REVIEW OF THE SUSPICIOUS ACTIVITY REPORTS REGIME

(The SARs Review)

Sir Stephen Lander

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SOCA
SERIOUS ORGANISED CRIME AGENCY

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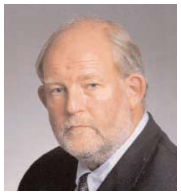
Foreword



By Charles Clarke, Home Secretary and Gordon Brown, Chancellor of the Exchequer

Tracking down criminals, and seizing and confiscating their assets is key to tackling many of the threats and problems that society faces including terrorism, organised crime, illegal immigration, drugs, low level crime and disorder, and fraud.

Because money underpins international terrorism we are targeting terrorists' finances and in order to take the profit out of crime, we are also pursuing the assets of the people smugglers, the drug traffickers and dealers and the other criminals who make people's lives a misery. This means that comprehensive measures against money laundering are a critical part of the UK's defences.

Sir Stephen Lander's Review of the Suspicious Activity Reports (SARs) regime and the creation of the new Serious Organised Crime Agency provide valuable opportunities to improve the effectiveness of this system. The government welcomes the report's recommendation that SOCA should take overall responsibility for the effective functioning of the SARs regime.

Police forces and law enforcement agencies now, for the first time, have direct access to the database of Suspicious Activity Reports made by the financial services industry and other business sectors. They must use this valuable intelligence to maximum effect.

The restructuring of police forces offers the prospect of larger forces with the capacity and expertise to focus more effectively on this work.

We are committed to working in partnership with industry and regulators to promote a risk-based approach to the reporting regime. We must address the perceived communications gap between the UK authorities and business and we welcome the recommendations in this report on new mechanisms for improving this dialogue.

We have already made important progress. Over £185 million of criminal assets have been recovered over the last 3 years and over the last year we have made essential improvements to the SARs regime. But the challenge of reducing the harm caused by organised crime remains substantial.

The recommendations in this report, which will strengthen our defences against money laundering and improve our ability to seize terrorists' funds, are a significant advance.

Charles Clarke

Gordon Brown

Summary

1. This review of the SARs regime was commissioned in July 2005. Its terms of reference required it to be conducted in consultation with those who would be affected by its outcome. They invited focus on the opportunities for enhancement of the regime presented by the creation of a new national agency, the Serious Organised Crime Agency (SOCA). SOCA will, on 1 April 2006, take over from the National Criminal Intelligence Service (NCIS) responsibility for the regime's Financial Intelligence Unit (FIU) and its database of SARs.

2. The importance of the regime, given the terrorist and organised crime contexts, was well appreciated by those consulted. Its weaknesses were familiar ones: an absence of any single organisational focus for the work and of supporting regime-wide governance arrangements; the inconsistent training, and performance, of participants; poor dialogue between the reporting sectors on the one hand and users on the other; a lack of feedback from law enforcement on the successes achieved; the limited functionality available to access and manipulate the central database of SARs; and uneven law enforcement exploitation of the opportunities presented by the disclosures made. Nevertheless, despite these weaknesses, the regime was clearly delivering benefits in both the terrorist and money laundering contexts, and there was recognition that NCIS' performance as the FIU had improved. No one consulted, however, thought that there was not room for further improvement in overall performance.

3. The recommendations arising from this review (listed at Appendix I of the main report) fall into four groups: those concerned with SOCA's discharge of its responsibilities as the FIU; those that bear on the responsibilities of the reporting sectors; those concerned with exploitation of SARs by the regime's end users; and one on the implementation of the recommendations.

- SOCA as the FIU. SOCA should take over day to day responsibility for the effective functioning of the regime; and new governance arrangements (involving an annual report to Ministers, a management committee, a vetted consultation group and regular regime-wide meetings) should be introduced to oversee and support the discharge of that responsibility. There should be significant further investment in the timeliness of operation of the FIU and also in its database of SARs. Outsourcing of the operation of the database should be considered. SOCA should deliver regular reporting on the functioning of the regime, build up dialogue with reporting institutions and end users, assist regime participants with guidance and support for their training, and develop and propose a performance measurement framework for the regime as a whole.
- The Reporting Sectors. It would be inappropriate to seek to suppress the overall number of SARs, but SOCA should help reporters address uneven reporting and poor quality reporting. A risk-based approach to supporting the weaker performers should be devised with the relevant regulators. Problems with the consent regime need addressing, but outside this review.
- The End Users. All end users should accept the obligation of confidentiality in their handling of SARs and that obligation should be reinforced by further administrative measures. SOCA should so manage the SARs database as to provide a value-added service of information, intelligence and leads to end users. All end users should report twice a year to SOCA on their use of SARs. Her Majesty's Inspectorate of Constabulary should include SARs and proceeds of crime work generally in its inspections. The Serious Fraud Office should have on-line access to the SARs database, in addition to those who already enjoy such

access. Each police force should nominate a senior officer to oversee its SARs work, and should seek to integrate such work into mainstream policing so as to secure “all acquisitive crime” benefits and to avoid over reliance on the limited number of trained Financial Investigators available. Regulators should not have direct access to the SARs database, but each should agree with SOCA the reporting it requires derived from that data. SOCA should be responsible for ensuring that Government Departments receive the intelligence reporting and SARs regime performance data they need.

- Implementation. Realism is needed in judging what can be delivered to improve the SARs regime and over what timescale, given the large and diverse participant community and the difficulty of some of the enforcement work involved. Nevertheless, it is realistic to expect improvements in performance against a timetable covering the eighteen months from 1 April 2006.

Introduction

1. It was announced on 19 July 2005 that the Chancellor of the Exchequer and the Home Secretary had asked me, as chair designate of the Serious Organised Crime Agency (SOCA), to review the Suspicious Activity Reports (SARs) regime and to report, by March 2006, on how investigations of suspicious transactions could best be pursued under SOCA.

2. Terms of reference for the review were agreed in September 2005 as follows:

   - to review the operation of the existing SARs regime to determine its strengths, weaknesses, costs and benefits; and
   - to make recommendations for the future operation of the regime under SOCA, taking account of the views and interests of the regulators, the regulated sectors and of UK law enforcement.

   This is the report of my review. A summary of my recommendations is at Appendix I. A list of terms and abbreviations used is at Appendix II. A regulatory impact assessment of my recommendations is at Appendix III.

3. In conducting my review and preparing this report I have been assisted by a team of staff drawn from the agencies which will be subsumed into SOCA when it launches on 1 April. They have brought to the work a mix of skills, and experience of the subject, which has proved invaluable. Together we have consulted widely through individual meetings, workshops and in the margins of conferences; by circulating, for response in January 2006, a consultation document setting out our developing thinking; and, more recently, by sharing draft chapters of this report to secure comments and commitment from interested parties. The organisations we have consulted are listed in Appendix IV. I am grateful for the interest shown by all, for the helpful suggestions we have received, and for the time of many people, inside and outside Government, freely given.

4. The judgements made and conclusions reached in this report, nevertheless, remain my own. Where my recommendations would commit others or impact on their current approach, I have sought to obtain their agreement or to record their concerns. I have aimed to carry those involved with the regime with the conclusions I have reached. While I cannot claim to have done so on every detail, nor to have reflected every opinion in this text, I believe that what I am proposing will command a wide measure of support. Where doubts remain, I judge they mostly derive from some scepticism about the ability of those involved, in particular within SOCA and in law enforcement more generally, to deliver what is envisaged here, rather than about the appropriateness or desirability of the proposals themselves. Since deliverability is, of course, a key issue, I address it in Part VII of this report.

