

TECH 02/06

GUIDANCE ON CHANGES TO THE MONEY LAUNDERING REPORTING REQUIREMENTS: THE EXEMPTION FROM REPORTING KNOWLEDGE OR SUSPICION OF MONEY LAUNDERING FORMED IN PRIVILEGED CIRCUMSTANCES

Guidance issued in February 2006, for auditors, accountants and tax advisers on the application of changes to the requirement to report knowledge or suspicion of money laundering formed in privileged circumstances, as provided for in The Proceeds of Crime Act 2002 and Money Laundering Regulations 2003 (Amendment) Order 2006, coming into force on 21 February 2006.

This Guidance has been prepared with the assistance of Counsel's advice. However, this is a new development in the law, which has not yet been interpreted by the Courts. If any person using the Guidance is in doubt over the action they should take, they are advised to take further advice.

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Executive Summary

- The Proceeds of Crime Act and the Money Laundering Regulations have been amended, to extend the exemption from reporting knowledge or suspicion of money laundering formed in privileged circumstances to accountants, auditors and tax advisers who are members of appropriate professional bodies (referred to in the amended legislation as relevant professional advisers), with effect from 21st February 2006. “Relevant Professional Advisers” will include (at least) members of the Institute and other CCAB bodies, all partners of Member Firms and their staff.
- This will mean that information received during work done in privileged circumstances (i.e. provision of legal advice and acting in respect of litigation) that causes knowledge or suspicion of money laundering will no longer need to be reported to NCIS, thus providing a level playing field for the clients of relevant professional advisers and professional legal advisers. Services where this is likely to have particular relevance includes legal advice on taxation matters, forensic work in respect of litigation and advice on aspects of business law.
- The exemption from making a money laundering report will not apply where the services provided will be used in the furtherance of a criminal purpose (the crime/fraud exception) but this exception is complex and further advice may need to be sought, before a decision is made as to its application.
- The exemption from the need to make a money laundering report when working in privileged circumstances is not optional, but must be used where it applies, in the same way that legal professional privilege is compulsory for lawyers where it applies. However, the exemption only applies to money laundering reporting under the terms of the Proceeds of Crime Act 2002 and not, e.g. to the reporting requirements of the Terrorism Act 2000 – it does not extend legal professional privilege to relevant professional advisers in any other circumstances. Nor does it affect any reporting responsibilities of relevant professional advisers other than money laundering reporting responsibilities.
- The exemption only applies to matters where the obligation to make a money laundering report arose on or after 21st February 2006. This means that information or other matter received giving rise to knowledge or suspicion of money laundering prior to 21st February does not fall within the exemption and a report may still need to be made even if it is submitted to NCIS after that date.

Introduction

1. A professional legal adviser who suspects or has reasonable grounds for knowing or suspecting that another person is engaged in money laundering is exempted from making a money laundering report where his knowledge or suspicion comes to him in privileged circumstances, under section 330 of the Proceeds of Crime Act 2002 (the Act) and the Money Laundering Regulations 2003. In such circumstances, provided that the information is not given to him with the intention (by his client or another person) of furthering a criminal purpose (“the crime/fraud exception” - see paragraphs 16 to 20 below), s.330(6) affords the legal adviser a complete defence to a criminal charge for not making a money laundering report .
2. With effect from 21st February 2006, s.330(6) was amended by The Proceeds of Crime Act 2002 and Money Laundering Regulations 2003 (Amendment) Order 2006 so as to extend this reporting exemption to a new but limited category of advisers: “other relevant professional advisers”. Relevant professional advisers are defined in the legislation as:
 - an accountant, auditor or tax adviser who is a member of a professional body which is established for accountants, auditors or tax advisers (as the case may be); and
 - which makes provision for (a) testing the competence of those seeking admission to membership of such a body as a condition for such admission; and
 - (b) imposing and maintaining professional and ethical standards for its members, as well as imposing sanctions for non-compliance with those standards.

The exemption also extends to persons in partnership with, or employed by, the relevant professional adviser to provide them with assistance or support. The information must come to these partners or employees in connection with this assistance or support and to the relevant professional adviser in privileged circumstances.

