

Accuity Industry Report: The Challenges of AML for Law Firms 2016



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Executive Summary

The legal sector is facing unprecedented regulatory intervention and an increased focus on anti-money laundering (AML). Legislation triggered by the EU 4th Anti-Money Laundering Directive (4MLD), as well as recent high-profile media scandals such as the Panama Papers revelations, are driving change and putting law firms' financial crime compliance screening procedures under the spotlight.

The Challenges of AML for Law Firms 2016 Survey, designed in collaboration with the Law Society of England and Wales, aimed to identify whether there has been a shift in focus for risk and compliance professionals in this sector, and how the industry anticipates further changes to compliance standards relating to financial crime.

Some of the key insights which surfaced from the survey include:

- The process of reporting compliance and AML breaches is regarded by almost half of those surveyed as an extremely challenging task, highlighting how important it is for firms to define and promote clear compliance policies and procedures, as well as to provide regular internal training for employees.
- Identifying ultimate beneficial ownership, understanding the corporate structures of overseas clients, and obtaining source of wealth information are also among the greatest current AML challenges for law firms.
- A high level of compliance screening is carried out by most firms during client and matter inception; however, automated ongoing client screening is not yet in place at all firms.

Some of the challenges recognised are similar to those faced in other regulated sectors, such as banking and insurance. As we would expect, professionals working within the legal sector have a strong understanding of the need for thorough due diligence and actively seek new ways to improve their compliance processes.

The full results of the Challenges of AML for Law Firms 2016 Survey have been collated in the following report to help law firms benchmark their compliance strategies against the market.



Demographics

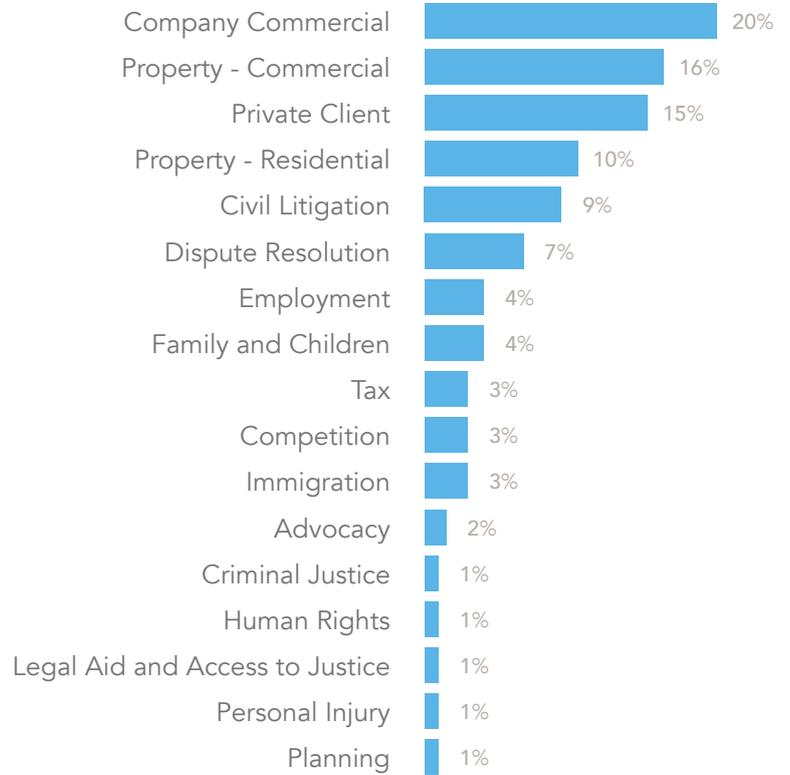
100+

Over 100 compliance professionals from law firms responded to the survey.

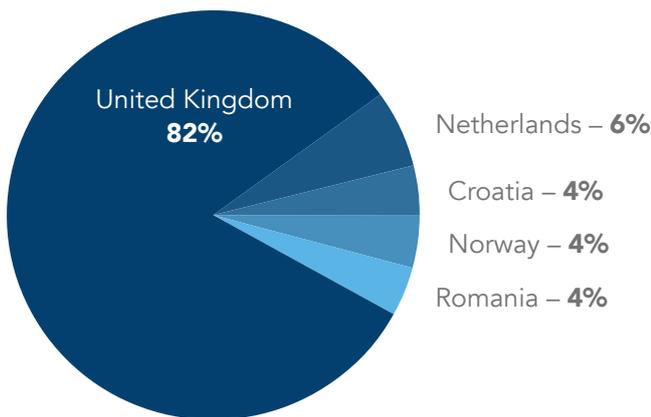
Job titles included:

- MLRO
- Head of Risk & Compliance
- Head of AML
- Compliance Officer
- Managing Director
- Partner
- Practice Manager

