganisation of business in this area.
- **Seizure and forfeiture of cash.** There is a separate fourth power available to law enforcement officers, who can seize, detain and seek the forfeiture of suspicious cash of £1000 or above. In order to maximise the flexibility of this measure, the Government is exploring the scope for expanding the definition of cash to include a wider range of negotiable instruments.

**Box 2.6: Taking the profit out of crime**

In 2005, a defendant pleading guilty to four counts of being knowingly concerned in the fraudulent evasion of excise duty, following an HMRC investigation into imports of cigarettes and tobacco from Spain.

The defendant claimed to have had no assets and claimed Income Support, but a financial investigation by the North West Regional Asset Recovery Team uncovered evidence of a lifestyle that was at odds with his declared earnings as well as large cash payments; over sixty additional importations by the defendant or by couriers employed by him; and weekly sales of tobacco in the region of £8000. He was later ordered to pay a confiscation order of £1,421,824 within 6 months or face a default sentence of 7 years in prison.

An ongoing investigation led by the Metropolitan Police Service's Money Laundering Investigation Team led to perhaps one of the single largest forfeitures of cash: £1,568,117. This was recovered from a series of safe deposit boxes and addresses in London and Nottingham, and was thought to belong to a man living in Thailand. Four suspects have been arrested in connection with the money.

In 2005 HMRC Financial Investigators learnt that the girlfriend of a recently convicted drug smuggler intended to pay off her boyfriend's confiscation order 'in cash'. She was intercepted as she attempted to pay the money into the Court and the cash was seized under POCA. On testing, the notes were found to be heavily contaminated with Cannabis. A subsequent forfeiture order was granted for £49,100 with £2000 costs.

## Disrupting the financing of terrorism

**2.25** The terrorist finance offences set out above mean that those that fund and facilitate terrorism can be held to account before the law. Also, just as action against money laundering frustrates the criminals' ability to sustain their activities, so action against funds linked to terrorism impedes the operations of the networks involved, and ultimately helps to thwart attacks.

**Seizing terrorist property** **2.26** Law enforcement agencies, acting through the Courts, are therefore equipped with powers to restrain and confiscate "terrorist property" as well as seize cash suspected of being connected to terrorism – in much the same way as applies for Proceeds of Crime powers.

**2.27** The Government is considering the case to adapt elements of these powers in the light of operational experience and the evolving threat. There are good arguments, for example, for introducing a more practical definition of cash; extending the penalty for terrorist financing; and enabling the forfeiture of property in relation to all terrorist offences – not just 'terrorist finance' offences. This would help ensure that facilitators of terrorism are increasingly vulnerable to disruption by law enforcement.

**Freezing terrorist assets** **2.28** This armoury of powers has been significantly bolstered since 9/11 with the development of a terrorist asset-freezing programme operated by HM Treasury, in partnership with counter-terrorism agencies.

**2.29** United Nations Security Council resolution 1267 requires Member States to freeze the funds, other financial assets and economic resources of persons listed at the UN on suspicion of association with Al-Qaida or the Taliban. United Nations Security Council resolution 1373 requires similar action to be taken against persons suspected of

committing, attempting to commit, participating in or facilitating acts of terrorism. The UK meets its obligations under these Resolutions through recently enhanced domestic legislation - the Terrorism (United Nations Measures) Order 2006 and the Al-Qaida and Taliban (United Nations Measures) Order 2006.

**2.30** Where there are reasonable grounds to suspect that a group or individual facilitates terrorism, the Treasury can direct that their funds be frozen and that it is an offence for any person to make funds available to them. Very often, this action is taken in concert with other Governments. In respect of Al-Qaida specifically, a Committee of the UN Security Council publishes a list of individuals or groups suspected of association with Al-Qaida or the Taliban against whom States are required to impose an asset freeze. The EU also maintains a list of persons suspected of involvement in terrorism. The asset freeze therefore has a global reach.

### The disruptive power of asset freezes

**2.31** Asset freezing is therefore an important part of the international community's counter-terrorist effort. Specifically, asset freezing can:

- deny terrorists and their facilitators the ability to raise funds and to move them through the international system. This is the key disruptive effect of an asset freeze – equivalent to turning off their financial pipeline;
- create a cordon around any funds which are already in the financial system – reflected in figures of funds frozen; and
- harvest the entire financial system for lead financial intelligence on any funds held by the designated individual or group – which can help to provide valuable information on connections between individuals and groups and their activities.

**2.32** For these reasons, asset freezes are an integral part of the Government's financial tool-kit for tackling the threat of terrorism.

### Enhancing asset freezes

**2.33** The Government's goal is to ensure that the UK has a proactive asset-freezing regime that is fully effective in disrupting the flow of terrorist finance. As the nature of the terrorist threat is constantly evolving, so the operation of our asset freezing regime must also develop to deal with the changing nature of the threat. In recent months, the Government has made a number of changes to strengthen the operation of the UK's asset freezing regime:

- in July 2006, the Government introduced new restrictions on the payment of state benefits to the households of UN listed persons. Under this system, the Treasury imposes active and risk-based licence conditions on the payment and use of benefits to give greater protection against the risk that these might be diverted to terrorism. Since July, this approach has been applied to two listed individuals and six households;
- in October 2006, the Terrorism (United Nations Measures) Order was enhanced to provide further restrictions on making funds, economic resources and financial services available to anyone who has been designated in the UK by the Treasury as a person suspected of committing, attempting to commit, participating in or facilitating acts of terrorism;
- in November 2006, an updated Al-Qaida and Taliban (United Nations Measures) Order 2006 was adopted, further strengthening our powers to freeze assets, including the property, of persons listed at the United Nations;

- the Treasury has agreed on the advice of the law enforcement agencies to use ‘closed source’ evidence in asset freezing cases where there are strong operational reasons to impose a freeze, but insufficient open source evidence available. In order to ensure the fairness of any court challenge to the imposition of a freeze, the Government will introduce a procedure for the appointment of special advocates to represent the interests of the applicant in respect of the closed evidence; and
- accountability to Parliament is also being increased through quarterly reporting to Parliament on the operation of the UK asset freezing regime.

## Summary

**2.34** The first duty of any government is to protect its citizens. To meet this responsibility in the face of international criminal and terrorist threats, the UK and its allies have established a framework of key standards to safeguard the integrity of the financial system.

**2.35** This framework, which enjoins Government and industry together, is being deployed in the UK to deter, detect and disrupt crime and terrorism. Solid legal foundations that outlaw criminal and terrorist finance are combined with preventative safeguards in the Money Laundering Regulations that help to identify and forestall wrongdoing. Where criminals and terrorists move through any part of the financial system, measures exist to help follow the money trail they leave behind, cut them off from illicit funds, and bring them before the courts.

## ASSESSING THE IMPACT OF AML / CTF MEASURES

Financial measures, underpinned by key principles of effectiveness, proportionality and engagement, are becoming increasingly integrated into the UK’s approach to tackling crime and terrorism. A review of progress so far shows that the contribution of the private sector is of immense value in delivering high-grade financial intelligence and that the audit trails made possible by AML / CTF measures are being followed by law enforcement to hold perpetrators to account. A bridgehead is being built into the criminal economy itself, with nearly £100 million of criminal assets now recovered annually.

To build on these achievements, the Government is seeking to know more about the changing nature of the criminal and terrorist threat to drive continuous improvement.

**2.36** All stakeholders need to know more about the impact of the AML / CTF system in deterring, detecting and disrupting financial threats:

- the regulated sector, which has seen an increase in its compliance burden, needs to be clear what impact its efforts are having;
- law enforcement agencies need to understand how financial tools, alongside more traditional techniques, can protect the public and degrade the long-term capacity of criminal and terrorist networks;
- SOCA needs a clearer picture to inform its running of the SAR system; and
- policy makers need to decide whether the system needs strengthening in any area, or whether they need to make better use of the controls that already exist. They must also understand how the criminal economy works

in order to identify possible areas of vulnerability. For example, longer term asset recovery targets need to be set in the context of our best assessments of how much money is actually out there and potentially available for seizure.

**2.37** In order to understand these issues better in relation to criminal markets, the Home Office has been working on a series of projects to assess the size of the criminal economy; the totals potentially available for asset seizure; estimates of criminal cash flows and the evidence of the impact of our current AML controls. In parallel, a series of studies have been undertaken externally and within SOCA into Suspicious Activity Reports and the Joint Asset Recovery Database (JARD).

**2.38** Combined with analysis on levels financial investigations and asset recovery, this analysis reinforces the Government's view that:

- suspicious Activity Reports are providing high-grade financial intelligence. Even relatively simple preliminary checks suggest that financial institutions had good grounds for suspicion in a significant proportion of cases, perhaps 40 per cent. More detailed scrutiny might well suggest the proportion is even higher;
- the value of suspicious transactions identified through SARs could amount to a significant proportion of estimated total money laundering flows through the regulated sector – perhaps around 20-30 per cent of the total; and
- powers to 'follow the money' and attack criminal assets are creating a more hostile environment for criminals and terrorists.

**2.39** The regulated sector is keen for better guidance and feedback on the reports that it makes. The most striking aspect of the analysis has been that the SARs that are being made are clearly generally of high quality. With the improved feedback regime that SOCA is putting in place, it is expected that the SARs regime will become still more effective.

## Sizing the criminal economy

**2.40** Estimates about the size of the criminal economy and of how criminal funds are moved and used need to be treated with caution. The underlying analysis, which is about to be published, has never before been carried out anywhere in the world, so the methodology will inevitably need to be refined over time. It nevertheless reflects the Government's drive to build knowledge on criminal markets to enhance action to disrupt them.

**2.41** The estimates relate to the total turnover of organised crime in the UK and are divided between different parts of the criminal supply chain. This gives an indication of what proportion of assets are likely to remain in the UK, and what proportion may go overseas. Allowances have then been made to cover 'business costs' of organised criminals, on the grounds that this money will not be available for seizure. Finally, broad estimates have been made of what proportion of net income organised criminals are likely to invest in areas where the assets could ultimately be seized; for example property or shares.

