



The Law Society

# Money Laundering Guidance: Company and Commercial

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## Introduction

1. The nature of company structures can make them attractive to money launderers because of the element of secrecy, including the ability to obscure true ownership, and to protect assets for relatively little expense. For this reason it is important that company and commercial solicitors remain alert throughout their retainers, and with existing as well as new clients.
2. Practitioners working in other areas of practice may also act for, or deal with, companies, e.g. special purpose companies formed solely for property ownership. This guidance is also designed to help solicitors in this situation.

## Part I - Money Laundering Regulations 2003

3. Solicitors who provide legal services to clients in connection with financial transactions and who provide services in relation to the formation, operation, or management of companies must comply with the Money Laundering Regulations 2003, see regulations 2(2)(l) and 2(2)(m) and paragraph 3.12 of the Guidance. Non compliance with the Regulations can amount to a criminal offence. Commercial lawyers should take a cautious approach to their own compliance if there is any uncertainty (see paragraph 3.14 of the Guidance)
4. Paragraph 3.16 of the Guidance gives a broad summary of the requirements under the Regulations. One of the requirements is client identification, and paragraphs 3.109-3.119 of the Guidance suggest how to identify different types of corporate clients, including UK and overseas companies, subsidiaries, and partnerships.
5. Regulation 3 is a requirement to establish such other procedures of internal control and communication as may be appropriate for the purposes of forestalling and preventing money laundering. In chapter 6 of the Guidance, the Law Society suggests that solicitors approach this subject on the basis of risk.
6. To help comply with Regulation 3, firms conducting company or commercial work should give careful consideration to the level of information they require before accepting instructions or commencing a transaction, and as the relationship develops take into account any available information regarding the company's general approach to its own regulatory compliance. Solicitors' due diligence checks are part of an ongoing process rather than a one-off exercise restricted to the initial decision whether or not to act. The structure and business of companies can change over time, and solicitors need to remain alive to this (see also paragraph 7 below).

7. Solicitors will usually obtain a range of information in the normal course of taking instructions which also gives comfort in the context of anti-money laundering. Solicitors should be alert to the warning signs of money laundering when analysing this information and assessing whether they should ask more questions. For example, whilst there is no absolute legal requirement to obtain information about the provenance of funds involved in every transaction, solicitors will normally obtain some details about how transactions are to be financed and that information should be assessed on a risk basis, and if a risk is identified more information should be requested, e.g. when funds from a suspect territory are going to be used more information should be sought before proceeding (see paragraph 6.2 and Annexes 5 and 12 of the Guidance).
8. Solicitors concerned about the level of checks they need to make on any specific matter may wish to talk things over with their MLRO. Clear records should be kept of the questions posed and answers received, but whether more confirmatory documentation is required will be for solicitors and their MLROs to decide on a case by case and risk basis. Talking things over with Professional Ethics may also help, see below. Seeking a sensible amount of information early on can avoid difficulties which may arise if suspicions are formed later on in transactions (see paragraph 2.26 of the Guidance).

## Referrals

9. Referrals of clients from overseas, particularly where the solicitor never meets the client, may pose particular challenges. In these situations the introducer may be able to provide helpful information, although solicitors should not place total reliance upon the apparent credibility of an introducer. The internet can be a very valuable tool to find out more about companies, although the information obtained should be sensibly assessed for reliability. Asking company clients direct for information is often the easiest and best option, although documentary evidence from independent sources is always preferable where it is available. Whatever the source of the information it is important that it is analysed and understood, for example if necessary that it is translated.
10. When the Money laundering Regulations 2007 come into force, the current intention<sup>1</sup> is that they will permit solicitors to place reliance on the identification checks performed by other firms who introduce clients to them. However, it will not be possible to place reliance on all firms. Reliance is only permitted in three cases: firstly, where the introducing firm is regulated by one of the professional bodies named in the draft Regulations (e.g. the Law Society), secondly, where the introducing firm is from an EEA state, subject to mandatory professional registration recognised by law and supervised for compliance with the requirements of the Third Money Laundering Directive, and thirdly, where the firm is from a non-EEA state, is subject to requirements equivalent to those in the Third Money Laundering Directive, is supervised for compliance with those requirements, and is subject to mandatory professional registration recognised by law. Since, ultimately, the obligation to identify the client remains with the solicitors proposing to act for the client, they will need to consider on which other firms they are prepared to place reliance. The