5. My report is set out in seven parts. Part I (paragraphs 8-16) sets out the context of this review. Part II (paragraphs 17-24) briefly describes, for new readers, the key features of the SARs regime and its legal basis. Part III (paragraphs 25-36) analyses the strengths, weaknesses, costs and benefits of the regime as it currently operates. Part IV (paragraphs 37-49) sets out my proposals for the responsibilities that SOCA should discharge as the owner of what the Financial Action Task Force (FATF) describes as a Financial Intelligence Unit (**the FIU**), that is the unit that receives and distributes SARs. Part V (paragraphs 50-60) addresses the role of those who are required by law to report SARs (**the reporting sectors**); while Part VI (paragraphs 61-95) examines the role of all those, as regulators, in law enforcement and in Government, who have an interest in using the information[1] supplied (**the end users**). Finally, in Part VII (paragraphs 96-104), I look at the implementation of my proposals.

[1]Throughout this report I have used the term “information” to describe the contents of SARs. I have done this to avoid engagement with an ongoing debate about whether SARs are or are not “intelligence”, or in what circumstances they become “intelligence”. The term “information” in this context should be taken as descriptive, and not a judgement concerning value or utility.

6. It is worth noting that, while the terrorist and money laundering reporting arrangements that give rise to SARs derive from different legislation (see paragraphs 20-23), they in practice operate as one regime, with the same reporting sectors, one central database, and one principal means of sharing the reports with users. Accordingly, except where indicated otherwise, my analysis and recommendations in this report should be taken as applying to both contexts.

7. My report, given the focus of the initial Ministerial commission, is concerned principally with what SOCA could do to improve the functioning of the regime. But I considered a large number of detailed issues and received many full accounts of stakeholders' views during the review. Not all are addressed here, since not all, in my judgement, require attention or fall to me to consider. Nevertheless, this report necessarily goes into some detail in addressing the status quo, areas for improvement and my proposals for change. It is designed to allow interested readers to follow the reasoning behind my recommendations, to let participants in the SARs regime see what I believe should be expected of them, and to give Ministers an opportunity to consider my recommendations and to decide whether they wish to endorse the overall approach proposed.

8. This review was initiated largely because of a renewed United Kingdom (UK) focus on terrorist financing in the wake of the events of 7 July 2005, and continuing concerns in the City and the professions about the burdens imposed by the SARs regime, against an apparent lack of successful exploitation of those SARs by law enforcement. It is not the first review to consider these issues. In 2003, the Government commissioned KPMG to review the effectiveness of the money laundering reporting regime[2]. KPMG made wide criticisms and a number of recommendations covering the development of the SARs database, the monitoring of law enforcement outcomes, improved training, greater and more visible Government commitment to the regime, the introduction of electronic reporting and the standardisation of reporting processes. Progress has since been made on the majority of those recommendations, but the concerns that led to the commissioning of the KPMG review have remained.

9. In 2004, Her Majesty's Inspectorate of Constabulary (HMIC), assisted by the Crown Prosecution Service (CPS) and Her Majesty's Magistrates' Court Service Inspectorate, reviewed law enforcement efforts at asset recovery under the Proceeds of Crime Act 2002 (POCA)[3]. Their report highlighted the importance of asset recovery to the reduction of crime, but criticised what was seen as a failure to maximise the use of financial intelligence, in particular in relation to overall acquisitive crime. The same point was picked up by Matt Fleming in 2005 in his wide-ranging report on the SARs regime for the Jill Dando Institute of Crime Science at University College, London[4]. He concluded that, despite improvements made following the KPMG review, SARs were still, up to 2004, under-used by law enforcement in this country. His recommendations, covering governance arrangements, the capabilities of the SARs database (known as ELMER), and law enforcement efforts in the field, have provided an important input to this review.

10. Academic research in this country and elsewhere has explored some of the same issues. Most jurisdictions have undergone a similar path to the UK, starting with an awakening understanding of the links between money laundering and organised crime, and the potential beneficial impact of anti-money laundering (AML) and counter-terrorist financing (CTF) activity; through legislation on proceeds of crime and the introduction of reporting mechanisms; to, finally, a more mature system of law, but with problems of scale and effective end user action. Indeed, on this last point, UK practice appears certainly no less (and in some cases considerably more) effective than that of a number of other jurisdictions. In research on the situation in the Netherlands, for example, the comment was made that, "due to a lack of organisational facilities, manpower, expertise, and, last but not least, interest, valuable financial information does not get enough attention in the process of law enforcement"[5]. Similarly, in Japan, out of 98,935 reports received in 2005, law enforcement was only able to pursue 18 cases[6].

11. Since much of this policy and academic scrutiny of the UK (and others') arrangements was undertaken, however, the UK context has changed significantly, both in terms of the appreciation of its security and criminal environment, and also in relation to the law enforcement players who should be among the principal users of SARs. The events of 7 and 21 July 2005, for example, brought home to many the vulnerability of the UK to terrorist attack from Al Qaida associated groups and individuals, and the critical importance of

[2]KPMG, "Money Laundering: Review of the Reporting System", London, 2003.
[3]HMIC, "Payback Time: Joint Review of Asset Recovery Since POCA", London, 2004.
[4]Matthew Fleming, "UK Law Enforcement Agency Use and Management of Suspicious Activity Reports: Towards Determining the Value of the Regime", London, 2005.
[5]Hans Nelen, "Hit them where it hurts most? The proceeds of crime approach in the Netherlands", Amsterdam, 2004.
[6]Statistics provided by the National Police Agency of Japan.

taking every opportunity, including through the interdiction of the terrorists' funding, to undermine their planning. Separately, Home Office work over the last two years designed to illuminate the harm caused to the UK by organised crime has pointed with greater clarity than hitherto to the very sizeable sums of money, much of it in cash, obtained here by criminals, in particular by drug dealers, people smugglers and traffickers, and fraudsters. This in turn has drawn attention to the volume of money laundering that must be going on in and through the UK to allow those criminals to make use of their illegal profits. In short, recent events have emphasised for the UK the continuing importance of its AML and CTF arrangements.

12. There are two further points worth making here which were raised during the review by a number of City interlocutors. The first concerned the important part that the CTF and AML regimes, as well as the UK's robust financial regulation, were perceived to have in supporting the reputation for probity, and thus the competitiveness, of the City of London. The second concerned the issue of collective security. A disclosure relating to terrorist or criminal property by one institution was thought by some to be likely to protect others in future. By their nature, such arguments are difficult to validate, but I record them as they bear on the perceived value of current arrangements.

13. So far as the law enforcement context is concerned, three recent developments provide important context for the future of the regime. The first has been the creation of two new national law enforcement organisations, Her Majesty's Revenue and Customs (HMRC) and SOCA. The former, created by the amalgamation of the Inland Revenue (IR) and Her Majesty's Customs and Excise (HMCE) through the Commissioners for Revenue and Customs Act 2005, is responsible for all enforcement work on fiscal crimes affecting the UK. The new joint department will enjoy unrivalled experience in, and significant resources for investigating, financial crime. The latter was created by the Serious Organised Crime and Police Act 2005 (SOCAP) out of NCIS, the National Crime Squad, those staff formerly in HMCE involved in the investigation of drugs and associated money laundering, and some experts from the Immigration Service. It will, once launched, be responsible not only for investigating serious organised crime, but also for supporting UK law enforcement generally in its work.

14. In the context of the SARs regime, it is worth pointing out that SOCAP gives SOCA powers and functions that are pertinent to the FIU role it will inherit from NCIS. It provides SOCA with three functions: the prevention and detection of serious organised crime; the mitigation of the consequences of such crime (s.2); and the function of gathering, storing, analysing and disseminating information (s.3). It makes clear that SOCA's functions are not restricted to serious or organised crime but potentially bear on all crimes, and that those functions are to include assistance to others in the discharge of their enforcement responsibilities (s.5). It establishes gateways for SOCA to share information with (s.33), and to receive information from (s.34), a wide range of collaborators in pursuit of its functions. The definitions in SOCAP of those collaborators include all law enforcement organisations, Government Departments and regulators, as well as agencies discharging the same functions overseas (s.3). SOCA's statutory foundation thus provides it with powers to share information with, and to support, exactly those partners who have a direct interest in using the information in SARs.