**Laundered criminal profit** **2.42** This work has suggested that organised crime domestically generates over £2 billion of assets in *seizable* form annually, while a further £3 billion is likely to be sent overseas.

**2.43** The exercise has also allowed some provisional estimates to be made on the total sums laundered in the UK. This is a particularly hard figure to estimate because there are widely varying definitions of what constitutes money laundering. At the narrow end of the spectrum, money laundering is sometimes defined as the specific technical behaviour of ‘layering’ and ‘placing’ to disguise the source of criminal funds. At the other end, the UK criminal offences cover the possession, control or transfer of most criminal property.

**Criminal turnover in the regulated sector** **2.44** In this case, money laundering is defined as being that part of the total turnover of organised crime that is likely to pass through any part of the regulated sector. Analysis to date suggests that this figure is around £10 billion<sup>6</sup>.

**2.45** This will inevitably be an under-estimate of the total since it will exclude laundering the proceeds of other acquisitive crime, and some offences like tax evasion, as well as those significant parts of the criminal economy likely to be in cash and where the cash is not moved through the regulated sector. Examples would be where cash is physically exported, or where cash is spent for consumable goods such as food and business costs.

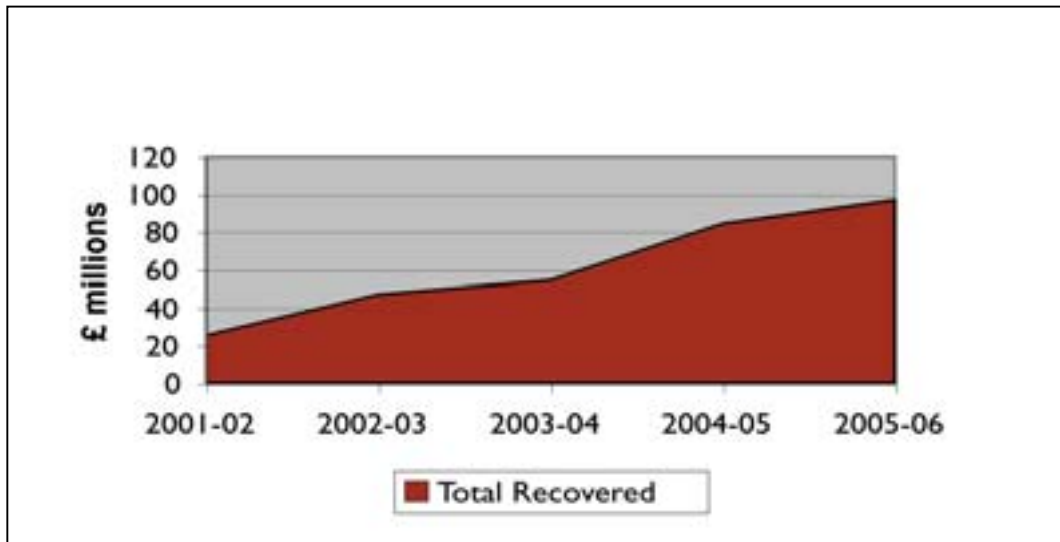
### Recovering the proceeds of crime

**2.46** Improving our performance in recovering the proceeds of crime is a key Government priority. Recovering criminal assets has a whole range of benefits, including:

- depriving criminals of the ability to fund further illegal activity;
- increasing risk and decreasing reward for criminals;
- increasing the numbers of offences brought to justice, through wider use of the new POCA powers;
- improving confidence in the criminal justice system, by ensuring criminals are not able to benefit from their activity; and
- returning money to the taxpayer or to incentivise further asset recovery work.

**2.47** Performance in recovering criminal assets has improved significantly over recent years as Proceeds of Crime powers have bedded down. A record amount of £96.5 million was recovered in 2005-06, as set out in the chart below.

<sup>6</sup> The amount laundered in the UK is still likely to be very much at the lower end of the 2 – 5 per cent of GDP previously estimated by the IMF.

**Chart 2.1: Recovering more proceeds of crime**

**2.48** The target for 2006-07 is £125 million. The Government paper 'Rebalancing the Criminal Justice System' set out a target to double this performance again to £250 million in 2009-10 with a longer term vision to detect up to £1 billion.

**2.49** The Home Office analysis on the scale of criminal assets is designed to inform this process of setting future targets. Clearly, with over £2 billion of seizable assets generated annually, there is a long way to go. But delivering the 'Rebalancing' target would represent an almost tenfold increase in only eight years, ensuring that losses to criminals from asset recovery work will become for the first time a major factor that they need to take into account.

### Disrupting terrorist finance

**2.50** Terrorist finance powers help identify terrorists and hold them to account by equipping law enforcement agencies with the information contained in the financial system and with new avenues for prosecution.

**2.51** But in order to create a more hostile environment for terrorism, Government agencies seek to identify and disrupt flows of funds linked to international terrorism - degrading the capacity of terrorist networks to sustain themselves and stage attacks.

**2.52** At the present time, law enforcement agencies have seized significant quantities of cash in respect of counter-terrorist investigations: 33 seizures under the Anti-Terrorism Crime and Security Act approximating £444,000, with a further £650,000 seized under the Terrorism Act. In Scotland, there have been two major terrorist finance cash seizures since 2003, resulting in the total seizure of £72, 252.

**2.53** Asset freezes target those suspected of being involved in terrorism, including those that fund terrorism, on a preventative basis. At the present time, these powers frustrate the ability of 443 individuals (359 of whom are listed in respect of Al-Qaida) to raise, move and use funds. The same is true for 184 entities (126 of which relate to Al-Qaida).

**2.54** Asset freezes not only cut off the financial pipeline to suspected terrorists but in many cases, they will also trap funds already in the financial system and isolate these from listed groups and individuals. At the present time, around 200 accounts and half a million pounds linked to designated terrorist suspects are frozen in the UK.

### Seizing terrorist cash

**2.55** Like financial investigation more generally, asset freezes have become increasingly hard-wired into UK counter-terrorist efforts, alongside non-financial measures such as control orders and proscription. Box 2.7 illustrates a recent example.

#### Box 2.7: Asset freezing in practice

On 10 August 2006, the police arrested a number of suspected terrorists in connection with an alleged plot to explode airplanes leaving the UK in mid-flight. Acting on the advice of the police and the Security Service, the Treasury froze the assets of 19 of these individuals on 11 August. The asset freeze was imposed within 24 hours of the police arrests and was in place before banks opened in the morning. This was the quickest and most comprehensive asset freeze that the Treasury has undertaken and it has yielded valuable operational benefits. The Executive Secretary of the Financial Action Task Force (FATF) has said in relation to the 11 August freeze that: "The measures taken were exemplary, this is a concrete application and implementation of FATF standards".

## Deploying financial intelligence

**2.56** Real dividends can be achieved from high quality financial intelligence and investigation. The Government therefore believes that this should be a mainstream part of everyday law enforcement activity.

**2.57** The Government continues to explore the power of the Suspicious Activity Reporting system, and financial intelligence more generally. A number of studies have been undertaken on the database of SARs which have yielded preliminary evidence on the quality of the financial intelligence it contains.

**2.58** Around 200,000 SARs are made annually. Studies of a sizeable sample of SARs have suggested a median value of around £10,000 with a mean of £35,000. The total value of underlying transactions may therefore be in the £3-7 billion range, though there may be some multiple reporting of the same transaction (for example, both by an estate agent or solicitor and by the bank making the payment).

### The intelligence power of SARs

**2.59** Comparisons of small samples of SARs with information on the Police National Computer and force intelligence databases suggested that 30-40 per cent of SARs were made in respect of individuals known to the police for other reasons. A separate independent study of SARs within SOCA has suggested that around 40 per cent were linked in non-obvious ways (for example, through common addresses) while around 25 per cent matched records of frauds in the financial industry's CIFAS database.

**2.60** Overall, current estimates are that around 40 per cent of SARs relate to transactions that are genuinely suspicious – suggesting that SARs may already be revealing £2-3 billion of money laundering each year, or some 20-30 per cent of the estimated national criminal flows.

**SARs and terrorism** **2.61** SARs also play an important role in relation to terrorist finance enquiries. A reporting firm that identifies suspicious financial activity may have no way of knowing whether it relates to an attempt to disguise funds linked to acquisitive crime or to terrorism. However, the FIU is able to combine such reports with other confidential datasets and just under 2,100 SARs were noted as being of possible terrorist interest in 2005.

**2.62** These are already impressive results. Moreover, SOCA is committed to working closely with the regulated sector to improve the quality and accuracy of reporting, which should ensure an even better degree of coverage in future.

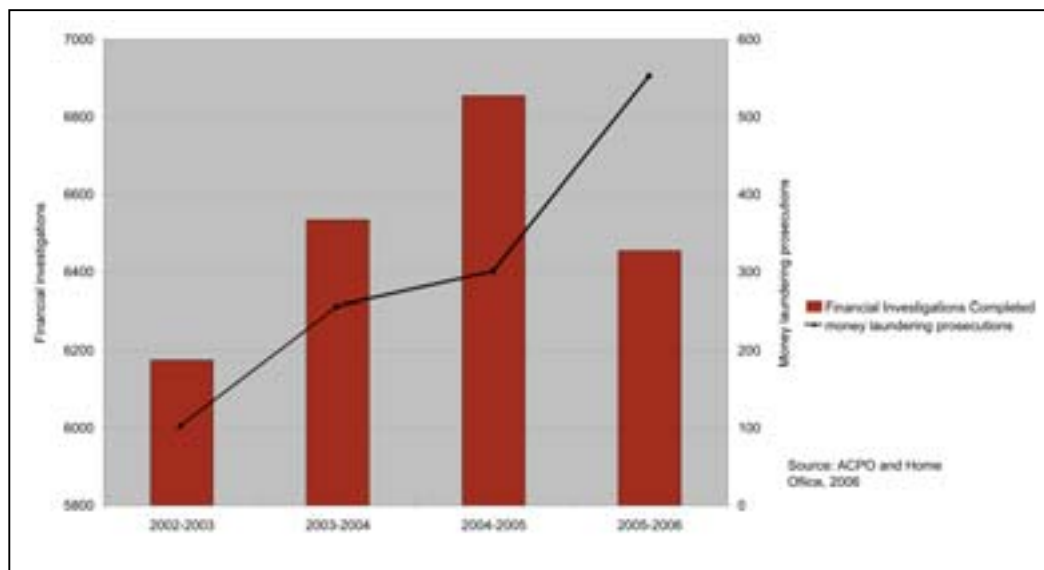
### Following more money

**2.63** There are also strong indications that the value of the financial intelligence and investigation is being increasingly recognised and that the tools outlined earlier in this chapter are becoming a mainstream part of law enforcement's 'toolbox' to aid enquiries and prosecute criminals.