Main Practice Areas



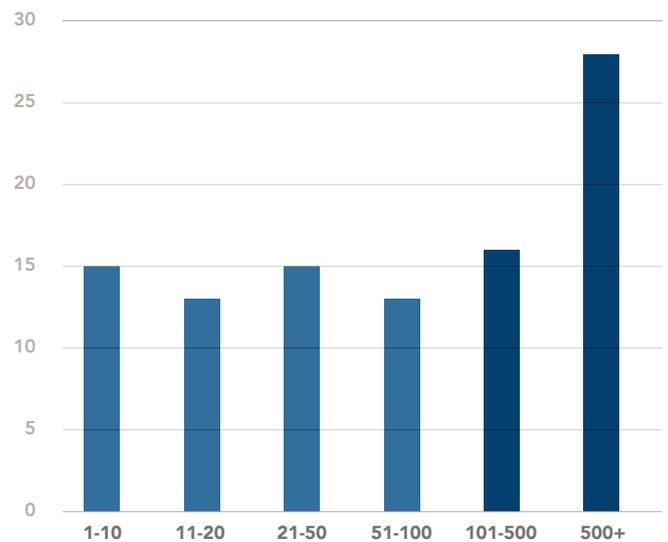
Regional breakdown of survey participants



82% of participants were from law firms within the UK.

18% of participants were from law firms throughout Europe.

Size of firm



Small Firms - 56%
(under 100 people)

Large Firms - 44%
(101 or more people)

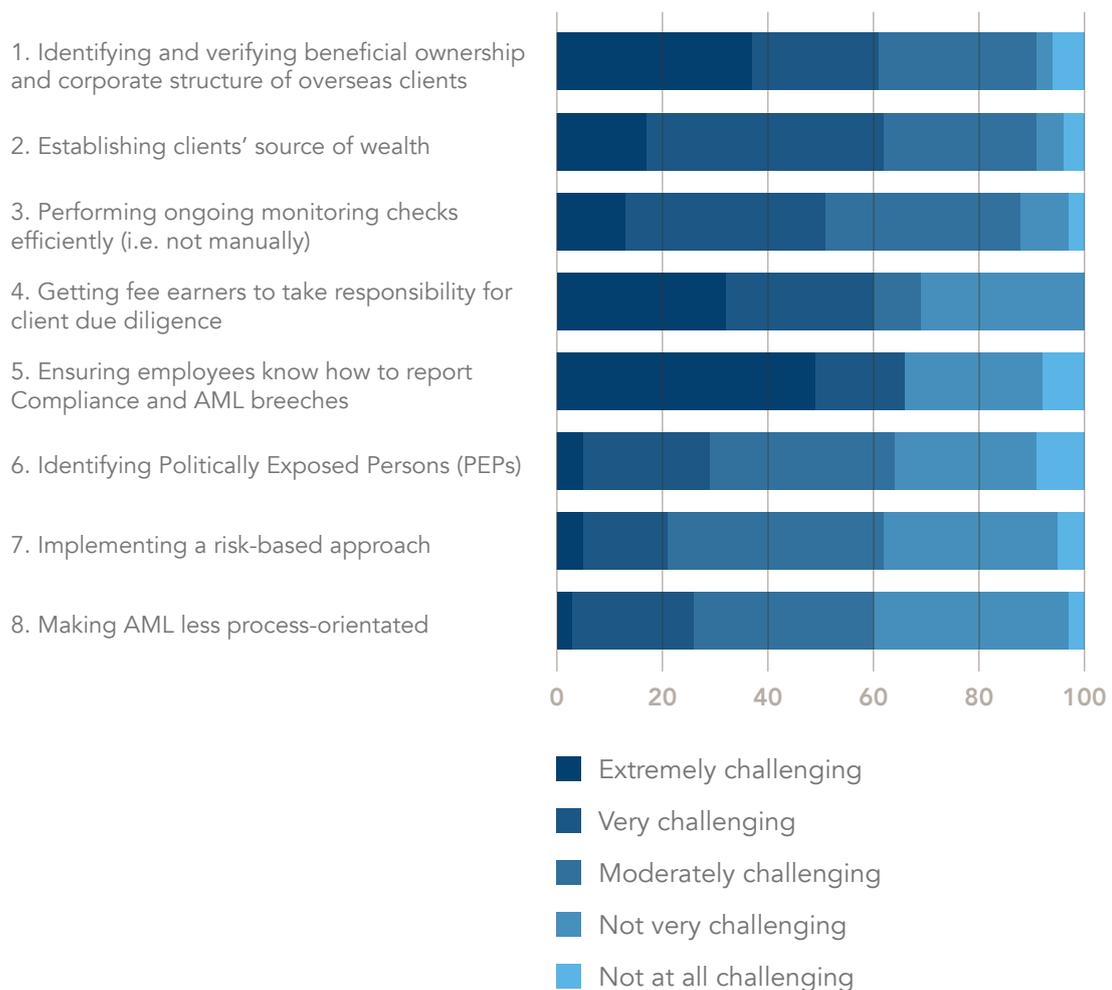
The Greatest Challenges of AML for Law Firms

The survey asked participants, ‘How challenging do you find the following aspects of AML?’ with options ranging from ‘extremely challenging’ through to ‘not at all challenging’.