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<sup>1</sup> As at the date this guidance was issued, the draft Regulations were subject to consultation. This paragraph reflects the provisions of the draft Regulations published on 22 January 2007. Note that reliance may also be placed on authorised credit and financial institutions.

introducing firm's size and reputation may assist in making this decision, as may sight of its anti-money laundering procedures.

## **Insolvency**

11. Solicitors who act for Insolvency Practitioners ("IPs"), who in turn act for insolvents, should be aware that Regulation 4(3)(d) makes it clear that as well as identifying IPs solicitors must take reasonable measures to identify insolvents, see paragraph 3.36 of the Guidance. Solicitors may choose to ask their IP client to assist with identifying the insolvent as the IP must also comply with the Money Laundering Regulations 2003.
12. The Association of Business Recovery Professionals issues guidance about how IPs can identify insolvents. This guidance states that where an IP is appointed by a court order or by a creditors' meeting convened by the official receiver without any prior involvement with the insolvent, reliance on the order of appointment or the initial bankruptcy or winding-up order is considered to be sufficient evidence of identity. This would apply to the following cases:
  - Appointment as provisional liquidator by order of the court;
  - Appointment as liquidator in a winding up by the court ( whether by court order following an administration, at a creditors' meeting convened by the official receiver or directly by the Secretary of State);
  - Appointment as administrator by order of the court; and
  - Appointment as trustee in bankruptcy (whether at a creditors' meeting convened by the official receiver or directly by the Secretary of State).
13. Alternatively, IPs may have relied upon the original insolvency practitioner who assisted with convening a creditors meeting, or relied upon a bank. Solicitors should be careful about placing too much reliance on checks which were originally made by a non-client who is more remote from their retainer, although ultimately this will be a matter for the solicitors' own risk assessment. If there is a heightened money laundering risk solicitors may choose to identify the insolvent themselves.

## **Use of client account**

14. If solicitors wish to hold funds as stakeholder or escrow agent in commercial transactions they should carefully consider the checks they wish to make about the funds they intend to hold before they are received and whether it would be appropriate to formally identify all those on whose behalf the solicitor is holding funds. Solicitors should consider Solicitors Accounts Rule 15 note (ix) which prohibits the use of the client account simply for a banking purpose.
15. Solicitors should carefully consider any proposal that they collect funds from a number of individuals, whether for investment purposes or otherwise, and should be careful about circulating widely their client account details. Payments from unknown sources may be received, and this poses a significant money laundering risk.
16. For further guidance on use of client account see paragraphs 6.23-6.30 of the Guidance.

## Confidentiality Agreements

17. Commercial solicitors will already carefully consider any confidentiality agreements they are asked to enter into. Whilst section 337 of POCA will override any confidentiality clause, there are two principal issues for solicitors to bear in mind. Firstly, they should be cautious in entering into confidentiality arrangements subject to foreign law, where a breach of the confidentiality obligation may expose the firm to a claim in an overseas jurisdiction where the protection of section 337 may not apply. Secondly, solicitors should be careful not to give express confirmations that information will remain confidential, as such representations could be considered to be misleading.

## Formation of companies

18. Given that companies can be useful money laundering vehicles, solicitors forming companies should be alert to any warning signs that in future the company may be misused for money laundering, or terrorist financing. It may be helpful to clarify the reasons for formation of a company in a foreign jurisdiction. In cases of doubt it may be better to refuse the instructions. Forming companies in countries where there are few anti-money laundering requirements should give rise to particularly careful checks.