**Financial investigation** **2.64** All terrorist investigations involve a terrorist finance element. The numbers of these in recent years runs into hundreds. The number of terrorist finance production orders issued by the National Terrorist Financial Investigation Unit increased by 22 per cent to 694 in between 2005 and 2006.

**2.65** In relation to other crime, the number of financial investigations and money laundering cases has increased in recent years – with strong indications that Proceeds of Crime powers are becoming increasingly hard-wired into every-day law enforcement activity.

**Chart 2.2: Anti-money laundering investigations by year**



**Box 2.8: Following more money - tackling international corruption**

The Treasury has developed structures, in effect since October 2006, to provide early warning and tasking in relation to the money laundering risks posed by foreign politically exposed persons (PEPs) with financial interests in the UK. These provide for a systematic approach to intelligence assessment, with SOCA coordinating and supporting the activity of key law enforcement partners.

In parallel, the UK has increased law enforcement capacity to investigate allegations of bribery and money laundering. DFID has allocated some £6 million over three years to establish the International Corruption Group, which brings together the Proceeds of Crime Team within the Metropolitan Police and the Overseas Anti-Corruption Unit within the City of London Police Service.

The Anti-Corruption unit consists of a 10-person team with a specific remit for foreign bribery investigations. Set up in November 2006, it has already taken on 4 investigations and made its first arrests in January 2007. The Proceeds of Crime Team now have 12 officers to combat money laundering. Recent progress in Nigerian money laundering investigations has seen up to £1,200,000 returned and £500,000 in the process of being returned.

## Learning the lessons

**2.66** This section has illustrated the Government's drive to know more about the changing nature of the criminal and terrorist threat to drive continuous improvement. It has shown that the contribution of the private sector is of immense value in delivering high-grade financial intelligence and effective audit trails that can, and are being, followed by law enforcement. A bridgehead is being built into the criminal economy itself, with nearly £100 million of criminal assets now recovered.

**2.67** These are substantial achievements. But there is scope to go much further in realising the full value of the framework that has been created in recent years.

**2.68** The Government believes that there remains considerable scope to make greater use of financial powers and intelligence, such as SARs, including by local police forces. Breaking SARs down geographically suggest that a typical Basic Command Unit might expect to have at the very least £10 million per year worth of suspicious transactions reported in its area. This again reinforces the need for financial intelligence to be an integral part of everyday action to reduce the harm from organised crime.



# 3

## SECURING THE FUTURE: STRATEGIC PRIORITIES FOR THE NEXT FIVE YEARS

The Government's first priority is to reduce the harm caused by crime and terrorism. To help do this, its objectives are to deter money laundering and terrorist finance; detect it when it happens; and disrupt those responsible. Success relies on all stakeholders acting in a way that is effective; proportionate and engages others across the system – including those on the front line in law enforcement and in business.

The international framework of money laundering and terrorist finance measures applied in the UK has helped save lives and deliver justice for the victims and the perpetrators of crime and terrorism. The UK's dynamic financial services industry continues to boast a reputation for world-beating innovation, based on integrity and proportionate regulation.

The Government is committed to building on this progress and the principles that have underpinned it. In coming years, it will focus on six strategic priorities that will extend the reach and effect of financial measures against criminal and terrorist threats.

It will work with front-line agencies, supervisors and industry to ensure that resources and activities across the system are aligned around these over the next five years to safeguard the UK's security and prosperity for the future.

**3.1** Tackling the evolving threat of crime and terrorism requires an approach to money laundering and terrorist finance that is effective, proportionate and based on the highest levels of engagement.

**3.2** This agenda enjoins multiple stakeholders – each with clear roles of their own. But in order to mount a stronger challenge to criminal and terrorist finance going forward, activity across the system as a whole should be strongly focussed on the need to achieve six key strategic priorities in the years ahead.

**3.3** Anti-money laundering and terrorist finance activity will be made more **effective** by a focussed effort to:

- ensure that activity is targeted to best effect by building the collective understanding of criminal and terrorist activity; and
- make the fullest and best possible use of financial tools to tackle crime and terrorism.

**3.4** Activity will become increasingly **proportionate** as further steps are taken to:

- entrench the risk-based approach by explicitly focussing effort in areas that are relatively more vulnerable to exploitation – and demonstrably mitigating the risk of abuse in these areas; and
- reduce the burdens created by crime and security measures on citizens and business to the minimum required to protect their security.

**3.5** Recognising that the shared efforts of stakeholders, in the UK and internationally, are required to succeed, the Government will prioritise efforts to deepen the culture of **engagement**:

- domestically – by encouraging information sharing and collaboration within public sector, and between public and private sectors; and
- internationally - to provide a global solution to a global challenge.

**3.6** The Government will deliver concrete measures to support these priorities, the first of which are outlined below. But to be successful, these priorities must drive the efforts of all stakeholders – from the local police force to the largest investment bank. They represent a strategic framework for action by all stakeholders in coming years.

## PRIORITY I. BUILDING KNOWLEDGE

Evidence-based policy-making and intelligence-led policing both rely on knowledge. The more we understand criminal and terrorist threats, the more we can promote proportionate legislation and target law enforcement efforts to where they have most impact in reducing harm.

We will not be effective without a good understanding of the problem and our impact in tackling it. We will not know the weaknesses in our current approach; our current impact on the threats and how we can increase it further in future.

Therefore our first strategic priority must be to build and share knowledge of the problem. This objective is foundational: it ensures that activity, including in the priority areas that follow, can be targeted to best effect by building the collective understanding of the underlying criminal and terrorist threat.

### The need to know

**3.7** Knowledge drives Government interventions at the strategic and tactical level.

**3.8** In relation to the former, Chapter 2 showed, for example, how a better estimate of the size and nature of criminal markets has underpinned new targets on asset recovery. Similarly, a priority for the UK's FATF Presidency will be to enhance that organisation's capacity to identify the key vulnerabilities in the financial system that are threatening its integrity.

**3.9** Similarly, the tactical direction of law enforcement activity is enhanced through a better understanding of the underlying threat, for example by knowing:

- how are funds being laundered?
- is it getting harder, easier, less or more expensive to do so?
- how is illicit activity being displaced into new areas?

**3.10** The answers to questions like these provide opportunities to probe weaknesses and stop threats - for example through closing legislative loopholes and providing alerts to industry. Indeed, all of the strategic priorities in this document enhance the Government's capacity to act in response to better knowledge of the threat.

## Structures to build knowledge and direct action

**3.11** Knowledge of criminal and terrorist finance comes from diverse sources – including high-level assessment, underpinned by the lessons learnt from operational experience; data matching; Suspicious Activity Reports and other intelligence.

### The UK threat assessment

**3.12** In recent years, the UK has radically restructured its architecture for managing serious crime so that action is either aimed directly at the need to build knowledge or directly connected to a better understanding of the threat. The key features of this are:

- the **UK Threat Assessment (UKTA)**. This provides a best picture of the problem, prepared by law enforcement, intelligence and policy organisations, and is updated annually;
- the **National Intelligence Requirement (NIR)**. This defines the gaps in current knowledge, prioritised according to how much they should be filled;
- the **UK Control Strategy**. This provides an overview of how the UK should respond tactically to the problem and gaps outlined in the UKTA and NIRs; and
- a **series of ‘Programmes of Activity’**. These co-ordinate activity targeted at particular threats identified in the UKTA, including all relevant partners (from the Government, law enforcement, regulators, private sector).

**3.13** Whilst the idea of a UKTA and NIRs has existed for some time; with the arrival of SOCA, the UK’s capacity to take a co-ordinated approach to tackling the problem has been enhanced.

## Knowing more in future

**3.14** All those involved in AML/CTF activity share the need to make knowledge-building the foundation of their day-to-day business.

### Building knowledge of illicit markets

**3.15** In relation to money laundering associated with serious crime, there is an ongoing need to maximise performance on producing high quality financial intelligence and ensuring that this is acted on promptly. This requires there to be a better understanding of the money laundering threat; of the risk perceived by perpetrators; and of how criminal markets are best disrupted.

**3.16** To build further knowledge of illicit markets SOCA will:

- **undertake further data mining of the existing stock of SARs**. Better understanding of criminals’ preferences in money laundering should enable SOCA to give clearer feedback and guidance to the regulated sector, and add more value itself to the intelligence passed on to law enforcement;
- **examine closely trends in prosecutions for POCA money laundering offences** and task its own teams and law enforcement partners to identify criminals’ own perceptions of risk, and to what extent it is increasing; and
- **fulfil a National Intelligence Requirement to improve understanding of the cost of money laundering services**. If efforts in this area are successful, then this should lead to rising costs of providing money laundering services.

**3.17** In parallel, **the Home Office will continue to work to improve understanding of what proportion of total money laundering is being picked up through the SAR regime.** Over time, improved feedback and guidance to the regulated sector should see the quality of the picture improve, though at the moment the margins of error in the calculations are too great to make this a reliable performance tool in its own right.

**Identifying and tackling key threats abroad**

**3.18** In order to target its efforts effectively, the Government requires a strong understanding of overseas financial threats to UK interests – whether these relate to particular jurisdictions; financial sectors or even particular firms, any one or all of which can provide a permissive environment for crime and terrorism. The private sector too has a requirement for such assessments so that it can better guard against risks of money laundering and terrorist finance.