The following chart ranks those areas most frequently considered challenging, by grouping together the results for ‘extremely challenging’, ‘very challenging’, and ‘moderately challenging’.

‘How challenging do you find the following aspects of AML?’

The greatest AML challenges faced by law firms



1. Identifying and verifying beneficial ownership and corporate structure of overseas clients



Extremely challenging – 37%

Very challenging – 24%

Moderately challenging – 30%

Not very challenging – 3%

Not at all challenging – 6%

Over 91% of those who responded to the survey categorised the identification and verification of beneficial ownership and corporate structure of overseas clients as challenging—and it is easy to see why this is such a complex task for law firms.

4MLD has introduced the concept of keeping a central ultimate beneficial ownership register which identifies the ultimate beneficial owner of companies or trusts. The recent Panama Papers scandal has also highlighted the need for such a centralised register.

The real difficulty, however, is in populating and maintaining this database. In the UK, a public register of companies through Companies House with additional beneficial ownership data was introduced earlier this year; however, the depth and accuracy of the data available are yet to be verified. It is likely that firms will need to conduct their own independent checks to supplement the information provided by public registers, creating additional complexity in the AML screening process.

2. Establishing clients' source of wealth



Extremely challenging – 17%

Very challenging – 45%

Moderately challenging – 29%

Not very challenging – 5%

Not at all challenging – 4%

Equally, establishing clients' source of wealth was considered challenging by 91% of those who answered the survey, with larger firms (firms of over 100 people) finding this far more challenging than the smaller firms surveyed.

A likely cause is the complexity of the relationships between larger law firms and their clients, and the difficulty of obtaining the necessary information for a large client base. In comparison, smaller firms working closely with a narrow pool of clients may consider it easier to obtain this level of information.

It is important for firms to understand their clients' source of wealth to ensure funds have been obtained in a legitimate way. If an individual cannot explain how they received a large influx of cash into their bank account or how they were able to acquire certain assets, it may raise concerns, calling for further due diligence. A client's right to privacy can create a barrier to obtaining such information, making it difficult for firms to decide on the appropriate course of action.

3. Performing ongoing monitoring checks efficiently (i.e. not manually)



Extremely challenging – 13%
Very challenging – 38%
Moderately challenging – 37%
Not very challenging – 9%
Not at all challenging – 3%

88% of individuals surveyed listed the ongoing monitoring of their client base as a challenging AML task. This is likely to be due to the investment in technology required to put ongoing monitoring in place.

Initial due diligence during client or matter inception is something that firms now carry out as a matter of course. This is relatively easy to do using simple lookup tools for ID verification and AML screening. However, manually checking clients' information is not a sustainable process when it has to be done regularly and investment in more sophisticated screening software is necessary to make ongoing monitoring possible, scalable, and cost-effective.

Many law firms are now making the move from online lookup tools to a combination of screening technology and comprehensive compliance data, which can integrate with internal systems and run automated checks continuously. Configured correctly, this raises red flags to the compliance team whenever a match occurs, enabling them to investigate further and take the appropriate course of action.

4. Getting fee earners to take responsibility for client due diligence



Extremely challenging – 32%
Very challenging – 28%
Moderately challenging – 9%
Not very challenging – 31%
Not at all challenging – 0%

The fourth biggest challenge selected was ensuring fee earners take responsibility for customer due diligence, at 69%.

Since fee earners are typically incentivised to attract new clients, it is within their interests to make the onboarding process as straightforward as possible. Without a full understanding of the firm's compliance obligations, they may regard customer due diligence as a burden or be reluctant to ask potentially intrusive questions when forming new client relationships. Firms must therefore strike a balance between enforcing high compliance standards and enabling new business opportunities.

5. Ensuring employees know how to report compliance and AML breaches



Extremely challenging – 49%

Very challenging – 17%

Moderately challenging – 0%

Not very challenging – 26%

Not at all challenging – 8%

66% of individuals found educating internal staff on how to report compliance and AML breaches challenging, with a higher proportion of ‘extremely challenging’ responses, at 49%, than any other question. This is a concerning statistic given the importance of raising compliance breaches and the implications of not doing so correctly.

Consistency of reporting and record keeping is important, since external regulators and auditors typically review firms’ AML policies and how their procedures support those policies. Many recent penalties have highlighted inconsistent application of procedures as a primary concern.

The inconsistent application of a policy is often a result of a lack of training or the turnover of compliance staff. It is crucial that all staff receive regular AML training and are kept up to date on the latest penalties, as well as the methods of detecting and reporting instances of financial crime.