15. The second law enforcement development of importance to the SARs regime is the

likelihood of restructuring of police forces in England and Wales. At the time of writing, the extent of such restructuring is still under consideration. The relevance to the SARs regime is the prospect of a number of larger forces better able to concentrate specialised resources onto work on the proceeds of crime, including on the suspicions raised in SARs. The UK's proceeds of crime legislation is still comparatively new and law enforcement's use of it is still developing. It is widely thought that it has the potential, properly used, to make a significant impact on criminal conspiracies affecting the UK, but appropriate staffing of the work remains a constraint.

16. Finally, the Fraud Review launched by the Attorney General and the Chief Secretary to the Treasury in October 2005 is already examining some of the key issues about law enforcement capacity to investigate financial crimes that are directly relevant to their similar capacity to investigate SARs[7]. Although fraud and proceeds of crime work (including on SARs) depend on different statutes, and tend, therefore, to be considered as posing separate problems and requiring different approaches to investigation, the skills and training required of investigators, in fact, overlap. Since the Drug Trafficking Act 1985, police forces have secured specialist training and accreditation for Financial Investigators (FIs) to undertake this work. Such training and accreditation is now provided by the Assets Recovery Agency (ARA), under the provisions of POCA s.3, at the rate of about 30 officers a month. The supply of FIs, however, at approximately 2,000 nationally, falls short of what is required by the volume of work available, reflecting the importance of other priorities, particularly within policing, and the difficulty of securing and retaining the right people for this work. The danger here going forward is that efforts to improve law enforcement engagement on fraud on the one hand, and on the exploitation of SARs on the other, might have the inadvertent consequence of undermining each other. This needs to be borne in mind when we come to look at the role of the end users of SARs in Part VI of this report.

[7]The Fraud Review will address the following questions: "what is the scale of the problem? What is the appropriate role for Government in dealing with fraud? How could resources be spent to maximise value-for-money across the system."

Part II: The SARs Regime

17. Before examining the current health and utility of the SARs regime in the UK, it may be helpful briefly to rehearse the principal features of the regime and the legal basis on which it operates. Reporting of money laundering suspicions (in a drugs context) goes back to legislation in 1986[8], and the Organisation for Economic Co-operation and Development established FATF to co-ordinate AML efforts in 1989. FATF, supported by the UK, has subsequently formulated forty "Recommendations" to member countries concerning AML arrangements, as well as nine "Special Recommendations" on CTF strategies. FATF reviews compliance with its various "Recommendations" through a process of "mutual evaluation". The UK's arrangements are to undergo this process of review during 2006-07.

18. FATF Recommendation 26 required that each member country should establish an FIU to receive, analyse and disseminate SARs and other relevant information. The FIU should have timely access to financial, administrative and law enforcement information in order to analyse the SARs effectively. In 1995, a number of national FIUs joined to form the Egmont Group. The Group subsequently defined the role of an FIU as "a central national agency responsible for receiving (and as permitted requesting), analysing and disseminating to the competent authorities disclosures of financial information:

    a) concerning suspected proceeds of crime and potential financing of terrorism, or

    b) required by national legislation or regulation in order to combat money laundering and terrorism financing."

19. The European Union has also formulated AML and CTF instruments within which the UK must work. The First EU Directive in 1991 obliged member states to enact legislation which outlawed money laundering and required financial institutions to identify customers, keep records, maintain internal AML mechanisms and report suspicious transactions. In 2001, the Second EU Directive required the extension of money laundering legislation beyond drug trafficking to all crimes. The Third EU Directive (MLD3) will come into force in December 2007. It reproduces much of the Second Directive but is more detailed and contains some new provisions. In particular, it explicitly deals with terrorist financing; provides new definitions for Politically Exposed Persons (PEPs); introduces the requirement for Money Service Businesses, Trust, and Company Service Providers to be licensed or registered under a fit and proper test; enhances the customer due diligence regime, encourages a risk-based approach and prohibits anonymous accounts. It requires there to be monitoring and supervision of all the institutions covered by the Directive, and the collection of statistics on the effectiveness of the regime and on feedback. It also carries forward from earlier Directives a system in which institutions should refrain from suspicious transactions until they have informed the FIU (Article 24), and a requirement for something like a tipping off offence (Article 28).

[8]The Drug Trafficking Offences Act 1986 provided reporters with a defence from a charge of money laundering if they disclosed their suspicions to a constable.

20. The UK's current primary legislative response to these international agreements and legal instruments has been delivered in the Terrorism Act 2000 (TA) and POCA. Part 3 of the TA is concerned with terrorist property which is defined as "money or other property which is likely to be used for the purposes of terrorism … the proceeds of the commission of acts of terrorism, and the proceeds of acts carried out for the purposes of terrorism" (s.14). It creates offences in relation to 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" (ss.15-18). The legislation establishes a disclosure regime where an individual "believes or suspects that another person has committed an offence" and where he "bases his belief or suspicion on information which comes to his attention in the course of a trade, profession, business or employment." In such circumstances, the individual or his employer "commits an offence if he does not disclose to a constable as soon as is reasonably practicable- (a) his belief or suspicion, and (b) the information on which it is based" (s.19). He also commits an offence if a "constable forbids him to continue his involvement in the transaction or arrangement to which the disclosure relates, and he continues his involvement" (s.21).

21. Part 7 of POCA contains a number of similar offences but related to money laundering more generally. The primary money laundering offences are all concerned with the actual use of, or dealing with, criminal property: concealing criminal property (s.327), making arrangements in respect of it (s.328), and its acquisition, use and possession (s.329). It also establishes what are in effect two distinct regimes for the handling of suspicions about criminal funds (ss.330-339). The first requires institutions in the regulated sectors to disclose (as SARs) to the FIU any suspicions that arise concerning criminal property. The second allows persons and businesses generally, and not just those in the regulated sectors, to avail themselves of a defence against money laundering charges by seeking the consent of the authorities (effectively via the FIU) to conduct a transaction or undertake other activity (a "prohibited act") about which they have concerns. The legislation gives the authorities seven days to respond. Where consent is refused, the transaction or activity must be frozen for a further 31 days[9]. Finally, the making of disclosures generally is governed by tipping off provisions (s.333) which make it an offence, having made a disclosure, to reveal information which is likely to prejudice any resulting law enforcement investigation. It is worth noting that the definition of criminal property in the legislation (s.340) is wide ("a person's benefit from criminal conduct … in whole or in part and … directly or indirectly … money … all forms of property, real or personal, heritable or moveable … things in action and other intangible or incorporeal property"); that the legislation can operate retrospectively ("whether the conduct occurred before or after the passing of this Act"); and that it criminalises actions taken overseas which "would constitute an offence … if done in the UK"[10]. The consequence of these provisions is that all acquisitive crime is caught as well as proceeds of crime generated overseas, not just serious organised crime and proceeds obtained within the jurisdiction.

22. The TA and POCA create distinct legal regimes, but, as indicated at paragraph 6, in practice their operation in this context overlaps. Those reporting their suspicions can find the distinction difficult to make. In consequence, SARs surfaced under POCA may be relevant to a terrorist investigation, and suspicions raised in a terrorist context may, in fact, bear only on acquisitive crime. It is right, therefore, to see the two Acts as operating, in this regard, as one regime, and that is the sense that should be read into the term throughout this report. There are, of course, some distinct features. NCIS currently deploys a specialist team within the FIU, for example, which seeks to identify

[9]There is also a similar, but little used, consent arrangement in the TA. In that Act there is no time limit within which the authorities must respond.
[10]SOCAP s.102, to be commenced shortly, creates a defence where overseas conduct is legal under local law.

leads to terrorist activity from all SARs, whether TA or POCA derived, to pass to the National Terrorist Financial Investigation Unit at Scotland Yard (NTFIU), and SOCA will continue this. Also, while all SARs are entered on the same database, for obvious security reasons only those not thought to bear on CTF are available to the remainder of law enforcement users.