**3.19** There are many examples already whereby overseas risks are identified and shared with industry. For instance, the UK-funded Transparency International maintains a key database of international perceptions in relation to jurisdictions that are particularly vulnerable to corruption. This is widely used by industry in making judgements on appropriate levels of customer due diligence.

**3.20** The Treasury will assess options to enhance the Government’s capacity to identify overseas financial risks to UK interests at an early stage and to ensure that this knowledge is acted on by those best placed to do so.

**Continuous improvement against terrorist finance threats**

**3.21** The framework for developing terrorist finance policy and operations will be strengthened in order to maximise its contribution to the UK’s long-term strategy against terrorism, known as ‘CONTEST’.

**3.22** The details of CONTEST, which has been applied since 2003, were set out in a public report in July 2006. This described the key objectives of UK strategy as being to:

- prevent the next generation of terrorists by tackling radicalisation and winning the battle of ideas;
- pursue terrorists and those that sponsor them;
- protect the public, key national services and UK interests overseas; and
- prepare for the consequences of a terrorist attack.

**3.23** Action to combat terrorism through the use of financial tools is an integral part of the “PURSUE” strand of this strategy. It contributes to the Government’s wider understanding of the terrorist threat and supports its efforts to:

- create a more hostile environment for terrorists - for example, by promoting an effective partnership with industry and by tackling vulnerabilities in key financial sectors; and
- disrupt terrorist networks – for example through asset freezing or by prosecution reinforced by financial investigation and intelligence. Such financial tools sit alongside non-financial measures such as Control Orders and deportation as part of a comprehensive armoury of measures against terrorists and their supporters.

**3.24** The Government's main coordinating committee for overseeing work in this area, the Terrorist Finance Action Group, is charged with maximising the contribution of the CTF community towards PURSUE objectives. This committee, which brings policy, operational and supervisory experts together provides the framework for developing greater knowledge of terrorist finance threats in order to drive continuous improvement in tackling them.

**3.25** To deliver these goals, TFAG will reinforce its work under four main programmes in coming years. These are:

- **Threat Assessment:**

This will develop the Government's knowledge of the terrorist threat by building knowledge of how terrorists raise, move and use funds at home and abroad, and the opportunities and vulnerabilities this presents.

- **Knowledge Requirements:**

This will identify gaps in the UK's knowledge of terrorist finance threats, both in terms of specific targets and the general intelligence picture, and the steps needed to address them.

- **Policy interventions:**

This will make the wider environment for counter-terrorist finance action (which includes the Government's relationship with stakeholders in industry and the framework of policy and supervision) increasingly effective for UK counter-terrorist investigators and increasingly hostile for terrorists and their facilitators.

- **Disruption:**

This will promote the effective disruption of specific terrorist targets (including the financial facilitators of terrorism) by developing the UK's capability to use financial tools to optimum effect. This effort will enjoin all stakeholders in the CTF community, including law enforcement and supervisors, and integrate with the use of non-financial measures such as control orders and deportation.

**3.26** The litmus test for success, and the goal to which the Government's counter-terrorist finance community sets itself, will be whether year on year, the financial aspects of the terrorist threat are better understood and whether financial tools are deployed increasingly effectively in tackling them. While much of the Government's work in this area will remain confidential, the Terrorist Finance Action Group will track progress against these goals as an integral part of the Government's 'PURSUE' strategy.

## Summary

**3.27** In the years ahead, all organisations with a stake in tackling the financial aspects of crime and terrorism should be able to demonstrate how their activity responds to the collective knowledge of criminal or terrorist threats in a coordinated way.

## PRIORITY 2. MAINSTREAMING FINANCIAL CAPABILITIES

Being effective is not just about targeting the right activities – as identified through enhanced knowledge of the threat – but targeting these with the right tool. All resources are limited and it is essential to use those that are available to best effect.

The Government's second strategic priority is therefore to make the best possible use of the financial tools, including those to recover criminal assets.

**3.28** The financial tools described in this document are already helping to deter, detect and disrupt crime and terrorism. But the Government believes that their potential contribution could be much greater. If used proactively, and in an integrated way alongside more traditional police powers and techniques, money laundering and terrorist finance measures could achieve much greater reductions in the harm that threats cause.

**3.29** There will therefore be a reinforced effort to:

- make maximum use of financial powers already in place – for example, by bringing asset recovery levels up to a level that fundamentally alters the incentive structure for criminals;
- fill key legal gaps in financial capabilities where these appear; and
- 'mainstream' the use of financial tools as an integral part of crime and terrorism strategies, for example, by ensuring that all staff have the awareness and skills they need.

**3.30** In all cases, success requires that these efforts happen alongside measures to gauge the impact of different tools to drive continuous improvement.

### Making the most of existing powers

**3.31** Government agencies benefit from significant legal powers to identify and disrupt illicit funds and as Chapter 2 showed, these are becoming increasingly integrated into law enforcement efforts against crime and terrorism. Action against criminal and terrorist finance is a key means by which the harm associated with these threats can be reduced. It is critical, therefore, that the UK fully capitalises on the opportunities provided by these powers and by growing levels of financial expertise. Three examples that illustrate how this is happening in the areas of asset recovery, asset freezing and financial supervision are set out below.

#### Substantial asset recovery

**3.32** Chapter 2 explained how money laundering powers were being used to separate criminals from their assets in a way that undermines both the motivation to commit crime the opportunity to do so. The fact that nearly £100 million is being recovered annually is a significant achievement. But it is clear that the size of the criminal economy is such that there is the potential to go much further.

**3.33** The Government believes that future targets to identify and recover criminal assets should reflect this and should drive performance in this area beyond what has been achieved so far. **The need to deliver a substantial increase in criminal asset recovery - £250 million in 2009-10 with a longer term vision to detect up to £1 billion - will therefore be treated as a key part of the success of this strategic priority, to be reflected across the law enforcement community.**

**Proactive asset freezing** 3.34 The Government, and its international partners, believes that the pre-emptively freezing the assets of suspected terrorists is an integral part of an effective strategy to disrupt terrorism itself. In recent years, the Treasury, in partnership with the counter-terrorism agencies, has developed the facility to make proactive use of these powers, balanced with proper safeguards on their use.

3.35 The Treasury has agreed, on the advice of law enforcement agencies, to use closed source evidence in asset freezing cases where there are strong operational reasons to impose a freeze, but insufficient open source evidence available. **Proposals will be brought forward for a special advocate procedure to ensure that appeals and reviews in these cases can be heard on a fair and consistent basis.**

3.36 Building on the reforms set out in Chapter 2, **the Treasury is setting up a dedicated Asset Freezing Unit, which will work closely with law enforcement and security agencies. This will increase the expertise and operational focus that the Government is able to bring to bear on asset freezing, acting at all times in response to advice from law enforcement and security agencies.** The Government will consider over the coming year whether to make further changes to the organisation of asset freezing work. In addition, the Government will further enhance the UK's asset freezing regime by continuing to:

- strengthen further the linkages between asset freezing and the Government's wider counter-terrorism framework;
- further improve co-ordination across the system, consistent with the distinct roles and responsibilities of the different departments and agencies involved in asset freezing;
- monitor closely the legal framework on asset freezing to ensure that it remains effective in meeting operational needs and meeting our commitments under UN Security Council Resolutions and EC Regulations;
- regularly review processes for asset freezing decisions to ensure that the relevant procedures continue to be fair and efficient and fulfil the UK's legal obligations; and
- work with regulators and other bodies to ensure a robust and proportionate approach to compliance with and enforcement of financial sanctions.

**Reinforcing the FSA's financial crime capacity** 3.37 The FSA has reorganised its financial crime and intelligence resources with the creation of the Financial Crime and Intelligence Division (FCID), taking effect from January 2007. The new division brings together existing financial crime expertise, backed up with additional resource, and extends the FSA's capacity to:

- undertake more thematic and case work on financial crime issues, including money laundering and terrorist finance threats;
- provide specialist support to other areas within the FSA when required; and
- prepare for the new supervisory responsibilities the FSA will take on when the Third Money Laundering Directive is implemented at the end of 2007.

3.38 The team will be led by financial crime experts, supported by personnel drawn from various parts of the organisation to ensure that the FSA's financial crime, supervisory and other skills are deployed together to tackle financial crime issues.

## Enhancing financial powers

**3.39** As financial powers become increasingly tested on the front line, the Government learns more about the opportunities they provide and how they can be enhanced. For example, the introduction of ‘Financial Reporting Orders’ described in Chapter 2 provided a small but extremely powerful extension to existing POCA powers that help deliver lifetime financial management of the UK’s most serious criminals.

**3.40** The Government believes that obstacles to the effective use of financial powers necessary to reduce harm should be removed. As well as having important implications for how the Government shares data, this principle also requires Government departments to consider how the existing portfolio of AML/CTF powers can be enhanced to increase their utility for law enforcement.

**Enhanced terrorist finance powers** **3.41** The Government will continue to assess how powers to identify and disrupt funds linked to terrorism can best be enhanced to meet the practical needs of law enforcement, matched with legal safeguards that strike the right balance between the need to protect the public and safeguard their rights. Options could include, for example:

- making current powers to investigate and detain suspected terrorist funds more user-friendly for the police, for example by allowing greater use of civilian forensic accountants; increasing the opportunity for *ex-parte* court hearing in cases where suspected terrorist cash has been detained; and modernising the definition of cash; and
- increasing the severity of the maximum penalty available to life imprisonment.

**Enhanced criminal finance powers** **3.42** In order to strengthen the existing portfolio of powers to disrupt the finances of serious criminals, **the Government has recently brought forward proposals for a new type of flexible civil order, capable of being imposed against individuals or organisations, whereby a court would work to a civil standard of proof to determine that a proposed measure was a necessary and proportionate way of reducing the threat from organised crime.**

## Mainstreaming financial tools

**3.43** Making financial tools an integrated part of everyday activity to combat crime and terrorism requires that opportunities be seized to capitalise on resources that may not have been designed with this in mind – but can nevertheless make a crucial difference.

**3.44** An organisation that has genuinely ‘mainstreamed’ the use of financial tools is one in which staff at all levels have the awareness, skills and resources they need to contribute towards money laundering and terrorist finance objectives.