6. Identifying Politically Exposed Persons (PEPs)



Extremely challenging – 5%

Very challenging – 24%

Moderately challenging – 35%

Not very challenging – 27%

Not at all challenging – 9%

Given the availability of various commercial databases that provide extensive detail on Politically Exposed Persons and other negative news to identify risk exposure, it is surprising to see that **64% of those who answered this question consider identifying PEPs as a challenge.**

The results show that firms of under 100 people consider identifying PEPs to be a greater challenge than larger firms, which is likely due to the investment required to obtain a PEP database, as well as the resources need to perform regular screening and deal with matches.

4MLD highlights the need to screen domestic PEPs as well as foreign PEPs. While the number of UK-specific PEPs is not high (Accuity’s PEP database currently records approximately 46,000 UK PEPs), the added level of complexity of including domestic PEPs will require firms to adjust their current screening processes.

7. Implementing a risk-based approach



Extremely challenging – 5%

Very challenging – 16%

Moderately challenging – 41%

Not very challenging – **33%**

Not at all challenging – **5%**

Although **only 5% consider the implementation of a risk-based approach extremely challenging**, a high proportion of law firms appear to be finding this at least moderately challenging.

Applying a risk-based approach can help law firms to proactively seek information about money laundering threats. It is crucial that firms regularly assess their money laundering risk and put in place systems and controls that will help them manage and mitigate that risk. In an ideal scenario, every law firm would have ongoing monitoring solutions in place that can help improve the efficiency of dealing with high-risk entities on a continual basis.

8. Making AML less process-orientated



Extremely challenging – 3%

Very challenging – 23%

Moderately challenging – 34%

Not very challenging – **37%**

Not at all challenging – **3%**

Although not categorised by many as ‘extremely challenging’, **the issue of making AML less process-orientated was flagged by the majority of law firms as either moderately or very challenging**, suggesting that it is still a significant task.

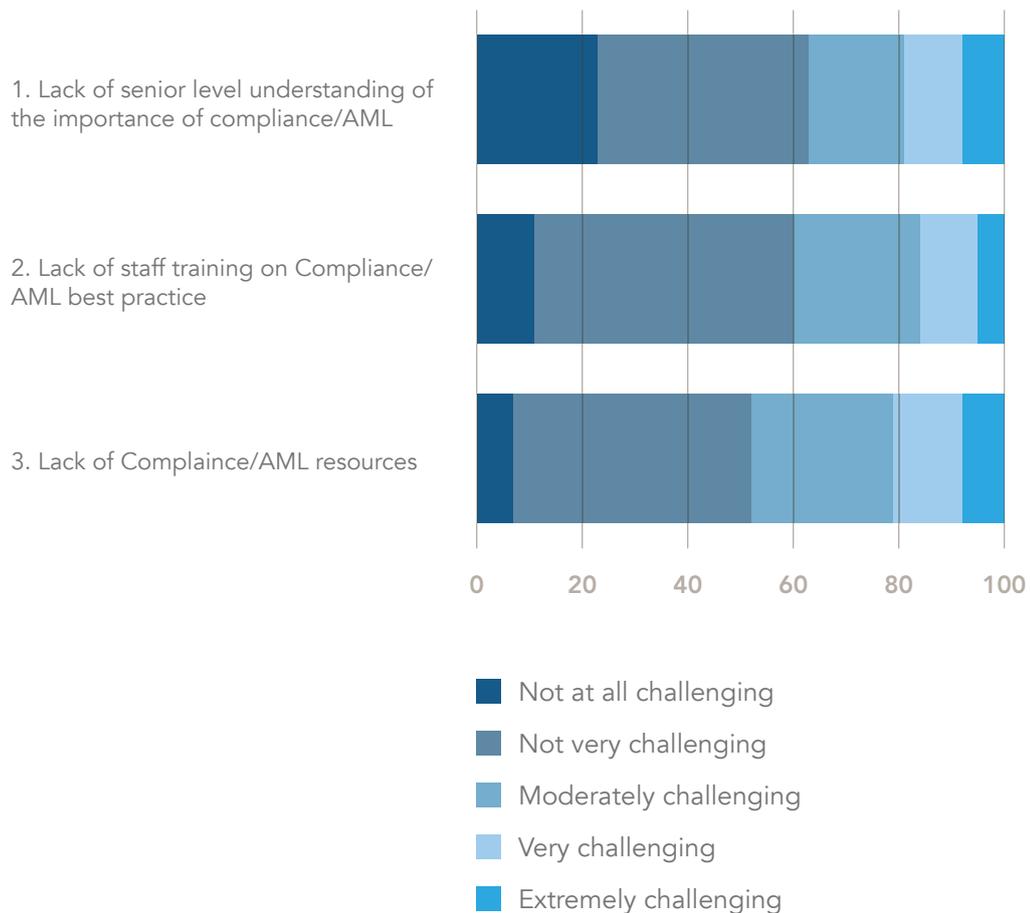
KYC and AML processes can be complex, requiring firms to constantly review their customer accounts and transactions against the current available data. While regulators do not specify how firms should conduct these checks, consistency across processes is critical and is typically best accomplished using automated systems.