3. The legislation does not list which professional bodies meet the criteria listed in s 330 (14), but the ICAEW meets those criteria and, accordingly, persons who are members of the ICAEW, those in partnership with ICAEW members in firms regulated by the ICAEW and the employees of such firms and persons are within the scope of the exemptions. If firms or individuals are in any doubt as to whether these provisions apply to them, it is recommended that they seek legal advice.
4. Before considering the detail of these legislative changes and looking at how they will operate in practice, it is important to emphasise that:
 - persons who are either professional legal advisers (i.e. solicitors or barristers) or relevant professional advisers (as defined in s 330 (14) as

supplemented by s 330 (7B)) and are working in privileged circumstances are now given equal treatment as regards duties to make money laundering reports; and

- a client will, accordingly, be treated in the same way as regards money laundering reporting under s 330 when instructing either a legal adviser or a relevant professional adviser in privileged circumstances.
5. However, the amendments referred to above affect only the duty to make money laundering reports and related disclosures under the Act and in no way extend legal professional privilege to relevant professional advisers in any other circumstances.
 6. If a relevant professional adviser considers that the information or other matter on which his knowledge or suspicion is based came to him in privileged circumstances, he must apply the privileged circumstances exemption in s 330 (6) (unless the crime/fraud exception applies) and so has no discretion to make a money laundering report. This means that the relevant professional adviser could find himself in a situation where he might wish to make a report but is prevented from doing so by the privileged circumstances exemption. In such circumstances, he should consider whether he may continue to act, but will need to bear in mind the provisions of the Act relating to prejudicing an investigation.
 7. Whether or not the privileged circumstances exemption applies needs to be considered carefully, including a consideration as to whether the relevant professional adviser was working in privileged circumstances when the particular information or other matter came to him. This is an important consideration, as a relevant professional adviser may be providing a variety of services to a client, not all of which may create privileged circumstances for this purpose. Accordingly, it is strongly recommended that a careful record is maintained of the provenance of information considered when a decision is made on the applicability or otherwise of the privileged circumstances exemption.
 8. Not all work carried out by relevant professional advisers will fall within the definition of “privileged circumstances”. Set out below is a description of the two types of privileged circumstances and some examples of work which may fall within or outside of them.

Legal advice

9. For the privileged circumstances set out in s 330 (10) (a) and (b) to apply, the following conditions need to exist:
 - there needs to be a confidential communication (written or oral) between the relevant professional adviser and his client, or a representative of the client, in which the client seeks or the relevant professional adviser gives legal advice;

- that communication must take place within the confines of a professional relationship between them; and
- the communication must relate to legal advice (i.e. advice concerning the rights, liabilities and obligations or remedies of the client under the law).

Litigation

10. For the privileged circumstance set out in s 330 (10) (c) to apply, the following conditions need to exist:

- a confidential communication (written or oral) between the relevant professional advisor and the client or third party;
- the confidential communication must be made for the dominant purpose (i.e. the overriding purpose) of being used in connection with actual, pending or contemplated litigation.

Defining contemplated litigation is difficult. In summary, it is usually necessary to be able to identify some act that gives rise to a cause of action in relation to which some threat of legal action has either been clearly intimated or is more than reasonably likely to follow. The party seeking to claim the benefit of litigation privilege must show that he was aware of circumstances that rendered litigation between himself and a particular person or class of persons a real likelihood rather than a mere possibility.

Examples of Privileged Circumstances

11. Examples where relevant professional advisers might frequently fall within privileged circumstances as regards legal advice privilege include:

- advice on taxation matters, where the tax adviser is giving advice on the interpretation or application of any element of tax law and in the process is assisting a client to understand his tax position;
- advice on the legal aspects of a take-over bid, for example on points under the Companies Act legislation;
- advice on duties of directors under the Companies Act;
- advice to directors on legal issues relating to the Insolvency Act 1986, e.g. on the legal aspects of wrongful trading; and
- advice on employment law.

12. Examples where relevant professional advisers might fall within privileged circumstances as regards litigation privilege include:

- assisting a client by taking witness statements from him or from third parties in respect of litigation; and
 - when instructed as an expert witness by a solicitor on behalf of a mutual client in respect of litigation.
13. It should be noted that conducting audit work does not of itself give rise to privileged circumstances for this purpose, as the relevant professional adviser is neither providing legal advice, nor is he instructed in respect of litigation.
14. It is recommended that the reasons for the conclusion reached as to whether the privileged circumstances exemption applies are carefully documented. If the relevant professional adviser decides it does apply, he must act in accordance with the privileged circumstances exemption unless the crime/fraud exception applies. If in doubt, it is recommended that firms seek legal advice.