**3.45** This principle has diverse implications – for example in terms of staff training; knowledge management; technical intelligence collection (for example, by directly building financial intelligence) - even facilities management matters, for example, by ensuring that financial investigators are sufficiently connected to other colleagues.

**Box 3.1: Mainstreaming in practice: new roles for Companies House**

Just as the regulated sector has requirements placed upon it to help detect, deter and disrupt money laundering and terrorist financing, so too must the wider public sector play its part.

Companies House is a unique repository of information on UK companies. This has allowed it to play an increasing role in combating fraud, using the information it holds on company formation to shed light on corporate fraud trends and techniques. Given the prevalence of companies in sophisticated money laundering schemes, Companies House data is also potentially of great value to law enforcement in conducting money laundering investigations.

A new work programme will start this year to build the relationship between Companies House and law enforcement and ensure that the potential for company data to help tackle crime and terrorism are being fully realised in practice. For example, work is already underway to explore how Companies House can make use of the Suspicious Activity Reporting system. Progress in these areas will be assessed by December 2007.

**Summary**

**3.46** By turning the financial system against criminals and terrorists, anti-money laundering and terrorist finance measures are helping to protect the security and well being of the UK, with the potential to go much further.

**3.47** To seize this opportunity, law makers and law enforcers should make the fullest use of the financial powers now available and seek enhancements to these where there is potential to reduce harm further. Senior managers in particular have a responsibility to make the financial fight against crime and terrorism a mainstream part of their efforts to protect the public – demanding the right skills, awareness and resources across their organisation.

**PRIORITY 3: ENTRENCHING THE RISK BASED APPROACH**

The Government's third priority is to entrench the risk-based approach.

All stakeholders should be able to clearly account for how they identify areas that are relatively more vulnerable to exploitation and focus resources and activities to mitigate the risk that these pose.

Just as criminal and terrorist threats are both diverse and dynamic, so our approach must be both flexible and responsive in order to target the changing threat effectively. The risk-based approach therefore demands active management, with policy makers, firms and supervisors working closely together to identify and address key risks.

**3.48** The role of the risk based approach in delivering an effective and proportionate challenge to money laundering and terrorist finance was set out in Chapter 2. **These benefits make the risk based approach a strategic priority for the Government in the years ahead.** The Government expects to see it reflected at all levels of AML/CTF activity – from industry and supervisory practice to strategic decisions on the direction of the AML/CTF system as a whole.

## Industry practice

**3.49** Firms are better placed than the Government to identify and manage the evolving risks they face. Senior managers in particular have the key role in dealing with financial crime risks alongside the range of other risks faced by their business. The Government therefore eschews detailed and prescriptive requirements on firms in the Money Laundering Regulations in favour of a high-level, principles-based legal framework that gives firms the flexibility to adapt their controls to their circumstances.

### Flexibility and responsibility for firms

**3.50** Recent reforms have supported this approach. Revised guidance for the financial sector produced by the Joint Money Laundering Steering Group, approved by the Chancellor in February 2006, contains detailed material on how firms can apply a risk-based approach to controls. In January 2006, the FSA decommissioned its detailed rulebook of AML requirements in preference to high level requirements – effectively leaving the Joint Money Laundering Steering Group guidance as the single source for firms looking for detailed information on how to implement systems and controls. New targeted guidance for credit unions and for notaries was approved in October 2006 and February 2007 respectively.

### Promoting risk-based practice

**3.51** The Third EU Money Laundering Directive entrenched, for the first time, risk-based principles in EU law. The Directive will be implemented in the UK by the end of 2007. The UK has played a leading role in establishing an ‘Electronic Advisory Group on the Risk-Based Approach’ within the FATF in March 2006 to promote public–private sector dialogue on how best to apply the risk based approach in practice.

**3.52** In addition to reducing inappropriate prescriptive requirements on firms, there are two areas where the Government will promote further assistance to firms in identifying the financial risks posed by crime and terrorism.

**3.53** Firstly, opportunities to share risk-relevant information between government and firms should be increased. Early examples of this are outlined below in relation to working collaboratively with business.

**3.54** Secondly, **the Government will ensure that all sectors that are subject to AML/CTF controls have adequate guidance available to assist them.** Where appropriate, the authorities will work with drafters of guidance (and through the Money Laundering Advisory Committee’s Working Party on guidance) to give guidance the status of Treasury approval. This will give sectors additional comfort if they implement controls in line with the recommended best practice.

**Box 3.2: Proportionality and flexibility in money laundering controls**

The Government believes that the application of money laundering and terrorist finance controls should be unremittingly risk-based and intelligence led.

For example, the UK has successfully argued that the recently agreed Third EU Directive on money laundering should allow firms to apply 'know your customer' checks on a risk sensitive basis that provides for 'enhanced' or 'simplified' customer due diligence to be applied in different circumstances.

Consistent with this, the Financial Services Authority abolished its detailed rule book of AML/CTF requirements in 2006 – reflecting an explicit move away from 'tick-box' supervision to an approach that considered whether firms are identifying and mitigating their particular risks effectively.

The Hampton Review of better regulation, commissioned by the Chancellor in 2004, confirmed there should be no inspection of businesses without a reason, and regulators' resources and inspection activity should be strengthened in areas where the risks are greatest.

The Hampton Review also recognised that a penalty regime should be manage the risk of re-offending, and the impact of the offence, with tougher penalties for businesses that persistently or seriously break the rules. This should be accompanied with greater focus upon giving advice and support to businesses on how to comply with regulations. All bodies responsible for enforcing regulations on money laundering are expected to match up to these principles.

**Best practice for supervisors**

**3.55** All bodies with responsibility for supervising firms' compliance with money laundering requirements should adopt and promote an approach that is increasingly risk-based and intelligence led. This is essential if maximum attention is to be given to high-risk areas, whilst minimising the impact of regulation on areas where the benefits do not outweigh the costs.

**3.56** Revised Money Laundering Regulations, published in draft in January and which will be introduced by the end of 2007, will require all firms in the regulated sector to be supervised for compliance. This will mean that a number of bodies will take on new responsibilities for AML supervision, including a number of accountancy bodies, the Office of Fair Trading and HM Revenue and Customs.

**Supervisors' Forum** **3.57** As these new systems bed down in the years ahead, existing supervisors will continue to refine their approach. **In order to ensure that at all supervisors (including some bodies that are taking on supervisory responsibilities for the first time) perform at the level of the best, the Government will create a new forum to bring together all organisations with responsibility for ensuring compliance with domestic and international AML/CTF standards.**

**3.58** The forum, which will be chaired on a rotating basis, will entrench a risk-based, intelligence-led approach to supervision. In addition to this primary goal, it will have a wider remit to share information on threats and vulnerabilities.

**Box 3.3: Supervisors' Forum: Objectives**

To promote world-class risk-based supervision, specifically by

- sharing understanding and best practice on risk-based supervision;
- providing a forum to pool experience of supervisory investigations; enforcements and other action;
- considering how best to measure and monitor performance of supervisory activity in reducing harm; and
- discussing SARs performance (in its joint status as the SARs regulators' forum).

## Safeguarding vulnerable sectors

The section above explained how a genuinely risk-based approach requires supervisors and businesses to develop and share knowledge of changing threats, and use this to focus on areas that are particularly vulnerable to exploitation.

But this requirement applies equally to Government at a strategic level. In areas where the potential for exploitation is found to be particularly high, it is important that activities and accountabilities are focussed on the need to redress the balance.

**3.59** The Government is increasingly focussed on areas within the AML/CTF framework where the threat of criminal and terrorist finance has increased to a degree that requires enhanced intervention and monitoring to protect the public.

**3.60** The agility with which criminals and terrorists adapt to changing pressures requires that this be a rolling programme of evaluation and intervention – rooted in a stronger assessment of the threat, as provided by Priority 1. Following assessment through 2005-06, there will be a focus in the first instance on three key sectors: money service businesses, international cash movements and the terrorist misuse of charities as a means to raise, move and use funds.

**3.61** In each case, dedicated work programmes are required by the lead departments and supervisors to ensure that these sectors become increasingly hostile to money laundering and terrorist finance.

## Enhanced safeguards for Money Service Businesses

**3.62** The Money Service Business (MSB) sector (which comprises bureaux de change; international remittance; and cheque cashiers) is an integral part of the UK's financial services industry. The sector has grown extremely rapidly in recent years, most swiftly at the smaller end of the market, and delivers around £2.3 billion in remittances to the developing world each year at low cost to UK consumers.

**3.63** This strategic and commercial significance makes the MSB sector part of the critical infrastructure of the UK financial system that must be protected accordingly.

**Risks for MSBs 3.64** Money laundering supervision was first introduced for MSBs in 2001 in recognition of the particular risks that can attach to firms in this area. In particular, the sector deals with particularly high volumes of cash. It remits significant funds overseas. Business relationships between firms and customers can be extremely short – and often one-off. The capacity necessary to apply robust money laundering controls can be particularly challenging for very small firms.

**3.65** Appropriately for a new regulatory system in a diverse sector, supervisory arrangements were kept deliberately light-touch, with the primary focus on education and outreach (in 2006 alone, HMRC delivered seminars to over 140 MSBs in the UK).

**3.66** However, a review by the Treasury has identified a number of indicators that make a strong case for an explicit shift towards more aggressive identification and pursuit of money laundering and non-compliance in the sector:

- about one in five money laundering investigations, and one in three terrorist finance investigations, features the exploitation of MSBs;
- roughly 45 per cent of MSBs visited by HMRC have been judged to have failed to implement one or more of the key requirements of proper money laundering controls - although this partly reflects the risk-based nature of the visits programme. Six per cent of these traders have been judged to be seriously non-compliant;
- there is an inconsistency between the sector's own identification of suspicious activity within the MSB sector, and that of the wider reporting sector. SARs made by MSBs have fallen significantly in absolute numbers over the last few years, against a trend of significantly increasing numbers of SARs from all disclosing institutions (40 per cent growth over 2004-05); and
- one third of all SARs received on businesses have been reporting the suspicious activity of MSBs. A review of flagged money laundering operations in the SOCA's database of Suspicious Activity Reports identified that 19 per cent of the total featured the exploitation of MSBs.