23. The TA and POCA are supplemented by secondary legislation in the form currently of the Money Laundering Regulations (MLRs) of 2003. These set out in greater detail the AML requirements laid on firms, including those concerning the need for a "nominated officer", described as a Money Laundering Reporting Officer (MLRO), to oversee reporting obligations, and to submit SARs to the FIU. They set out "know your customer" provisions designed to enable firms to verify the identities of their clients, record keeping obligations and provisions on staff training. The MLRs are at a comparatively high level to allow reporting institutions flexibility in the way they are met.

24. Finally, the legislation is supported by Government and industry advisory bodies, most notably the Money Laundering Advisory Committee (MLAC). MLAC, jointly chaired by the Home Office and Her Majesty's Treasury (HMT), was created in 2004 from predecessor groups to facilitate dialogue, take decisions on the SARs regime, and make recommendations on the general functioning of the UK's AML arrangements. It has a number of sub-groups, the most relevant to this report being the Reporting and Feedback sub-group, which is the main forum currently for discussion of the SARs regime. Other work is carried forward by Identity, Guidance Notes and Communications sub-groups. Both the plenary and sub-groups have members from law enforcement, reporting sector representative bodies and Government agencies. Trade and professional associations and trade bodies, such as the Law Society's Money Laundering Task Force and the Joint Money Laundering Steering Group (JMLSG), also play a part in supporting the regime. The JMLSG, currently chaired by the Chief Executive of the British Bankers' Association, for example, is a body consisting of representatives from financial trade associations. It has been a forum primarily for agreeing guidance on the SARs regime for practitioners. These groups give the regime some corporate identity which would otherwise be totally lacking.

Part III: Costs, Benefits, Strengths & Weaknesses

25. There is a perception in the regulated sectors that the SARs regime is broken: that institutions are spending some millions of pounds complying with burdensome legal obligations, yet Government is not similarly committed and there are virtually no results in terms of crimes prosecuted and the seizure of terrorist or criminal funds as a consequence of their efforts. This perception is principally focussed on the AML arrangements, but similar concerns, while muted by a reluctance to criticise post the events of 7 July 2005, were expressed during the review about the parallel CTF arrangements. While it is understandable that these perceptions may have arisen, they are, however, inaccurate. Not only is Government itself also spending sizeable sums on the regime, but there have continued to be significant SAR-related law enforcement successes and intelligence gains from its operation, albeit usually out of sight of those who provided the original lead information. However, as the KPMG, Jill Dando Institute and HMIC reports referred to already have all indicated, and as NCIS as the current FIU itself accepts, there is significant room for improvement in the way the regime functions. Before examining how those improvements might be delivered, this part of my report examines what is currently going on in the regime, and analyses its costs and benefits and its strengths and weaknesses.

The Facts

26. Matt Fleming provided a clear and detailed account of the operation of the regime up to 2004 in his Jill Dando Institute report to which reference should be made for a full understanding of how it operates. The key features to focus on from 2005 were:

- the total number of SARs submitted. During 2005, just under 195,000 (TA and POCA) SARs were received by the FIU. This compared with less than 20,000 in 2000 and less than 100,000 in 2003, presumably reflecting both growing familiarity among reporters of the new POCA regime and of in-house systems designed to detect suspicions, and also the addition in POCA of new reporters. The 2005 figures concealed a drop in reporting by solicitors from nearly 19,000 in 2004 to 9,600 plus in 2005 following the Court of Appeal judgement in Bowman v Fels[11]. Two thirds of SARs were received electronically, one third in hard copy. The most prolific reporters were banks (65% of the total), accountants (7.5%), building societies (6%), solicitors (5%) and money transmission agents (5%), although 2005 saw a significant growth in reporting from bureaux de change, and insurance and finance companies;
- the proportion of SARs of CTF interest. In 2005, just under 2,100 of the total SARs (1%) were judged by the FIU terrorism team to be of potential interest in a terrorist context, of which about 650 were passed on to the NTFIU for more detailed investigation. There was a slight peak of reports of interest following the events of 7 and 21 July 2005.
- the total number of consent requests. During 2005, about 9,500 consent requests were received at the FIU, of which 8% were refused. The total was a reduction on 2004, again largely because of the Bowman v Fels judgement already mentioned. Most consents in 2005 were sought by solicitors (54% of all requests), banks (17%), building societies (8.75%) and finance companies (8.5%). The average turn round time for the FIU to respond to a consent request during 2005, having first consulted law enforcement as necessary, was less than three days;
- the speed with which the SARs database is updated. Major backlogs of paper (as opposed to electronic) SARs awaiting entry onto the ELMER database had long

[11] The judgement (Bowman v Fels [2005] EWCA Civ 226 (8 March 2005)) established that lawyers advising clients in the course of litigation were not to be regarded as being involved in "arrangements" for the purposes of POCA s.328.

been a feature of the regime. These were, however, virtually eliminated in November 2005, and changes made by NCIS in early 2006 reduced the "receipt to database" time for hard copy SARs further to five days;

- law enforcement access to the database. All police forces obtained direct electronic access to the ELMER database during 2005, and over 1,000 officers are now trained in its use. Despite predictable IT teething problems over the change and some initial police reluctance to lose the FIU selection service hitherto provided by NCIS, the arrangement is now widely appreciated. The search tools for accessing the data, however, remain rudimentary;
- FIU intelligence support to SARs end users. During 2005, NCIS produced a number of intelligence assessments on aspects of money laundering for reporting sectors and end users, and an increased quantity of SARs-based intelligence products for law enforcement. These were generally, though not universally, well received; and
- the use of SARs and consent requests by law enforcement. There is currently no proper central record of the use made by law enforcement of the SARs and consent requests received, nor effective systems in place to generate or collect such information.

The Costs

27. Concerns have, understandably, been expressed by commentators about the costs to the regulated sectors of the TA and POCA regime. These are not insignificant: in 2003 KPMG assessed the costs to business of setting up the arrangements to be about £60m. However, it is worth recording that current work by PriceWaterhouseCoopers on the administrative burdens imposed by Government in the UK is producing a very much lower figure for the ongoing (non-capital) costs to those sectors of reporting their suspicions. Their figures for those ongoing costs are not far adrift from the sums currently spent by Government itself annually on the FIU (summarised in Part VII of this report) and on the FIs who are the main investigators of SARs. It is also the case that some larger reporting institutions integrate their counter fraud efforts with their SARs work and do not, as a result, see the latter as imposing wholly additional expenditure. Nevertheless, whatever the overall burden, it remains the case that TA and POCA do impose ongoing costs on business, and this needs to be borne in mind by the other participants in the regime whose responsibility it is to extract operational value from the information provided.

The Benefits

28. The absence of the central end use data mentioned above is a significant weakness in current arrangements, but consultations undertaken during this review revealed that that absence, in fact, conceals a good deal of relevant successful law enforcement activity around the UK. Three specific 2005 AML examples may help to demonstrate the kind of successes being achieved:

    - resulting from a single SAR. Two men were sent to prison after an investigation launched following receipt of a single SAR. They were also required to pay confiscation orders totalling over £0.75m. In another case, £1.5m was forfeit after an investigation similarly based on one SAR;
    - resulting from a combination of SARs from the same organisation. A money laundering investigation was launched after a number of SARs were received from the same reporting institution. This resulted in the disruption of a criminal organisation, linked to known drug traffickers, and responsible for laundering in excess of £12m. It involved the imprisonment of a principal money

launderer, an extradition request for another, a confiscation order for over £200,000, and a cash seizure of a similar amount; and

- resulting from a combination of SARs from different organisations. At the request of a law enforcement inter-agency drugs group, NCIS interrogated the SARs database to investigate possible drug smuggling activity at ports. About 19,000 SARs were analysed and that produced forty suspect individuals who are now the subject of law enforcement investigation. Charges are anticipated.