Recording and Discussion with MLRO

15. Even where the client service team believe that the privileged circumstances exemption applies, firms should consider whether all matters involving knowledge or suspicion of money laundering should still be reported to the MLRO. Discussion of a matter with the MLRO, where the purpose of the discussion is the obtaining of advice about making a disclosure under s 330, does not alter the applicability of the privileged circumstances exemption. Given the complexity of these matters, and the need for considered and consistent treatment with adequate documentation of decisions made, a referral to the MLRO is likely to be beneficial and is recommended.

The Crime/Fraud Exception

16. Before determining whether the privileged circumstances exemption must be applied, consideration needs to be given to whether the exemption is lost through application of the crime/fraud exception. This exception, as set out in s 330 (11), overrides the privileged circumstances exemption which:

“does not apply to information or other matter which is communicated or given with the intention of furthering a criminal purpose”.

This means that communications that would otherwise qualify under one or other of the above two types of privilege are not covered by the privileged circumstances exemption where the communication was intended to facilitate or to guide someone (usually the client but possibly a third party) in the commission, or furtherance, of any crime or fraud. An example of this might be where tax advice was sought ostensibly to enable the affairs of a tax evader to be regularised but in reality was sought to aid continued evasion by improving the evader’s understanding of the relevant issues.

17. The crime/fraud exception also applies where communication take place between a client or his adviser in circumstances where the client is the innocent tool of a

third party's criminal or fraudulent purpose. An example of this might be where a money launderer gives money to a family member, who is unaware of the source of that money, to purchase a property, for which purpose he communicates with his adviser.

18. At common law, the relevant crime or fraud which causes the application of this exception goes well beyond criminal offences and applies in relation to conduct that may only lead to civil liability, for example such as a transaction to defraud creditors contrary to section 423 Insolvency Act 1986: in other words, it is not necessary to show that the conduct will also give, or has given, rise to criminal liability. In fact, in a leading Court of Appeal decision (*Barclays Bank Plc -v- Eustice*), it was held that conduct that is sufficiently iniquitous as to amount to sharp practice can also cause the application of the exception.
19. The crime/fraud exception does not apply where the adviser is approached to advise on the consequences of a crime or fraud or similar conduct that has already taken place and where the client has no intention, in seeking advice, to further that crime or fraud. This means that a person who is concerned that he may be guilty of tax evasion can approach a tax adviser for legal advice in this regard without fear of the exception being invoked. This remains the case even if the potential client declines a client relationship having received the advice, and the adviser does not know whether the person will proceed to rectify his affairs. However, if the person behaves in a way that makes the adviser suspicious that he intends to use the advice to further his evasion, then a money laundering report could be required. For further guidance on reporting issues, reference should be made to the current CCAB Anti-Money Laundering Guidance (TECH 12/04, or its successor).
20. The crime/fraud exception is a difficult area and the Courts will not usually allow the exception to be invoked unless there is reasonably compelling circumstantial evidence available that demonstrates that the communications have in some way been intended to further the crime or the fraud. A mere speculation may not be sufficient as a basis to invoke it. It is strongly recommended that legal advice is sought in all cases of doubt.

Conclusion

21. Once circumstances exist that require the privileged circumstances exemption to be applied, then as regards the information or other matter covered by it, there is no discretion for the adviser to decide to ignore it. This means that the privileged circumstances exemption cannot be overridden just because the adviser wishes to make a money laundering report, but can only be overridden by the crime/fraud exception. Firms and individuals should always give careful consideration in such circumstances to whether they can continue to act and must remain mindful of other reporting responsibilities that they may have outside of the Act, e.g. under Statements of Auditing Standards, reporting responsibilities of firms regulated by the Financial Services Authority under the Financial Services and Markets Act and responsibilities to report misconduct of fellow members of

professional bodies. These duties are not affected by the privileged circumstances exemption, which applies only to reports required under the Act.

22. In summary, the following issues need to be considered before deciding whether to apply the privileged circumstances exemption:

- are those who received the information or other matter which gave rise to knowledge or suspicion of money laundering relevant professional advisers (s 330 (14) and s 330 (6) (b))?
- Was the relevant professional adviser acting in privileged circumstances (s 330 (10))?
- Was the information or other matter which gave rise to knowledge or suspicion of money laundering actually received in privileged circumstances (s 330 (10)) and not in some other communication or situation?
- Was the information or other matter received or communicated with the intention of furthering a criminal purpose (i.e. does the crime/fraud exception apply (s 330 (10))?)

If the answers to a), b), and c) are yes, and the answer to d) is no, the privileged circumstances exemption must be applied. If the answer to a), b), and c) are yes but the answer to d) is yes, the crime fraud exception applies and a money laundering report must be made. It is recommended that legal advice be sought in cases of doubt.

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