**3.67** A public consultation was launched in 2006 to gauge industry views on how best to manage the risk of abuse in the MSB sector in a proportionate and effective way. The responses highlighted the importance of firmly isolating firms and individuals linked to crime from the MSB sector and the need for HMRC to take an intelligence-led approach in its compliance and enforcement work. Existing guidance to the sector was strongly welcomed, but there were also calls for a new generation of guidance that reflected risk-based principles more explicitly. Penalties for non-compliance should be proportionate, but genuinely persuasive.

**Box 3.4: Case study: criminal abuse of Money Service Businesses**

Like any financial institution, MSBs are appealing targets for organised criminals.

One long-term HMRC (at the time HMC&E) investigation began when the Colombian directors of two bureaux-de change were detected paying large amounts of cash at high street banks three times a day. The operation revealed that:

- a suspect would make three or four deposits at the same time, each represented by a separate credit slip, as they wrongly believed that the banks would not report these transactions as suspicious;
- illicit “street” cash was co-mingled with cash obtained in the course of the ostensibly legitimate exchange business in bank accounts. Once grown to a satisfactory level, the sterling was transferred to US dollar accounts and wired to accounts in Miami and around the world; and
- principals of the two bureaux met with a number of other suspects to exchange bags, believed to contain large quantities of sterling street cash. These were taken to another four “dishonest” bureaux-de change in order to launder the cash by exchanging it into the US\$ high denomination notes.

A search of the SAR database revealed that no suspicious transactions were disclosed by any of these bureaux. It is estimated that the organised crime group behind the operation of the two bureaux laundered some \$70 million.

**A dynamic,  
secure MSB  
sector**

**3.68** In the light of the Treasury’s public consultation on the next steps for MSB supervision, and the strategic priorities set out in this document, **the Government will bring forward new enhanced measures to root out abuse of the MSB sector effectively and aggressively. Specifically, HMRC – which acts as both law enforcement agency and as supervisor in relation to the sector - will publish an action plan by June 2007** with benchmark indicators of successes, detailing how resources and activities will be directed towards delivering a greater deterrence, detection and disruption of money laundering and terrorist finance in the sector. This strategy will include specific measures to:

- illuminate the changing nature of money laundering / terrorist finance risks in the MSB sector so that progress in managing it can be tracked over time. For example, by tracking indicators such as levels of suspicious activity reports on or from the sector, or actual money laundering cases, this exercise will provide a set of ‘vital signs’ indicating criminal trends, techniques and vulnerabilities in the sector;
- direct supervisory and enforcement activity in a risk-based and intelligence-led way. The strategy will track progress made in disrupting money laundering through the sector – for example, by recovering criminal assets or prosecuting operators that provide financial services to criminals;
- provide the private sector with a greater assessment of the nature and scale of abuse in the MSB sector in order to allow firms to make more risk-based decisions when dealing with MSBs;

- replace the current registration system for MSB operators with a licensing system. This will equip HMRC with strong powers to root-out persistently non-compliant operators and those whom appear to be high-risk or whom intelligence suggests are associated with organised crime or terrorism;
- protocols to increase collaboration with other law enforcement and supervisory partners – by sharing financial intelligence. The strength of this partnership with stakeholders will be tracked over time; and
- measures to challenge unlicensed or ‘underground’ MSB activity, including through the publication of the register of MSBs and by providing guidance to legitimate firms.

**3.69** In order to provide the legal tools necessary to support a proactive enforcement effort against permissive firms, the Treasury has also issued for consultation proposals for a substantial uplift in possible penalties for non-compliance. These proposals are set out in the Government’s January 2007 consultation document on revised money laundering regulations.

### Enhanced safeguards for cash courieriing

**3.70** Cash provides a means to store value and complete transactions outside the regulated financial system. As a result, it remains the mainstay of the criminal economy.

#### Seizing suspicious cash

**3.71** Chapter 2 explained the key role that flexible powers to seize suspicious cash play as part of the armoury of powers to disrupt the criminal economy. Significant quantities of cash (around £40 million) have been seized in relation to money laundering cases. In relation to terrorism cases, 33 seizures have been made under the Anti terrorism Crime and Security Act totalling some £444,000. Terrorist-case related cash seizures under POCA amount to some £650,000<sup>7</sup>. In effect, cash seizure powers allow law enforcement to capitalise on the success of AML/CTF measures in forcing perpetrators to manage their finances in ways in which they are more vulnerable to disruption.

**3.72** The interdiction of illicit cash is therefore mission-critical to undermining criminal and terrorist finance. Significant inroads into the criminal and terrorist cash economy have been made. However, the assessment of law enforcement agencies is that the use of cash to store and move illicit funds has increased, is increasing, and needs to be diminished.

**3.73** An important indication of the significance of cash is illustrated by the amounts of sterling purchased by legitimate wholesalers operating overseas to meet demand for cash at home. This ‘repatriation’ illustrates both the quantum of cash that has left the UK and where in the world it has been consolidated. Both the amounts (which are not dissimilar from estimates of Class-A drug profit leaving the UK) and the distribution of these figures strongly suggest a significant illicit element.

<sup>7</sup> Source: National Terrorist Finance Investigation Unit.

### **Sterling repatriation to the UK**

**3.74** Law enforcement has identified numerous groups who choose to export large volumes of banknotes to be laundered overseas and repatriated to the UK. HMRC Financial Intelligence, working closely with SOCA, are involved in an ongoing project researching the levels of sterling cash being repatriated to the UK from overseas by UK - based banks. Initial indications shows that the total sterling banknotes repatriated during 2006 was in the region of £5.5 billion.

**3.75** The volume of flows of repatriated cash dwarf the amounts being currently seized at the frontier, and improving cash seizure performance is likely to be vital in meeting wider asset recovery targets.

#### **Box 3.5: The FATF on cash couriership**

“Reporting by intelligence and law enforcement indicates that cash smuggling is one of the major methods used by terrorist financiers, money launderers and organised crime figures to move money in support of their activities. Over many years, FATF typologies exercises have repeatedly highlighted the key role that cash couriers often play in money laundering operations. However, in recent years, evidence has emerged that cash couriers also play a significant role in the international financing of terrorism”.

FATF Best Practices paper on Special Recommendation IX  
<http://www.fatf-gafi.org/dataoecd/50/63/34424128.pdf>

**3.76** Against this background, there is scope to identify and interdict a greater quantity of criminal cash and exploit the potential of cash forfeiture to dislocate criminal networks. Over the next two years, a package of measures will be implemented to reinforce progress to date

**3.77** Within HMRC, the maximisation of illicit cash seizure and forfeiture will be prioritised as a key means of meeting Government asset recovery targets of £155 million in 2007-08 rising to £250 million in 2009-10.

**3.78** Central to these efforts will be greater connectivity between law enforcement agencies to develop and share the intelligence necessary to target operational activity effectively, reflected in a new performance framework for work in this area.

**3.79** It will also include a commitment to implement FATF Special Recommendation IX (as applied in the EU by the Payments Regulation) which requires mandatory declarations for cash movements in excess of EUR 10,000, in a way that maximises the opportunities to generate intelligence on cash movements and makes this available to all law enforcement agencies as appropriate including in relation to terrorism.

**Box 3.6: HMRC performance framework for cash detection and interdiction**

As part of a reinforced drive to identify and interdict cross-border cash smuggling, HMRC have developed a criminal finance strategy, the key features of which include:

- investment in strategic and tactical intelligence assessments to drive increased cash detection, interdiction, and gauge the success of law enforcement interventions in dislocating criminal networks;
- mainstreaming cash detection and interdiction throughout enforcement activities;
- maximum possible connectivity with other agencies to move intelligence fluidly, including information obtained from mandatory declarations;
- dedicated, professional resources to deliver quality interceptions; and
- maximum retention of seized cash.

## Enhanced safeguards for the charitable sector

### International standards on charities

**3.80** The UK has a historic tradition of supportive regulation for charitable organisations. The Charity Commission is the partner of choice for many countries seeking assistance in developing regulatory frameworks that support the development of a vibrant and giving charitable sector.

**3.81** However, any means of raising, moving and using funds is subject to the risk of exploitation, including by terrorists. As with other areas, this risk must be managed in a way that is proportionate, effective and based on engagement.

**3.82** In developing the key financial standards to combat terrorism, the FATF has found that “the misuse of non-profit organisations for the financing of terrorism is coming to be recognised as a crucial weak point in the global struggle to stop such funding at its source”<sup>7</sup>. The FATF’s response to this challenge, Special Recommendation VIII, requires that all countries should:

“review the adequacy of laws and regulations that relate to entities that can be abused for the financing of terrorism. Non-profit organisations are particularly vulnerable, and countries should ensure that they cannot be misused:

- by terrorist organisations posing as legitimate entities;
- to exploit legitimate entities as conduits for terrorist financing, including for the purpose of escaping asset freezing measures; and
- to conceal or obscure the clandestine diversion of funds intended for legitimate purposes to terrorist organisations”.

**3.83** The FATF standard recognises the potential of charities to be misused as a means of raising and moving terrorist-linked funds. It also reflects the role that ostensibly charitable activity can play in sustaining a terrorist infrastructure by providing a veil of legitimacy over its activities and acting as a recruitment and propaganda tool. But above all, it reflects the need to encourage a flexible and vibrant

<sup>7</sup> FATF Best Practices paper on Special Recommendation VIII, <http://www.fatf-gafi.org/dataoecd/50/63/34424128.pdf>

NPO sector that is sufficiently protected from terrorist abuse to prevent exploitation and protect donor confidence.

### Assessing vulnerabilities

**3.84** The Government's assessment is that while the scale of terrorist links to charitable activity is extremely small in comparison to the size of the charitable sector, the risk of exploitation of charities is a significant aspect of the terrorist finance threat. Over 2006, a significant proportion of investigations into the financing of terrorism included an assessment of links to charitable organisations.