29. The proportion of SARs that are of interest in a terrorist context is small, reflecting, of course, the comparative rarity of terrorism when set against the ubiquity of acquisitive crime. However, similar benefits have been obtained in relation to CTF objectives. As the Chancellor of the Exchequer indicated in his speech to the Royal United Services Institute on 13 February this year, terrorist assets worth £80m have been frozen since 2001, including those of over 100 organisations with links to Al Qaida. 2005 examples of CTF success include:

    - CT benefit from a single SAR. A SAR from a bank led to a cash seizure of about £15,000 probably destined for a group in Iraq; and
    - success achieved from dialogue around the regime. Following a presentation to one of the UK's main store card providers, the provider's AML department revised its know your customer procedures. As a result, the company identified and reported on a foreign national who had applied for a store card in London with a credit facility of £5,000. Law enforcement then established that he was wanted for terrorist offences overseas and had settled here unknown to the UK authorities.

30. The regime also provides SARs regarding politicians and officials originating from countries in which corruption is identified as being endemic (known as PEPs). This information has also facilitated a range of enforcement and intervention activities.

31. Despite these various successes, it is undoubtedly the case that commitment to the work of investigating SARs varies widely both within the police service and within the wider law enforcement community. Some users commit significant manpower to investigation and deliver a best practice approach, while others struggle to address the reports at all because of competing local or organisational priorities. It is worth pointing out that a few of the smallest police forces currently achieve impressive results from SARs in terms of reports scrutinised and assets seized, while some of the larger ones find resourcing the work the most difficult. Nevertheless, despite this inconsistent picture, it would be a mistake to underestimate the importance of SARs to law enforcement. A recent NCIS survey of the police service designed, not to test SARs use, but to secure feedback on the recently introduced ELMER access arrangements (see paragraph 26), provided incidental evidence of successful use by 37 of 52 UK forces. In one large force, following suspicions raised in SARs, £1.5m was restrained, £2.6m seized and £1.8m secured in forfeiture orders during the last year[12].

32. The consent regime also plays an important part in fighting crime and recovering its proceeds. Research undertaken on the first six months of 2004 indicated that it contributed to the restraint of at least £10m, the confiscation of at least £6.5m and the seizure of about £0.75m, and these figures excluded many occasions where consent was not refused but an enforcement outcome was nevertheless achieved later. From April 2004 to December 2005, for example, 2,670 consent requests were considered by IR/

[12]A restraint order has the effect of freezing property in order to preserve assets that may subsequently by the subject of a confiscation order. Constables or customs officers may seize cash if they have reasonable grounds for suspecting it is recoverable property (i.e. property obtained through, or intended to be used in, unlawful conduct). Forfeiture results when a magistrates' court is satisfied that cash seized is indeed recoverable property.

HMRC. While only 575 cases (22%) were refused as a result, 98% of the cases were actually investigated and approximately half of those resulted in action against the suspect in terms of civil recovery, intervention or criminal investigation.

33. A few examples give a flavour of the kinds of enforcement opportunities created by consent requests. In the first, a private bank requested consent to process an instruction from a company shareholder to withdraw a sizeable sum from a company account into a personal account outside the jurisdiction. The consent was refused and law enforcement was able to restrain the funds as part of an existing criminal investigation. In the second, a retail bank requested consent concerning a withdrawal of nearly £100,000 by a customer about whom suspicions had previously been reported. The customer was not already the subject of law enforcement investigation, but action undertaken on the basis of the consent request led to the seizure of the cash and the laying of money laundering charges against him. Finally, an insurance company requested consent in respect of payment of a claim. The claimant was, in fact, in prison on drugs offences, and law enforcement was able to gain a variation in the restraint order in excess of £20,000 arising from the claim.

Strengths

34. It may seem paradoxical to discuss the strengths of a regime that has been so regularly examined on account of its perceived weaknesses and failings, but consultations undertaken during this review provided some positive evidence to set alongside the criticisms. There was, for example, recognition that NCIS had upped its game as the FIU over the last year, and commendation for the efforts of individual NCIS staff. Improvements to the management of ELMER, in particular, were commented on positively by law enforcement representatives. It is worth emphasising also the value of a regime, whatever its deficiencies, that is already producing results in the courts and in the recovery of criminal profits.

Weaknesses

35. Finally, we come to the weaknesses identified during this review. Consultation with SARs regime participants, including NCIS, and scrutiny of regime paperwork has suggested that there remain, despite the successful results mentioned earlier, a number of significant weaknesses in current arrangements. The principal ones identified were the following:

- a lack of overall management of, and responsibility for, the regime. There was a widespread perception that effective overall management had been lacking. Stakeholders identified the absence of a common understanding of, and mutual agreement on, each participant's role; the absence of any central collection of data on the use made of SARs; no visible governance and performance management structures to reassure stakeholders, to provide direction, and to build confidence that reporters' efforts were valued and were being put to good use; and doubts about the availability of the right range of skills centrally and about the FIU's capacity to operate effectively;
- an absence of effective dialogue between participants. There was a widely held view that lack of effective communication between participants was a major weakness in the existing regime. It limited the effectiveness of the intelligence contained in SARs, undermined stakeholder relationships, and prevented mutual support and understanding. It should, it was asserted, be the FIU's responsibility to articulate the means by which improved dialogue could be achieved, on the basis of improved understanding of different stakeholders' needs, as well as to provide appropriate mechanisms for such communication. The reporting sectors were considered to have information internally that could be of value to the intelligence picture, which was not being captured and exploited. And it was thought that SARs' end users

could offer better feedback on the use to which SARs were put – whether for intelligence, intervention (including prosecutions) or policy-development purposes;

- inadequate IT. Stakeholders commented that robust and high-performing IT was vital to the successful operation of the SARs regime. Without timely, reliable access to the database, and sufficiently powerful tools with which to manipulate it, law enforcement could never deliver the impact on crime and terrorism desired. Some reporters also considered that better central IT had the potential to improve the efficiency of their processes, thereby reducing compliance costs. Finally, it was thought that the opportunities to extract better outcomes offered by IT were not being sufficiently exploited;
- inconsistent reporting by regulated institutions. Performance across the reporting sectors, and within sectors, varied widely. Some large institutions provided significant numbers of SARs and made correspondingly large numbers of consent requests, while other ostensibly similar ones made virtually none of the latter. The performance of smaller businesses was generally weaker than that of the big banks and building societies. Defensive reporting of little value was a problem with some reporters, but not with most. Some sectors had a more consistent and disciplined approach than others. Overall, while standards were improving, there were still performance problems in most sectors;
- inappropriate disclosures of SARs. Despite the existence of rules requiring law enforcement to respect the confidentiality of SARs, there had been some serious examples of inappropriate disclosure. These risked undermining the whole basis of the regime, and at worst might result in the threat of harm, or actual harm, to reporters. It was considered part of the FIU's responsibility to define and monitor confidentiality rules and introduce processes to enforce adherence to them; and
- gaps in guidance and training for regime participants. Significant gaps in guidance and training for regime participants were identified. These appeared to be preventing users from maximising the value inherent in the ELMER database, and to be contributing to the existence of a range of conflicting views about the purpose of the regime and the ways in which participants should contribute. There was, for example, concern about the apparent over-emphasis in reporting sector training on the regime's punitive elements as well as differences of view about what SARs should include and their value.