## Part II - Reporting Issues

19. In a typical corporate merger/acquisition/sale/take-over, there are a number of particular issues which solicitors need to be aware of and consider:

Information upon which suspicions are based when acting on such transactions, solicitors are in the regulated sector and therefore have dual reporting obligations, both under the failure to report offence of section 330 and in respect of the principal offences. Different tests have to be applied in each case to determine if the information is protected by privilege. When considering whether there is an obligation to make a report under section 330, either common law or statutory privilege under section 330(10) may be a defence. However, when considering whether a report is required as a defence to the principal offences, only common law privilege is relevant.

For example, when acting for the vendor, information may be received from the client about the target company which is protected under both heads of privilege. However, information which is received from other representatives of the client (for example, other professional advisers) may only be protected by statutory privilege. If information is initially received which is privileged, solicitors need to be alert to whether the privilege is lost in the course of the transaction. The information may be put into a data room and the purchaser, as part of the due diligence inquiries, may raise questions of the vendor's solicitors which, in effect, result in the information being received again by the vendor's solicitor. That second receipt from the purchaser, or its solicitor, would not be protected by statutory privilege unless the information was subject to common law legal privilege which had not been waived when it was placed in the data room (for example, a letter of advice from a solicitor to the vendor).

Is the privilege overridden by the crime fraud exception? A solicitor may determine that he has suspicion or reasonable grounds to suspect that another is engaged in money laundering (which may simply mean having in their possession the benefits of a criminal offence contrary to section 329). Where the information on which the suspicion is based could be protected by

legal professional privilege or statutory privilege, the solicitor will need to consider whether the crime fraud exception applies, either as a matter of common law or by virtue of section 330(11).

The answer to the above may depend on a number of factors:

- the nature of the transaction;
- the amount of the criminal property; and
- the strength of the evidence.

Each of these are considered in more detail below. Before considering the practical issues arising, solicitors should recognise the likelihood of criminal issues arising in the course of transactional work.

20. The extent of regulatory and legal burdens upon companies, and upon business more generally, increases the possibility of breaches which can be “criminal conduct” for the purposes of the Proceeds of Crime Act 2002. For example, the Companies Act 1985 contains many criminal offences, including many which give rise to criminal property (as to which see paragraph 18 below). It is not necessary for there to be a criminal conviction, or even for a prosecution to have been commenced. The relevant factor is simply that criminal conduct has (or is suspected to have) taken place, which has given rise to actual or notional criminal property.
21. For a number of criminal offences the only benefit (for the purposes of POCA) is saved costs. For example, it is criminal conduct not to notify the Information Commissioner that a company will be processing “personal data”. The saved notification fee should be treated as criminal property for the purposes of POCA.
22. It may be difficult to ascertain whether the property or funds which are the subject matter of the transaction are the “saved costs”, in whole or in part and are therefore tainted. Clearly where a solicitor is dealing with the whole of a company's business or assets no distinction is necessary. In other cases, it would be wrong for a solicitor to assume, simply because some assets are tainted, that all of the assets are tainted and/or that the specific assets being dealt with are tainted. In most cases, unless there is some basis for suspecting the assets in question do result from the saved costs, no report/consent may be required in respect of the principal offences. As stated below, a report may still be required in respect of the failure to report offences under sections 330-331.

### **The Nature of the Transaction**

23. Typically, sales and purchases may proceed by way of an asset sale or a sale of shares. Different issues arise in each case.

#### *Asset sales*

24. In the case of an asset sale, all of the assets may be transferred. If any part of those assets comprises criminal property, a money laundering offence may be committed. The vendor will be transferring criminal property and will be at risk of committing a s.327 offence. Similarly, both the vendor and purchaser may be involved in a prohibited arrangement, since the transfer of tainted assets will facilitate the acquisition by the purchaser of criminal property contrary to section 328. The only additional consideration, when considering the position of the purchaser, is whether it would have an adequate

consideration defence (under section 329(2)(c)) to a section 329 possession offence (i.e. where the purchase price is reasonable and constitutes adequate consideration for any criminal property obtained), and whether, in such a case, the purchaser should effectively be deprived of the benefit of that defence by section 328. It is a question of interpretation whether sections 328 and 329 should be read together such that, if the defence under section 329 applies, an offence will also not be committed by the vendor under section 328. Solicitors will need to consider this point and take advice as appropriate.