**3.85** In 2006, the Treasury and the Home Office initiated an assessment of existing safeguards for the charitable sector to identify the key requirements of an effective, proportionate response to the evolving threat of terrorist exploitation at home and abroad. The assessment, which will be published shortly, will make recommendations for the charitable sector together with the Charity Commission, other relevant Government departments and law enforcement agencies to enhance current work to reduce the risk of terrorist exploitation of the sector.

**3.86** In order to ensure that the Charity Commission has the tools it needs to respond to the wider terrorist threat impacting on all regulated sectors, extra resources will be made available to increase the Commission's capacity in this area, including an additional £1 million for the year 2007-08 with future funding finalised as part of the Comprehensive Spending Review.

### Summary

**3.87** Our challenge to criminal and terrorist finance must be as flexible and dynamic as the criminals and terrorists themselves. But this flexibility can only be achieved if firms in key sectors assess and manage the risks that apply to their businesses rather than follow extensive and prescriptive rules on how their systems should be designed.

**3.88** The Government has a key role to play in promoting this proportionate and risk-based approach. This Document has described the Government's principles-based legal framework that gives business the right degree of flexibility to tailor their approach. This Section set out new commitments to ensure that all regulated sectors have access to quality guidance and are supported by supervisors that take an avowedly risk-based approach. New measures are outlined below that will increase the flow of risk-sensitive information to firms to help them pin-point areas of vulnerability.

**3.89** At the highest level, the Government will respond to the lessons of operational experience by developing enhanced measures in those sectors where the threat appears to be increasing.

## PRIORITY 4. MINIMISING BURDENS ON BUSINESS

The Government's fourth priority is to reduce the burdens on citizens and business created by crime and security measures to the minimum required to protect their security.

The contribution made by those firms that form part of the framework of money laundering and terrorist finance controls has been decisive in helping to save lives; bring criminals and terrorists before the courts; and promote the UK's reputation as an honest place to do business. These benefits are not cost free. The Government will therefore continue to look for administrative burdens that cannot be strictly justified by the risks they seek to mitigate and remove them.

**3.90** Priority 3 stressed the importance of focussing on those areas and activities that posed the greatest risk of money laundering and terrorist finance. However, crime and security objectives will always place some burdens firms which are, in effect, the first line of defence against criminal and terrorist finance. The Government's fourth priority is therefore to continue to simplify the operation of money laundering and terrorist finance controls so that they can be applied at the lowest cost compatible with the effective management of risk.

**3.91** For example, revised guidance issued by the JMLSG and approved by the Chancellor in 2006 streamlined the system of customer identification for financial sector firms. This simplified the range of documents required by customers to prove their identity and encouraged the wider use of electronic means of verification of identity and reducing unnecessary duplication of identity checks.

**3.92** Two important next steps for this agenda are set out below. The Government will continue to work closely with law enforcement; firms; and supervisors to ensure that no business is asked to do more than is strictly necessary in order to maintain effective AML/CTF controls. Supervisors in particular will need to consider their relationship with the regulated sector holistically and identify areas for further simplification.

### **Simplification: the 3<sup>rd</sup> EU Money Laundering Directive**

#### **Simplified due diligence**

**3.93** The UK successfully argued the case that the third EU Money Laundering Directive should allow firms to reduce the customer due diligence checks in certain circumstances, and also to rely on a third party (that meets certain conditions) for undertaking the customer due diligence measures. **The Treasury is bringing forward legislation to enable simplified due diligence and reliance by the end of the year, resulting in estimated savings of up to £20 million per year.**

### **Streamlining suspicious activity reporting**

**3.94** The Government has been highly conscious of the need to ensure that the benefits of the money laundering regime outweigh their costs. Much has been done to increase the benefits that accrue to the public through the vital intelligence that suspicious activity reports represent. It has also committed to reducing regulatory burdens wherever this is compatible with our international obligations, and where the burdens are disproportionate to the benefits of the regulation.

**3.95** In the Serious Organised Crime and Policing Act 2005, amendments were made to address some particular concerns that had been raised by business. The obligation to report was lifted in cases of activities overseas which would have been illegal in the UK, but which were not illegal where they took place – addressing, for example, the theoretical requirement to report to SOCA the handling in Spain of the assets of a Spanish bullfighter.

#### **Simplifying the reporting system**

**3.96** In addition, SOCPA removed the requirement to report on transactions where neither the identity of the money launderer nor the location of the assets could be ascertained – reports which could be burdensome to the regulated sector, but which had no possible value to law enforcement.

**3.97** Finally, a new threshold system was introduced. This again disapplied the need to make further reports on small transactions (up to £250 or higher if agreed with SOCA) on accounts which had been subject to suspicious activity reports. The purpose of this

threshold was to allow institutions to continue routine transactions on suspicious accounts without having to make further reports.

**3.98** The regulated sector has welcomed the deregulatory intent behind these changes, and the removal of some obvious anomalies. Concerns have remained, however, about the ‘consent’ provisions in sections 327-329 and in section 335 of the Proceeds of Crime Act 2002 (POCA). These provisions have two purposes: they offer law enforcement agencies an opportunity to gather intelligence or intervene in advance of potentially suspicious activity taking place; and they offer individuals and institutions an opportunity to avoid liability in relation to the principal money laundering offences in the Act.

**3.99** The Lander Review of the SAR regime concluded that the provisions were operating one-sidedly. While there was clear value for law enforcement, they were causing difficulty for some key institutions and sectors in two areas. The first area relates to operating an account during the period when consent has been sought but not yet granted; and also prior to the expiry to the moratorium period when consent has been refused. The second issue relates to the restriction of the scope of consent to a specific “prohibited act”, thereby in one interpretation of the law requiring the consent process to be restarted for every transaction affected by the original suspicion.

**3.100** In the light of these concerns, the Home Office intends very shortly to put out for consultation proposals on the operation of the consent regime designed to maintain the value of the current regime for law enforcement while reducing burdens on the regulated sector.

## PRIORITY 5: ENGAGING PARTNERS AT HOME

The Government’s fifth priority is to maximise the effectiveness of collective action and ensure that information is properly shared within the public sector, and between public and private sectors, in order to identify and tackle financial threats.

**3.101** The community of public organisations involved in tackling crime and terrorism is extremely broad, with each responding to different objectives and accountabilities.

### Clear objectives for departments and agencies

**3.102** For example, Government departments work towards Public Service Agreements (including a shared PSA on drugs); along with Prime Ministerial priorities and the requirements of their own boards. Regulators have a mix of statutory and administrative objectives, whilst the Police are subject to the Policing Performance Assessment Framework, whilst the commercial sector is driven by the requirements of its customers and fiduciary duties to shareholders.

### Overarching requirements

**3.103** In addition, some overarching requirements already exist that apply across organisations. These include:

- the Government’s previous money laundering strategy, which set out the need for joint activity to tackle financial abuse in 2004;
- the Government’s comprehensive strategy to combat terrorism, known as ‘CONTEST’;
- asset recovery targets, which apply across law enforcement agencies; and

- the Government's terrorism objectives, which provide a strategic framework for tackling terrorism, including CTF.

### Effective coordinating structures

**3.104** A number of coordinating mechanisms align activity towards these shared goals. Examples include the Money Laundering Advisory Committee (which includes the private sector); committees to support the CONTEST strategy; and the Government's Asset Recovery Board.

**3.105** This collaboration between organisations, each with their own clear roles and accountabilities, is a defining feature of the UK AML/CTF regime. But to be successful, the structures that deliver strategic direction across organisations must be as efficient as possible and joint decision making must not dilute effectiveness. The Government will therefore continue to assess whether the mechanisms to coordinate action across the system are optimum and where there is scope to boost their productivity.

**3.106** In 2005, the Government set up the Asset Freezing Working Group. This cross-government group, chaired by the Treasury, considers and advises Ministers on potential asset freezing cases, brought to it by the police and the Security Service. The Asset Freezing Working Group has been effective in improving the proactive consideration of asset freezing cases. Building on this, **the Government will take steps to strengthen further the linkages between asset freezing, other counter-terrorist finance measures and the Government's wider counter-terrorism framework under the CONTEST strategy.**

### A commitment to data sharing in Government

**3.107** In addition to targeted improvements to the AML/CTF regime, there is a need to maximise the value both of SARs and other sources of financial intelligence that have already been made available to authorities.

**3.108** The value of financial intelligence is often not fully realised until it is combined with other sources of information. At the same time, criminals capitalise on a lack of routine data sharing that can mean the left hand in the public sector does not know what the right hand is doing, and contradictory information can be submitted to a range of different agencies without it being picked up. Yet data sharing within the public sector is often patchy, while sharing across the public - private divide is rarely even attempted.

#### Tackling intelligence failures

**3.109** The Government therefore believes that barriers that prevent the exchange of information necessary to reduce harm should be removed. This principle is a key part of this strategic priority on collaboration.

**3.110** The benefits of this principle are increasingly realised across Government. For example:

- the IMPACT programme for police forces is similarly putting in place a mechanism for sharing information across force intelligence databases;
- pilot exercises in the identity fraud arena and within SOCA are throwing up striking examples of what can be done when public and private data is shared, with particular potential to reduce financial crime, money laundering and fraud;

- a successful pilot exercise of public sector agencies submitting data to CIFAS, a private sector fraud information sharing service, suggested that a high proportion of address data (on average 31 per cent but as high as 40 per cent for some agencies) matched addresses already identified as being suspect by the CIFAS database; and
- The National Fraud Initiative, operated by the Audit Commission uses data matching techniques to tackle a broad range of fraud risks by the public sector, such as widespread non declaration of income by benefit claimants, council tenancy and right to buy abuse and employment fraud by failed asylum seekers and those who over-stay UK visas. The value of fraud and overpayments detected by the 1300 bodies taking part in the NFI in 2004-05 exceeded £111 million, a 33 per cent increase over the previous exercise. The ratio of savings identified to NFI costs is estimated at over 100:1.