The Least Challenging Aspects of AML for Law Firms

Based on responses to the same question, ‘How challenging do you find the following aspects of AML?’, the following chart ranks those areas of least concern, by grouping together the results for ‘not very challenging’ and ‘not at all challenging’.

‘How challenging do you find the following aspects of AML?’

The Least Challenging Aspects of AML Faced by Law Firms



1. Lack of senior-level understanding of the importance of compliance/AML



Not at all challenging – 23%

Not very challenging – 40%

Moderately challenging – 18%

Very challenging – 11%

Extremely challenging – 8%

At 63%, **lack of senior-level understanding of the importance of compliance and AML** appeared to be the least challenging issue of those listed.

It is positive to see that understanding of the need to conduct compliance and AML checks is well understood in most firms, and it is possible that the many high-profile penalties against financial institutions in recent years have served to inform and educate the legal sector about the potential consequences of due diligence failure.

Senior-level understanding of compliance and AML is also aided by the role played by institutions such as the Law Society in raising awareness of these issues. Money laundering continues to be a hot topic at industry events, with multiple seminars, meetings, and training sessions helping to bring this important issue to the fore.

2. Lack of staff training on compliance/AML best practice



Not at all challenging – 11%

Not very challenging – 49%

Moderately challenging – 24%

Very challenging – 11%

Extremely challenging – 5%

Similarly, **a lack of staff training on compliance and AML best practice does not appear to be a major challenge**, with 60% of individuals rating it either 'not very' or 'not at all' challenging.

Given that senior-level buy-in of compliance requirements is well understood, it is unsurprising that an appropriate level of staff training seems to occur within the firms surveyed.

This is a positive trend and firms should continue to leverage training resources to keep up to date on the latest issues relevant to AML compliance.

3. Lack of compliance/ AML resources



Not at all challenging – 7%

Not very challenging – 45%

Moderately challenging – **27%**

Very challenging – **13%**

Extremely challenging – **8%**

In other sectors, lack of resources is often cited as a major barrier to achieving the desired levels of due diligence; however, **more than half of law firms surveyed did not consider it challenging.**

Many firms appear to have strong compliance processes and screening solutions in place, with the ability to look up new accounts and transactions when conducting the required due diligence checks.

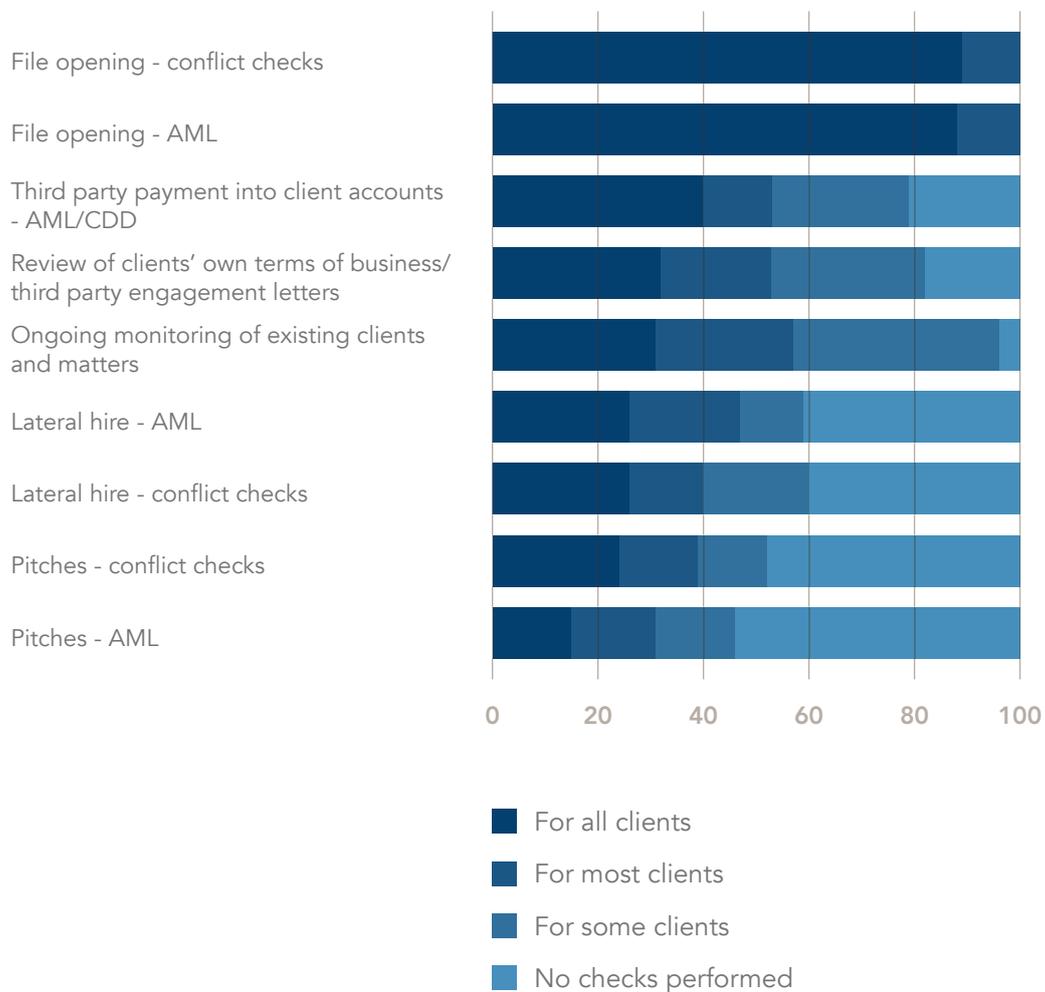
There appears to be a pervading culture of compliance within this sector and naturally, legal professionals are informed and aware of the legal obligations of AML compliance. This increased awareness translates to providing the appropriate resources to deal with AML compliance issues.