Conclusion

36. Overall, differing views were expressed during this review on whether the benefits of the regimes were proportionate to the costs. There was, nevertheless, a wide consensus on the importance of effective work against criminal and terrorist finance, and most reporting participants expressed themselves prepared to play their part, and meet the associated costs, if they could be assured that their efforts genuinely contributed to making the UK safer from crime and terrorism. Everyone consulted also thought there was room for further improvement in the way the regime operated. Some, particularly among MLROs, however, were wary, in the context of this review, of yet another false dawn.

Part IV: SOCA as the FIU

37. One consequence of the decision to set up a new agency, SOCA, and to subsume NCIS within it, is that a decision has already effectively been taken by Government that SOCA will assume responsibility for the FIU, along with the many other functions hitherto discharged by NCIS. Beyond repeating (see paragraph 14) that SOCA's statutory powers and responsibilities are sufficient and appropriate to the discharge of that function, the issues of who in future should be responsible for the FIU and who should act as "data controller" for the ELMER database of SARs thus do not require further examination. This part of my report, therefore, considers what duties must fall to SOCA as the FIU, and how it could best discharge its SARs responsibilities to deliver improvements in the way the AML and CTF regime operates. It should be noted, however, that since the successful functioning of the regime is dependent on the contributions of all its different participants, the proposals here need to be considered in combination with those in Parts V (reporting sectors) and VI (end users).

Responsibility, Accountability and Governance

38. Consultations undertaken during this review suggested strongly that the regime currently suffered from a lack of anyone willing and able to take an overview of its operation, or responsibility for its successful functioning. This deficit, it was thought, explained both why information flows between participants were so inconsistent and why the regime was not delivering as much as desired. Individual reporters and end users were largely committed to doing their part, but none had an overall view of what success looked like nor of the difficulties experienced by other participants. The MLAC arrangements were seen as useful in this context, but not as fulfilling the key need for someone to take day to day responsibility and to act as anchor for the regime as a whole. Since this was such a widely held view, and SOCA (both as FIU and as a key user in its own right) is the only body that could realistically take on such a role, **I recommend (Recommendation 1)** that SOCA should take overall responsibility for the effective functioning of the SARs regime. The Board of SOCA has indicated that it is prepared to do so.

39. SOCA would, of course, have no power to direct either the SARs reporting sectors or the regime's end users, nor does it seek it. Its responsibility here would be to encourage, exhort, influence, advise, support, measure and report rather than to direct. Governance and accountability arrangements would, thus, be necessary to tie other participants more directly into a collective approach to the work, and to ensure wider visibility and oversight of its outcomes. **I recommend (Recommendation 2)** that those arrangements should have the following features:

- a published Annual Report to Ministers on the operation of the regime, setting out volumes and outcomes and the statistics envisaged in MLD3, and highlighting key successes and any concerns;
- supervision of SOCA's discharge of its responsibilities in relation to the regime by a committee of SOCA's Board[13], comprising members from the reporting sectors, the regulators and from end users, as well as FIU management;
- a vetted group of representatives of the reporting sectors, of law enforcement and of the key policy departments, created out of the MLAC Reporting and Feedback Sub-Group, which SOCA should chair, to allow for discussion of sensitive casework and reporting issues, and to clear the circulation of SOCA guidance to the wider participant communities; and

[13]SOCAP Schedule 1 allows SOCA to establish Board Committees and to appoint non members of SOCA to those committees.

- for reporters, quarterly seminars, probably business sector by business sector, for MLROs and their senior management to allow for the airing of problems, for briefing on developing thinking on AML and CTF typologies, and for sharing best practice.

In addition, SOCA should contribute to the development of mechanisms designed to improve public/private sector co-operation in relation to CTF work to which the Chancellor of the Exchequer referred in his speech to the Royal United Services Institute on 13 February.

40. Taken together, these arrangements, along with those examined below, would have resource consequences for SOCA. These are examined in Part VII of this report. They should, however, help improve dialogue and feedback between regime participants (on which see also paragraphs 45-46 and 76-78). Also, importantly, they should ensure not only that there would be wider visibility of how the regime was operating, but also that SOCA's discharge of its central responsibilities would be both effectively scrutinised and properly supported by those affected by its approach.

The Receipt, Processing and Dissemination of SARs

41. I turn now to the functions that SOCA should perform as the FIU. First and foremost, there is an obvious need to ensure that the central record of SARs is managed efficiently and effectively. The responsibilities here should be two-fold. First is the requirement to manage the ELMER database so that new records can be submitted and stored promptly, the database is able to cope with the volumes of reports received and retained, there are appropriate fall back and contingency arrangements, and necessary and easy access can be provided to users. Second is the rather different need for SOCA to add value both to incoming SARs and to the data stored in ELMER to facilitate successful use. This second requirement, which bears on collaboration with different groups of end users, is examined in more detail in Part VI of this report. Here are considered the database management responsibilities.

42. ELMER currently contains about 500,000 SARs derived from AML and CTF disclosures. As already indicated (paragraph 26), electronic reporting is possible for some reporting institutions, via the Moneyweb portal, and is now used for a majority of disclosures. It is intended that new arrangements should be introduced during April 2006 allowing reporting through a web-based facility ("SARs On-Line") accessed via SOCA's website. Paper SARs, however, still form a significant minority of reports. They are currently entered onto ELMER by contract staff. The arrangements work reasonably well, but new disclosures are not instantly available on the database and can take days to enter. Also a paper system is inherently more inefficient and more liable to error than direct electronic entry. It has recently been agreed in principal via MLAC, with the aim of improving the consistency of SARs, that reporting should in future be undertaken on a standard prescribed form. The form, however, has not yet been introduced, not everyone finds it a helpful way forward, and there are some technical legal concerns about its contents that need to be resolved before its introduction. During 2005, developments to ELMER itself have, as indicated earlier (paragraph 26), made for faster access for police users, but the tools available for exploiting that access are inadequate. Overall, it could not be claimed that the current arrangements for receiving, storing, processing, and accessing SARs are particularly easy to use or yet fully effective. Moreover, this is despite recent welcome NCIS efforts and investment designed to improve the ELMER operation.

43. **I recommend (Recommendation 3)**, therefore, that if the regime is to work smoothly for all parties and maximum operational value is to be extracted from SARs in the future, there should be significant further investment to improve the timeliness of operation of the FIU and to secure more effective exploitation of the information as it arrives at, and when stored in, ELMER. I have identified a long list of necessary or highly desirable developments that are required, including:

    - the introduction (by Statutory Instrument under POCA s.339) of the prescribed form, but against an undertaking to review its effectiveness after two years of use;
    - the setting of a timetable for the extension of electronic reporting throughout the reporting sectors;
    - further enhancement of the portal to ease electronic reporting, for example to allow reporters to store and work on drafts of SARs and to copy and paste from earlier reports;
    - the development, with the reporting sectors, of a glossary of terms to be used in reporting to improve the quality and consistency of SARs, in particular in relation to the way in which the grounds for suspicion are described;
    - the replication of the ELMER database at a different location to provide effective fall-back and resilience;
    - growth in the capacity of ELMER to meet the increasing volumes of SARs being received and the growing access required by users;
    - the provision of more user-friendly access to ELMER for users and the deployment of data-mining and search agent tools to facilitate their manipulation of the data;
    - the development of management information tools on the database to enable the FIU to report more effectively on its operation and use; and
    - planned investment going forward in technology refresh for ELMER generally.