**3.111 The Serious Crime Bill, currently before Parliament, includes provisions to facilitate data sharing where this is currently blocked by legislation. The Bill enables sharing information on suspected frauds between the public and private sector, and also puts the National Fraud Initiative on a statutory footing.**

**3.112** An important area for development here is the routine matching of SARs against other key data sets in order to add value and prioritising those reports needing action. The Home Office discussion paper, *New Powers against Organised and Financial Crime* sets out a process for data matching of SARs against databases, including tax records, benefit records, identity databases and the private industry database of known frauds held by CIFAS.

**3.113** There is significant scope to reduce harm through such mechanisms in a way that strikes the right balance with the need to protect confidential data, as enshrined in the Data Protection Act. For example, every single SAR has been individually filed on the basis of a suspicion of crime, and all agencies have gateways enabling information to be shared with law enforcement for the purposes of preventing or detecting crime.

**3.114** The practicalities of this sort of data sharing are currently being looked at by SOCA, providing a practical example for others to follow.

### **Engaging the private sector**

**3.115** In principle, where the Government has information that can help direct private sector efforts to deter money laundering and terrorist finance, it should be shared.

**3.116** This principle is as relevant at the tactical level – for example, sharing details of stolen passports with banks to assess which accounts have been opened with these – as it is at the strategic level – for example, by informing judgements on the money laundering risks that a firm might be exposed to when conducting business in a particular country.

**3.117** As discussed earlier, the Treasury is looking to increase the flow of information to business so that they are more fully aware of the risks associated with particular areas and activities overseas. The number of innovative examples of risk-sensitive information sharing is increasingly – a trend that all stakeholders must build upon in the years ahead.

**Box 3.7: Innovative information sharing with the private sector**

SOCA has established new methodologies for effective information sharing with the private sector. The Vetted Group is a multi-agency forum comprised of experts from law enforcement agencies and the regulated private sector which considers sensitive intelligence on new money laundering risks. The group develops the intelligence using the specialist knowledge of its members and identifies areas where further joint working would be valuable. The group also reviews intelligence to produce declassified material which is tailored to be as relevant and meaningful as possible to the private sector audience.

This material is circulated by SOCA to the appropriate industry sector as an Intelligence Alert. Alerts have already been issued on the Abuse of Virtual Payments Systems and the Takeover and Redemption of Life Insurance Policies, and a further programme of activity for the Vetted Group is agreed to late 2007.

This approach allows the private sector to add value to SOCA intelligence analysis at an early stage and ensures that SOCA shares relevant information which will enable its partners to increase the resilience of their anti-money laundering procedures.

**PRIORITY 6: ENGAGING INTERNATIONAL PARTNERS**

Recognising that the shared efforts of stakeholders in the UK and internationally are required to succeed, the Government will prioritise efforts to deepen the culture of engagement internationally, to provide a global solution to a global challenge.

**The Financial Action Task Force**

**3.118** The Financial Action Task Force (FATF) has been in existence since 1989 as the key international anti-money laundering and now, counter-terrorist financing body. Since its inception, the FATF has worked to put the fight against money laundering on the international agenda and make it a truly global issue by raising international awareness of the need to adopt appropriate measures.

**3.119** The FATF's international stature has increased significantly over the last number of years and its 40+9 Recommendations have influenced and have been recognised as the international standard by other international organizations, such as the IMF, World Bank and the United Nations. The FATF has also encouraged the development of the FATF-style Regional Bodies (FSRBs), which play an important leadership role in their respective regions. All told, the reach of the FATF, through its own membership and that of the FSRBs extends to some 172 countries.

**The UK FATF Presidency**

**3.120** The UK will assume the Presidency of the FATF for twelve months from July 2007. While it can confidently be said that the FATF's work has had a positive impact on the global detection and prevention of money laundering and terrorist financing, and led to a marked improvement in the AML/CTF regimes that countries have implemented, both within and outside of the FATF membership, clear gaps and vulnerabilities remain. There is, for example, a divide in the level of implementation of AML/CTF measures between FATF members with more mature financial sectors and

countries that have less established financial sectors. In some countries the FATF Recommendations are simply not on the radar screen. At the same time, global trends in money laundering and terrorist financing continue to evolve requiring the international community to remain vigilant and to act without delay.

**3.121 The Government will therefore use its Presidency of the FATF to examine the challenges that now face the global AML/CTF architecture and increase the effectiveness of the FATF in an ever-changing and increasingly complex world.** In this context, the Government believes that there is scope for the FATF to adopt a more outward-looking and risk-based approach, built upon:

- enhanced multilateral surveillance of money laundering and terrorist financing threats around the world, both systemic and in given jurisdictions, leading to the development of clear policy responses, including, where appropriate, counter measures in respect of seriously non-compliant countries;
- stronger and more systematic engagement with the private sector to ensure that FATF analyses of money laundering and terrorist financing threats are of maximum value to those charged with carrying out customer due diligence and reporting suspicious transactions, and that the private sector itself can help and inform the development of FATF policy proposals;
- a strategic and forward-looking examination of the membership of the FATF, which identifies priority countries and develops clear and measurable outreach activities leading to their inclusion in the organisation itself;
- enhanced support for developing countries, for whom the international standards may seem daunting and impractical, through the provision of guidance on the appropriate sequencing of AML/CTF reforms alongside wider financial sector development and regulation;
- promotion of the risk-based approach to AML/CTF regulation, based on a common understanding of the advantages and principles of risk-based regulation and agreed guidance to assist businesses and countries in implementation; and
- an improvement in the focus of FATF evaluations of compliance so that they take greater account of the overall *effectiveness* of countries' AML/CTF regimes alongside the technical requirements of the FATF standards.

**3.122 The Government will also continue to work with and alongside the FSRBs given their vital role as regional champions for AML/CTF reform.** The UK is currently an observer country to six of these bodies and will continue to provide advice and input, including through expert technical assistance, to help the FSRBs and their member countries drive up standards throughout key regions of the world.

## The UK and the UN

**3.123 The Government will continue to work with UN partners to ensure the UN's counter-terrorist asset freezing regime is effective in combating terrorist financing.** Particular areas of focus will be continuing to improve the quality of identifiers; reviewing the handling of humanitarian exemptions; and supporting the role of the monitoring team in ensuring effective and consistent implementation.

## The UK and the EU

**3.124** The Government plays an active role in leading and shaping EU discussions on money laundering and terrorist financing. This document has described recent developments and success in the EU, including during the recent UK Presidency.

**Looking forward the Government will continue to work with its European partners to:**

- **promote the effective implementation of the Third Money Laundering Directive**, by sharing best practice in national experience and ensuring that any additional implementing measures agreed at the EU level provide the most effective response to money laundering and terrorist financing threats. The Government will also work with the European Commission to ensure that all Member States implement fully their obligations under the Directive;
- **ensure the swift, comprehensive and efficient design and implementation of international financial sanctions agreements at the European level**; and
- **strengthen the implementation of terrorist asset freezing in Europe**, by encouraging the further exchange of information on national policy approaches and promoting effective EU decision-making structures.



# A

## CONCLUSION: STRATEGIC PRIORITIES

**A.1** The Government’s strategic priorities to build on the success of anti-money laundering and terrorist finance measures are set out below.

<b>To further increase the effectiveness of action against criminal and terrorist finance, the Government will prioritise efforts to:</b>	<b>This is exemplified by:</b>
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- |   |  |
|---|--|
| 1. Build knowledge of criminal and terrorist threats to drive continuous improvement  | <ul style="list-style-type: none"> <li>• SOCA coordination of Programmes of Activity designed to build knowledge of, and target activity to address, criminal finance threats.</li> <li>• Home Office assessment programme to build understanding of the size and nature of the criminal economy.</li> </ul>   |
| 2. Make the best possible use of the financial tools we have, by making sure that all stakeholders make the maximum use of the opportunities provided by financial tools, including those to recover criminal assets. | <ul style="list-style-type: none"> <li>• Substantial increase in criminal asset recovery targets.</li> <li>• Proactive application of asset freezing powers, including the establishment of a dedicated Treasury Asset Freezing Unit.</li> <li>• Enhanced money laundering powers targeted at the most serious offenders.</li> <li>• Steps to ensure that Companies House data is fully utilised by law enforcement agencies.</li> </ul> |

<b>To ensure the ongoing proportionality of efforts in this area, the Government will prioritise efforts to:</b>	<b>This is exemplified by:</b>
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- |                                      |   |
|--------------------------------------|---|
| 3. Entrench the risk-based approach. | <ul style="list-style-type: none"> <li>• A new AML Supervisors’ Forum tasked with sharing experience and driving best practice.</li> <li>• Authoritative, accessible guidance on AML / CTF requirements for all regulated industries.</li> <li>• Enhanced measures to tackle abuse of the Money Service Business sector, including replacing the current registration system with a licensing system.</li> <li>• Enhanced safeguards for charitable sector, reinforced by additional funding for the Charity Commission.</li> </ul> |
|--------------------------------------|---|

4. Reduce the burdens on citizens and business created by crime and security measures to the minimum required to protect their security	<ul style="list-style-type: none"> <li>• Simplification measures for firms, set out the Money Laundering Regulations 2007, to allow them to reduce the customer due diligence checks in certain circumstances, and also to rely on a third party.</li> <li>• Consultation on reforming the consent and tipping-off rules.</li> </ul>
<p><b>To entrench a culture of engagement and collaboration - within the public sector; with business; and with international partners - the Government will focus its efforts on the need to:</b></p>	
5. Work collaboratively across the AML / CTF community, including to share data to help reduce harm	<p><b>This is exemplified by:</b></p> <ul style="list-style-type: none"> <li>• Legislative steps, through the Serious Crime Bill, to facilitate greater data sharing.</li> <li>• Steps to further improve co-ordination across the asset freezing system, consistent with the distinct roles of the different agencies involved.</li> <li>• Risk sensitive information shared between the public and private sector, including through the SOCA Vetted Group and alerts to industry.</li> </ul>
6. Engage international partners to deliver a global solution to a global problem	<ul style="list-style-type: none"> <li>• An FATF Presidency agenda to drive reform of international architecture.</li> <li>• Work to improve the operation of the UN counter-terrorist asset freezing regime and continued EU engagement across the range of AML / CTF issues.</li> </ul>



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