25. As well as making disclosures relating to the transaction, vendors and purchasers will need to consider their reporting obligations in respect of the position after completion.
26. The purchaser will, after the transaction, have possession of the assets and may be at risk of committing a s.329 offence (subject to the adequate consideration defence referred to at paragraph 25 above). The vendor will have the sale price in its possession. If the amount of the criminal property is material (where materiality should be defined by reference to the impact on the sale price), the sale price may indirectly represent the underlying criminal property and the vendor may commit an offence under section 329. For example, the sale price of a group of assets may be £20 million. If the tainted assets represent 10% of the total and the price for the clean assets alone would be £18 million, it is clear that the price being paid is affected by and represents in part the criminal property.
27. Where the client may commit a section 327, 328 or 329 offence, those acting for the vendor or purchaser will be involved in a prohibited arrangement and will need to make a disclosure along with their clients and obtain appropriate consent (when considering whether to advise their client about their reporting obligations, solicitors should have regard to the tipping off offence in section 333 and the similar offence in section 342<sup>2</sup>).
28. Where the solicitor acting for purchaser or vendor concludes they may have to make a report and seek consent, before so doing they will need to consider whether common law legal professional privilege applies. As stated above, that will depend on how the information has come to the solicitor. Generally, when acting for the purchaser, if the information comes from a data room, common law legal professional privilege will not arise. When acting for the vendor, privilege may apply if the information has come from the client for the purpose of obtaining legal advice.
29. Where common law privilege does apply, the solicitor will also need to consider whether the crime fraud exception applies. The relevant test is whether there is prima facie evidence of a suspicion that the solicitor is being used in furtherance of a crime, in this case, money laundering. There must therefore be prima facie evidence to support the suspicion that the solicitor is being used for money laundering (or some other crime).
30. Whilst the test is clear, its application is very fact sensitive. Recent authorities in the context of banks suggest that the degree of suspicion which is required to trigger a disclosure is low and subjective (*K Limited v Natwest Bank*<sup>3</sup>). There is no evidential threshold for suspicion under the principal money

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<sup>2</sup> See paragraphs 4.59 and 4.80 of the Guidance and section 6 of the Law Society's guidance on *Bowman v Fels*.

<sup>3</sup> [2006] EWCA 1039

laundering offences. By contrast, more is required to override common law legal professional privilege. Prima facie evidence to support the suspicion is required.

31. Whether the exception applies will also depend on the purpose in carrying out the transaction and the amount of criminal property involved. For example, if a company wished to sell assets worth £100 million which included £25 of criminal assets, the intention would not be to use the solicitors in furtherance of a crime but to undertake a legitimate transaction. Alternatively, if the amount of criminal property were £75 million, the prima facie evidence would be that the company did intend to sell criminal property and the exception would apply to override common law privilege. There will of course be cases close to the dividing line. In these circumstances, the solicitor will need to appraise what the parties' intentions are. Where there is a need to advise the client of the money laundering risks in proceeding with the transaction<sup>4</sup> and a client then decides, despite those risks, to continue without making a report, the solicitor may have grounds to conclude that there was such prima facie evidence of an intention to use the solicitor in furtherance of a crime and therefore privilege may be overridden. Of course, for the purpose of the crime fraud exception, it is not just the client's intention which is relevant (see paragraph 4.14 of the Guidance)
32. Where common law privilege applies and is not overridden by the crime fraud exception, it is nonetheless possible for the client to waive the privilege in order for a disclosure to be made (see sections 6 and 7 of the Law Society's Guidance on *Bowman v Fels*).