44. It will be apparent that this list includes improvements which are of two different kinds; those concerned with administrative change and those with IT developments. So far as the former is concerned, **I recommend (Recommendation 4)** that the FIU should press ahead with what is outlined here in consultation with other participants against the timetable set out in Part VII of this report. So far as the latter is concerned, **I recommend (Recommendation 5)** that active consideration be given to outsourcing the operation of the database to a service level agreement that would address the requirements identified here and meet participants' reasonable performance expectations. To facilitate consideration of this option, SOCA has already let a consultancy contract to explore the feasibility of such outsourcing and the likely costs, risks and benefits when set against in-house provision. This will report in September when a better informed decision can be made on future arrangements, including in the light of the outcome of the next Government spending round. Some indication of the likely costs involved, however, are also provided in Part VII of this report.

Dialogue

45. Consultations during the review revealed a particular concern among the reporting sectors about the absence of feedback on SARs from end users (on which see also paragraphs 77-79). This is, in fact, a symptom of a wider problem of a lack of dialogue between regime participants. It is, in my view, on improvement to that overall dialogue that attention needs to be focussed. The governance arrangements already proposed should provide a means of improving communication and understanding between regime participants, but, in addition, **I recommend (Recommendation 6)** that they could usefully be reinforced by a far greater volume of routine reporting by SOCA from the FIU designed to share perspectives on the operation of the regime as a whole. In addition to the Annual Report mentioned earlier, the following products might be appropriate:

    - details of overall reporting trends, including against the UK's (organised-crime focussed) National Intelligence Requirement;
    - strategic and tactical intelligence assessments and typologies, including periodic local assessments;
    - intelligence reports bearing on the prevalence of money laundering and the associated risks to reporting institutions;
    - quantitative and qualitative overviews of activity by reporting and end user organisation and sector; and
    - evidence, where available, of tangible benefits to the reporting sectors (a fraud prevented or damage to reputation avoided).

46. Separately, **I recommend (Recommendation 7)** that SOCA should build on the good work done by NCIS over the last year or two to build up bilateral dialogue between the reporting sectors and the FIU, and should extend such contacts to the main end users of SARs. The existing help desk service and bilateral meetings should, thus, be supplemented with a wider range of routine meetings for reporters and end users. Further, a specific avenue, probably in the form of a telephone hot line, should be established by SOCA to allow both groups to report concerns about breaches of SARs confidentiality (on which I comment more fully in Part VI of this report).

Training and Guidance

47. Consultations during the review revealed a considerable appetite for further central training and guidance both for the reporting sectors and for end users; indeed, there appeared to be requirements here in terms of quantity and range that it would be very difficult to satisfy. Nevertheless, **I recommend (Recommendation 8)** that SOCA should accept responsibility for producing guidance on the regime in support of the industry level guidance that already exists, and for providing some carefully defined input for other participants into the training they themselves provide for their own staff. Decisions on the content of such guidance, and priorities for such training, should be made following consultation through the MLAC associated machinery mentioned earlier. These arrangements might, for example, involve:

    - for the reporting sectors, guidance on the requirements of TA and POCA, on the completion of SARs, and on the information required in consent requests; and involvement in training events to provide feedback on good and bad practice, to report on successful outcomes from SARs submitted, and to share perspectives on progress against AML and CTF objectives; and

- for end users, guidance on securing the most from SARs, on the requirements for confidentiality and feedback (see Part VI of this report), and on effective use of new search tools on ELMER as they become available; as well as the provision of modules on the SARs and consent regimes within existing training courses, for example those run by the ARA (for FIs) and the National Centre for Policing Excellence (for the police service more generally).

48. It would also be appropriate for SOCA to provide some basic background on the regime on its website, as it is developed, including links to all existing publicly available guidance, contact details for the FIU and its help lines, and copies of the Annual Report mentioned earlier.

Performance Measurement

49. Finally, there is a clear need for SOCA, in its operation of the FIU, to provide better performance measurement of the AML and CTF regime and on its impact on the harm caused to the UK by crime and terrorism. NCIS currently enjoys only limited facilities to monitor the quantity and quality of SARs received and the extent of usage by law enforcement, nor does it have the resources to make systematic use of the information it does possess. Accordingly, **I recommend (Recommendation 9)** that SOCA should develop and propose to participants, through the governance machinery identified earlier, a performance measurement framework for the regime as a whole. This should define what is expected of participants (including SOCA itself), both in terms of performance and of information to demonstrate that performance, and indicators which would allow progress to be measured and assessed. It is well known that setting prescriptive targets can produce perverse results, so a light touch regime focussing on mutual visibility, not on predetermined outcomes, would be appropriate. It would need also to fit within the wider Government performance context, including the Home Office's work to define the harms caused by organised crime, the police performance systems, the Concerted Inter-agency Criminal Finances Action group (CICFA) targets and Joint Asset Recovery Database (JARD) indicators, and Local Criminal Justice Board measures. It is worth pointing out that the development of the ELMER database in the way envisaged earlier would provide some of the information required, for example on input from different reporters and sectors, and the volumes and types of access to the database by different users.

Part V: The Role of the Reporting Sectors

50. It is perhaps self evident that the interests and concerns of the reporting sectors are diverse, reflecting their different business activities and the different nature of their relationships with their clients. The SARs regime, for example, bears differently on the one hand on those, such as retail banks and building societies, who mostly have an essentially transaction based relationship with clients, and on the other on those, such as accountants, investment banks, financial advisers and solicitors, who more often have greater visibility of their clients' affairs as a whole and advisory responsibilities in relation to them. The reporting machinery, and such guidance as has issued in relation to it has, however, tended to operate on a one size fits all basis, which means that it has not always been as helpful as it could have been. Looking forward, therefore, it will be necessary to ensure that material that is provided from the centre is more differentiated by sector than it has been in the past. The dialogue that is necessary between participants should help both the FIU and end users to understand the needs of different sectors better and to respond accordingly.

51. During the consultations undertaken for this review, the views were expressed that the current TA and POCA regime was resulting in too many SARs being reported, that there was a tension between quantity and quality of reporting, and that the FIU was unable to cope effectively with the volumes of SARs received. Against the background of an increase in SARs from under 20,000 in 2000 to nearly 200,000 in 2005, there are clearly issues to consider here. But the remedy advocated by some interlocutors, that efforts should be made, through FIU direction, to suppress the numbers, would be inappropriate.

52. It is clearly the case, as already indicated (see paragraph 35), that there is room for improvement in the quality of the information provided in SARs and also a need to reduce defensive reporting of little value. There is, as well, a duty on SOCA as the agency responsible for the FIU to assist the reporting sectors in both endeavours. But, since reporting numbers remain uneven across and even within the various sectors, there is a pressing need also to address under reporting, involving the relevant regulators as necessary. If successful, those efforts would be likely to result in the pressure on volumes of SARs being upwards rather than downwards, and the same would be true following any addition of the new reporters envisaged in MLD3.

53. The main argument against seeking to suppress the numbers of SARs against some conception of a right size of reporting is, however, a more fundamental one. In passing TA and POCA, Parliament determined to set wide definitions of terrorist and criminal property and significant penalties for money laundering, and to retain a low threshold for disclosures, involving "suspicion", not "knowledge" or "belief". The consequence appears to have been the significant growth in reporting already noted. Two conclusions follow. First, it would be improper for SOCA as the FIU to seek, against some concern about reporting volumes, to insert its judgement about the threshold for suspicion in place of the duty to make that judgement laid on the reporters by Parliament. In any event, it is self evident that SOCA would never be better qualified to determine what is suspicious in the context of the reporters' business than the reporters themselves. Second, it could be argued that in inviting Parliament to establish the regime set out in TA Part 3 and POCA Part 7, Government was accepting the responsibility for ensuring that the resulting volumes of information were handled effectively. Finally, it is worth remembering that UK volumes of SARs are not out of range of the volumes being reported in some other comparable jurisdictions. Although the reporting requirements and numbers of reports vary widely from country to country, the USA

FINCEN received 435,000 reports in 2005; FINTRAC in Canada received 1.8 million in 2004-05 (though that figure includes cross border currency transfers); AUSTRAC in Australia received 1.2 million the same year (again including certain money transfers); while in the EU, where the numbers were generally lower than in the UK, the Netherlands FIU received 175,000 reports in 2004.