Screening Trends

The survey asked recipients, ‘Which of the following compliance/AML screening checks do you perform?’ seeking to assess the various stages of client inception and ongoing engagement at which due diligence is usually carried out.

‘Which of the following compliance/AML screening checks do you perform?’

Screening Checks Performed



File opening

The results show a clear trend of firms performing screening checks during file opening, with almost 90% performing conflict and anti-money laundering checks on 'all' new files and the remainder performing these checks on 'most' new files.

Payments

Around half of those questioned stated that they perform anti-money laundering or due diligence checks on third-party payments into client accounts for all or most of their clients. Just over 20% of those questioned do not screen third-party payments for any clients at all.

Review of terms of business

Around a third of those responding to the survey highlighted that they perform compliance checks during their reviews of all clients' terms of business or third-party engagement letters.

Ongoing monitoring

Almost a third of firms carry out ongoing monitoring checks on all clients and matters. With solutions available to automate the screening process, it is anticipated that this proportion will increase, particularly among larger firms. Although an investment in data and software is required to implement such a system, running screening checks continuously in the background enables firms to systematically pick up on any possible AML breaches without requiring manual intervention until a match is identified.

Lateral hire

The survey results show that some firms perform AML and conflict checks on lateral hires. As a major driver of growth, as well as a significant investment for law firms, it is good practice for these screening checks to take place and ensure lateral hires are recruited successfully.

Pitches

Compliance and AML screening during client pitches are the least common checks taking place according to the survey, although conflict of interest checks at this stage of the client engagement are slightly more common.

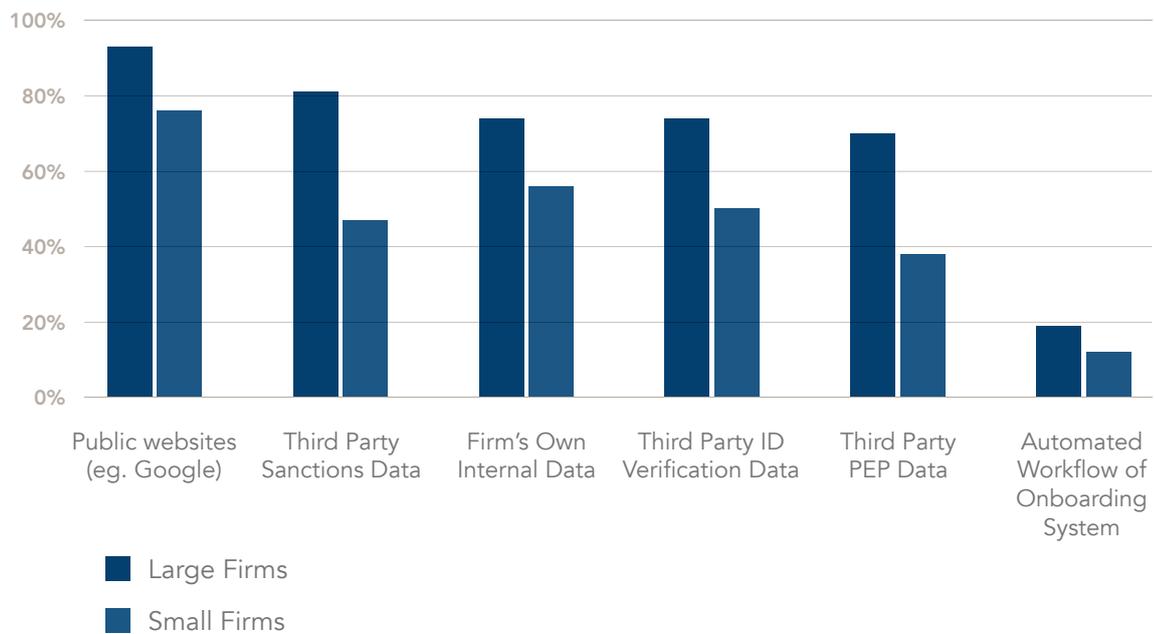
Most Popular AML Resources

The survey asked: ‘How do you currently conduct client screening?’ giving participants the option to select multiple methods in their response.