#### *Sale by way of Shares*

33. A sale by way of shares gives rise to different considerations. Unless the shares have been acquired by the shareholder with criminal property, they are unlikely to represent criminal property. Therefore, their transfer would not ordinarily constitute or give rise to a section 327 offence (for the vendor) or a section 329 offence (for the purchaser). Nevertheless, a section 328 offence may be committed depending upon the circumstances, including in particular the amount of criminal property within the company in question. For example, consent may need to be sought if:
  - The benefit from the criminal conduct is sufficiently material that the share price has increased as a result of the criminal conduct (see paragraph 34 below); or
  - As part of the transaction, directors will be appointed to the board of the target company and will be using or possessing criminal property (see paragraph 35 below); or
  - The purpose of the transaction is to launder criminal property, i.e. it is not a genuine commercial transaction.
34. Clearly, if a corporate vehicle has been used to commit criminal offences, some or all of its assets may represent criminal property. The value of the shares may also have increased as a result of the criminal activity. If the shares are then sold, the vendor and purchaser will be concerned in a prohibited arrangement since the selling shareholders will be assisted in retaining the benefit of the criminal conduct by turning the paper profit, being

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<sup>4</sup> Such advice would be subject to any tipping off considerations (see paragraph 27 and footnote 2 above).

the increase in the value of the shares, into cash. For example, if 10% of the profits of a company are earned from criminal activity, then it is likely that the share price would be lower if the legitimate profits only were taken into account. However, where the amount of the criminal property is not material, i.e. it would not have an effect on the purchase/sale price, the transaction is unlikely to give rise to a prohibited arrangement since the selling shareholders will not have benefited from the underlying criminal conduct by the company. For example, a company is being purchased for £100 million and within it are £25 of saved costs. Clearly, if the costs had been paid by the company, it is unlikely that the price would be £99,999,975. The fundamentals of the business which are driving its valuation are still likely to support a price of £100 million.

35. Even where the value of the criminal property is de minimis and immaterial to the purchase price, purchasers will still need to consider their position after the acquisition. Whilst shareholders do not "possess" the underlying assets of the company, the target company and directors may subsequently transfer, use or possess the assets, or be involved in an arrangement in relation to them for the purposes of sections 327 to 329. If as part of the transaction the purchaser proposes to appoint new directors to the board of the target those directors may need to make a disclosure and seek consent so that they may possess and use the criminal property. If that is a condition of the transaction or a step on completion, the solicitors (and vendor) involved may still need to make a disclosure (subject to legal professional privilege issues) and seek consent, because they will be concerned in an arrangement which facilitates the acquisition, use or control of criminal property by the new directors contrary to section 328.
36. In summary, the position may be as follows where the amount of the criminal property is immaterial. The target company sold will have in its possession the proceeds of criminal conduct and may need to make a disclosure. Solicitors learning of that in privileged circumstances (i.e. where the information is subject to either common law or statutory privilege) cannot make a disclosure unless the common law or statutory fraud crime exception applies. Those individuals or entities who, as a result of the transaction, will be in a position post completion to process and use criminal property will need to make a disclosure and seek consent before completion. The solicitors acting on the transaction and the vendor may also need to make a disclosure if they are concerned in an arrangement which facilitates that acquisition or use of criminal property.
37. Wherever a disclosure has to be made, before so doing, the solicitors will need to consider whether privilege applies and, where it may, whether the fraud crime exception applies. The issues on a share sale are no different to those on an asset sale (see paragraphs 29 - 32 above).