The results show that firms use a combination of different resources for compliance screening, rather than relying on a single source of information. Larger firms (more than 100 people) appear to use a broader range of resources than smaller firms, possibly due to their ability to invest in third-party data and technology.

‘How do you currently conduct client screening?’

Resources Used



Public websites

The majority of firms make use of public websites, such as Google, to assist in their compliance screening procedures. These are typically used when a potential red flag is identified, requiring a closer investigation of a particular client or case.

Third-party sanctions data

Over 80% of larger firms surveyed—and almost half of smaller firms—currently subscribe to third-party sanctions databases to enable them to identify matches within their client base. This is typically the most effective way for firms to monitor regulatory watch lists, as the data provider assumes responsibility for making adjustments to the data when list changes occur, as well as enhancing the data with supplementary information.

In-house data

74% of larger firms and 56% of smaller firms stated that they use their own internal data to screen against. This approach requires considerable resources to be allocated from within the firm, to ensure all information remains as complete and up to date as possible.

Third-party ID verification data

It is important to verify the identity of clients, and **74% of larger firms deploy third-party data to assist in processes** such as passport and documentation checking. However, only around half of the smaller firms represented in the survey use a third-party vendor to provide this data.

Third-party PEP data

When performing PEP due diligence, **70% of larger firms appear to use external databases or e-verification providers, compared with just 38% of smaller firms.** Though all firms are currently required to implement a risk-based approach in relation to PEPs, 4MLD requires all firms to screen domestic PEPs.

Automated workflow or onboarding system

Under 20% of firms currently use automated workflow or onboarding systems. It is clear that the cost and complexity involved in implementing this technology may be prohibitive for many firms; however, this type of solution can improve efficiency and help to make cost savings in the longer term.



Responding to Regulatory Change

Participants were asked: ‘How does your firm monitor and respond to regulatory changes?’ requiring a free text response. The following key themes were most prevalent in the responses:

1. Reliance on the MLRO and compliance function

Many of the survey participants referred to the MLRO’s role in shouldering the burden of monitoring and responding to regulatory change. Similarly, others mentioned their firm’s Compliance Officer, Practice Manager or more generally, the compliance department, as being responsible for understanding and promoting this information.

Responses highlighted that MLROs and compliance teams regularly disseminate internal updates within their firms, often on a daily basis. They do so via email newsletters, policy updates, and regular training sessions.

‘We have a regular risk review process which takes place monthly, as well as a quarterly risk committee. But the burden is left on the shoulders of the MLRO to implement any decisions.’

2. Internal forums & committees

Regular internal forums and committees were cited as another means of firms reviewing and acting on relevant legislation and regulation, generally taking place either monthly or quarterly. Firms appear to be using these forums as an opportunity to review the effectiveness of existing compliance processes, discuss any required changes, and implement the appropriate actions.

3. Relationships with the regulators

Several legal professionals who completed the survey mentioned monitoring the Solicitors Regulation Authority (SRA) website for updates. However, only one person noted having a direct relationship with regulators and government departments as a way of keeping on top of regulatory change.

4. External information sources

The survey results revealed that external authorities, including the Law Society and various bar associations, are heavily relied upon to provide regulatory news to law firms. In particular, the Law Society's regular email updates, events, and training courses were called out as useful sources of this information for firms

in England and Wales. Membership of other professional organisations and working groups was mentioned, as well as the use of external training partners and support companies as facilitators of regulatory awareness.

Lastly, articles published in the legal press, LinkedIn groups and blogs are being used by some firms as sources of current information, along with email newsletter subscriptions from a variety of organisations.

5. Lack of process

Several survey responses referred to monitoring regulatory change in an 'ad hoc' way, reacting only when a key regulatory change is announced. A minority of legal professionals stated that their firm does not currently respond very well, with little or no formal processes in place.