### **The Position of Shareholders**

38. Generally, in a purchase or sale transaction, solicitors will be acting for the vendor companies and not for the shareholders in the vendor. Nevertheless, such shareholders may become concerned in an arrangement prohibited by section 328. Issues for solicitors acting for a listed vendor company are most likely to arise when the nature of the transaction is such as to require a Class I or Class II Circular to shareholders under the Listing Rules. The first consideration is whether the shareholders are, or may become, aware, perhaps through risk warnings in the Circular, of the underlying criminal

conduct. Unless they are or become so aware, they are unlikely to have the necessary suspicion to be at risk of committing a money laundering offence. Secondly, where they are so aware, it is necessary to consider whether the amount of criminal property is material to the transaction (i.e. whether it would have an impact on the price or terms). If so, then the shareholders, in voting in favour of it, will become concerned in a prohibited arrangement and will require to make a disclosure and seek consent. Solicitors will also need to consider, in the context of an Initial Public Offering, what risk warnings to include in any Prospectus; where the money laundering or criminal conduct is material, shareholders may need to be put on notice of their own reporting obligations via such a risk warning.

39. If faced, this issue is best resolved through dialogue with SOCA to ensure that there are no tipping off concerns if details of the risks or steps required to be taken are set out in the public circular. Where shareholders need their own consent, their express authority will be required. This can be most simply achieved by asking the shareholders, at the same time as giving conditional approval for the transaction, to authorise the board of the vendor to make a disclosure and seek consent on their behalf.

### **What happens if no disclosure can be made due to LPP?**

40. In these circumstances, solicitors will have a reasonable excuse for not making a disclosure and will not commit a money laundering offence by virtue of sections 327(2)(b)), 328(2)(b) and 329(2)(b). Similarly, if no disclosure can be made to due common law legal professional privilege or statutory privilege, solicitors will have a reasonable excuse for not making a disclosure under section 330. However, whether they should continue to act may raise ethical issues. [NB: This Guidance is different to the *Bowman v Fels* guidance which reached a different conclusion and which will be updated.]

### **Interaction with obligations under s.330**

41. All those solicitors involved in acting for the vendor, purchaser or target will also need to consider their obligations to make a disclosure under the failure to report offence of section 330 and, if relevant, the application of statutory privilege (see section 330(10)) and whether that privilege is overridden. Whether the privilege applies at all will depend in part on the source of the information and the factors referred to at paragraph 19 above.
42. Where criminal property exists (including in the form of cost savings for the company, as to which see paragraphs 20-22 above), then subject to issues of legal professional privilege and statutory privilege under s.330(10) of POCA, solicitors in the regulated sector who receive information relating to such property in the course of their business in the regulated sector will clearly have a reporting obligation under section 330.

### **Overseas Conduct**

43. Where there is a foreign angle to the information received, such as information about a foreign subsidiary, solicitors should be aware of the wide definitions of "criminal conduct" in s.340(2) and "money laundering" in s.340(11)(d). For example, a solicitor may form knowledge or suspicion that a company has improperly manipulated its accounting procedures so that tax is paid in the country with lowest tax limits in which the company has a presence, or there may be concern about corrupt payments made overseas to commercial agents which may be illegal in the UK. Even where the conduct

is lawful overseas, where the conduct is serious, it will still be reportable if money laundering is taking place in the UK and the underlying conduct would have been criminal if it had occurred in the UK<sup>5</sup>. In some cases, the only money laundering activity in the UK may be the involvement in the transaction of a solicitor within the jurisdiction.

## Conclusion

44. Where knowledge or suspicion is formed of money laundering, through disclosure or by any other means, solicitors should carefully consider with the MLRO whether there needs to be a report to SOCA. It will be necessary to consider carefully the Law Society's guidance in relation to *Bowman v Fels*, including whether knowledge or suspicion has been formed on the basis of information received in circumstances such that it is subject to legal professional privilege. The *Bowman v Fels* guidance includes a helpful flowchart which should assist solicitors in identifying their options, although for the reasons given at paragraph 40 above, it will now need to be updated.

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<sup>5</sup> The provisions relating to overseas conduct are complex and reference should be made to sections 327(2A), 328(3) and 329(2A) and the Proceeds of Crime Act 2002 (Money Laundering: Exceptions to Overseas Conduct Defence) Order 2006 SI 2006/1070 in respect of 'money laundering' in the UK of the proceeds of lawful overseas conduct, and to sections 330(7A) and 331(6A) in respect of 'money laundering' taking place lawfully outside the UK.