Identifying and Screening High-Risk Clients

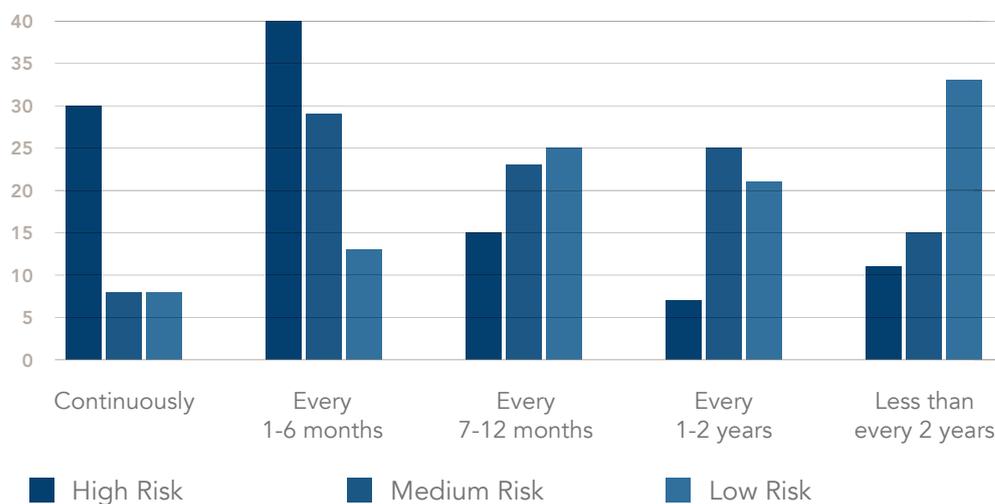
The criteria firms most commonly use to assess the risk level of clients span the following:

- Ownership structure
- Where the client is based geographically
- Where the client conducts business
- Scope of work or nature of the retainer
- Sector
- Entity type (e.g., trust, foundation, etc.)

The survey asked participants: ‘How often do you perform ongoing monitoring checks on active clients?’ within each risk level (high, medium or low).

‘How often do you perform ongoing monitoring checks on active clients?’

Frequency of Client Screening by Risk Level



30%

Firms appear to be screening high-risk clients much more frequently than medium- or low-risk clients, with 30% screening those they deem to be high-risk on a continuous basis.

8%

8% of firms represented in the survey perform due diligence continuously on all clients, irrespective of their risk level.

1/3

For low-risk clients, screening takes place far less frequently, with around a third of firms only conducting checks every two years or less.

The EU 4th Anti-Money Laundering Directive

Participants were asked to name one main impact of the EU 4th Anti-Money Laundering Directive that they think will affect their firm's compliance or AML procedures.

The topics which occurred most frequently in response to this question included the expansion of the definition of a PEP to include domestic PEPs, as well as the introduction of a centralised beneficial ownership database. Examples of the free text responses include the following:

'The central register of beneficial ownership should be a great help when conducting due diligence'

'The introduction of domestic PEPs to the PEP regime will have a significant impact'

'My firm's due diligence responsibility will expand'

'I may need to recruit more staff and carry out more analysis'

'Costs will increase for education, qualified personnel, and external support'

'The directive creates additional bureaucracy, which will require more manpower'

'We will need to do a full risk assessment of our current AML systems'

'Let's wait and see what the requirements are before spending time preparing'

'Since we apply a high standard of due diligence / AML to all clients, I don't expect any changes'

'The burden of additional due diligence, as simplified exemptions are being scrapped'

'We will need to transition from KYC to applying a more risk-based approach'

'A higher level of awareness, a greater emphasis and the expanded requirements of AML will increase the time, effort, and costs spent on compliance'



Accuity helps law firms to safeguard their reputations and minimise regulatory risk.

Endorsed by the Law Society, our anti-money laundering solutions are powered by the industry's largest database of high-risk entities, including sanctions, PEPs, adverse media, and enforcement data.

We enable law firms to understand the risk of doing business at every stage of a client engagement:

-  **During onboarding** – firms can perform checks before embarking on new client relationships
-  **Before opening files & matters** – firms can screen clients and transactions prior to starting work
-  **Ongoing monitoring** – firms can ensure the trusted relationships they have built remain trustworthy

For more information visit www.accuity.com/compliance

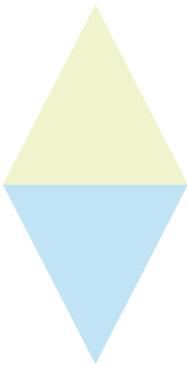


client success

“Bird and Bird was looking for an easy-to-implement and configurable solution to automate client screening and reduce time-consuming manual checks. After a successful implementation, Firco Compliance Link from Accuity has helped increase risk protection and control operational costs, meeting our needs perfectly.”

Trish Hardowar

Risk & Compliance Manager, Bird & Bird



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Accuity offers a suite of innovative solutions for payments and compliance professionals. Our portfolio includes comprehensive data and software that control risk and manage compliance, and accurate data and tools that optimise payments pathways. Backed by our deep expertise, the industry-leading solutions from our Fircosoft, Bankers Almanac and NRS (a U.S. entity serving securities professionals) brands deliver protection for individual and organisational reputations.

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