54. Accordingly **I recommend (Recommendation 10)** that, while it would clearly be appropriate for SOCA to assist the reporting sectors to fulfil their statutory obligations, it would be inappropriate, given current legislation, for SOCA as the FIU, or Government more generally, to seek to suppress the overall number of SARs. In short, the correct Government position on numbers of SARs should be volume neutral. In practice, as already noted in Part III of this report, the current suspicion based approach has been delivering operational benefits to law enforcement, and there are thus grounds for believing that the arrangements are not fundamentally flawed. This does not, of course, mean that reporters should be released from the obligation to distinguish effectively between the unusual and the truly suspicious, nor that the regime would be well served by the removal of the due diligence arrangements put in place by many to make that distinction.

55. I have already set out earlier in this report the responsibility that I recommend should fall to SOCA to assist reporters. In particular, I identified a need for better guidance and training support (paragraph 47), reform of the arrangements for electronic reporting of SARs (paragraph 43), and the provision of agreed performance measurement information for the regime as a whole (paragraph 49). In part VI of this report I address two issues of great importance to all reporters, the need for confidentiality in the way SARs are handled by end users, and the provision of feedback from those users on the benefits gained from the disclosures made. Here are examined three further issues of importance to the effective operation of the regime; action on under reporting and poor quality reporting, the consent arrangements, and the support that SOCA will need as the FIU.

Under Reporting and Poor Reporting

56. The uneven volumes and mixed quality of reporting both between and within sectors was noted in Part III of this report. Although these are at heart issues for the reporting institutions themselves and their regulators, **I recommend (Recommendation 11)** that SOCA should commit effort to identifying such problems and helping reporters address them. Changes already envisaged, such as a standard reporting form, and others now proposed, such as a glossary of terms to be used in describing the grounds for suspicion, should help the weaker performers; but identifying and remedying gaps in reporting would require collaboration with regulators and, given the size of the reporting community, a risk-based approach. **I recommend (Recommendation 12)** that this should be the subject of further discussion with regulators with the aim of devising joint programmes of work going forward. Other aspects of the relationship between SOCA and the regulators are covered in Part VI of this report.

Consent

57. The consent provisions in POCA were designed to offer persons and institutions an opportunity of avoiding liability in relation to the substantive money laundering offences by seeking consent from the authorities to act in relation to suspected criminal property. As indicated in Part III of this report, the consent regime has become important to law enforcement since it presents opportunities to intervene, in advance of suspect activity

taking place, that would often not otherwise be available. In principle, therefore, the arrangements offer benefits for both business on the one hand and for a key group of end users on the other. In practice, however, they appear to be operating more one-sidedly. It was repeatedly made clear during the consultations undertaken for this review, that, whatever the benefits to law enforcement, the provisions were very difficult for some key institutions and sectors to operate. This was, first, because of the concept of fungibility (in effect the inability to distinguish different amounts within the debt owed by a deposit taker to its client), which made it impractical for banks and others to distinguish criminal property in an account. But there were also associated difficulties created by the requirement in effect to suspend all activity while consent was awaited (or for the period of delay following refusal of consent) without the client noticing and thus of potentially falling foul of the tipping off provisions. The issue was highlighted for many by the judgement in Squirrell Ltd v National Westminster Bank plc. The position in which a bank might find itself in such a situation has since been clarified in the judgement in N2J and ACE Telecom v Cater Allen, although other legal challenges are in prospect[14].

58. In recognition of these problems, Parliament enacted in 2005 a threshold provision in SOCAP (s.103) which allowed deposit takers to operate accounts in respect of sums less than £250, or such larger sum as agreed with the authorities, without committing the money laundering offences. The institutions, however, continue to believe that this change, although designed to be helpful, did not directly address either the fungibility or the tipping off problems. There is anecdotal evidence that reporters are, in consequence, failing to use the consent procedure at all, with resulting risk to themselves and lost opportunity for law enforcement. I have consulted widely on this issue, both inside and outside Government, and I judge that:

- there are indeed problems here that need to be addressed if this part of the POCA regime is to operate with the support it needs; but that
- there are no administrative changes that could be introduced within the current statutory framework that would successfully remove them.

I have, accordingly, been discussing these issues separately with officials with a view to submitting advice to Ministers outside this review on alternative ways forward.

Support for SOCA as the FIU

59. The success of the SARs regime depends on an effective contribution from all types of participant. No one, in the reporting sectors, among end users and in SOCA, has a monopoly of expertise, wisdom or relevant knowledge. For SOCA, in particular, with all its new responsibilities, there will be shortages of relevant skills and experience in the early years, and the FIU staff will, thus, need to lean on other participants for support and advice. It is, therefore, gratifying to be able to record that a significant number of offers of secondments or temporary attachments to SOCA from reporting institutions were received during this review. SOCA management intends to pursue these over the months ahead.

[14]Squirrell Ltd v National Westminster Bank plc (Customs and Excise Commissioners intervening) [2005] EWHC 664 (Ch), [2005] 2 All ER 784. N2J Ltd and Ace Telecom Trading Ltd v Cater Allen (Her Majesty's Commissioners for Revenue and Customs and the National Criminal Intelligence Service intervening) QBD 21 February 2006 (unreported).

Part VI: Exploitation of SARs by End Users

60. We come now to examine what happens to SARs after they are received by the FIU, and in particular the exploitation of the information they contain by the regime's end users. As indicated in Part III of this report, there is much good work already going on in police forces and elsewhere to exploit SARs and consent requests, to detect and prevent crime and to recover its proceeds, but no one consulted during this review thought that enough was being done or that improved performance in this area was not possible.

61. This part of my report identifies ways of securing that improvement, and in particular the part that SOCA should play in that process both as the FIU and as an end user of SARs in its own right. It examines, first, three key features of the regime that need to be addressed if it is to work effectively and end users are to be able to make appropriate use of the information provided. It then looks at the particular needs and interests of different groups of users. The three key features that need considering are:

- the confidentiality of SARs;
- the effective exploitation of the ELMER database; and
- the provision of the right feedback to reporters to help them improve the usefulness of what they report.

Confidentiality

62. The concerns of many in the reporting sectors about the inappropriate disclosure of SARs by end users were mentioned in Part III of this report. Here are rehearsed the reasons why the information in SARs needs careful handling, an account of the action already taken to ensure greater confidentiality in their use, and some proposals for further development in this area.

63. The context here is important. Those providing SARs are, for the most part, reporting information derived from confidential relationships with their clients. They are under a statutory obligation to exercise their own experience and judgement in determining what is suspicious, and, having done so, to breach that client confidentiality and report to the authorities. They are, moreover, required to conceal what they have done from their clients, under threat of criminal penalties for tipping off. Subsequently, disclosure by an end user of the existence of a SAR, or of details from it, to a client or to an inappropriate third party risks causing material damage to the reporter. Well attested examples were provided during the review of reporters suffering commercial damage following inappropriate disclosure of a SAR as well as their receiving threats of retaliation. In the terrorist context, in particular, it is not surprising that reporters should be concerned that the confidentiality expected of them should be honoured in return by end users.

64. There is an issue here too about costs and benefits. Because of a wider public interest in successful work against terrorism and money laundering, Parliament has imposed costs on the reporting sectors to identify and report their suspicions. As explained earlier (paragraph 36), most institutions accept that those costs are necessary on that basis. It is clearly important that additional and unnecessary expenditure is not incurred by end users because of the way the resulting information is handled.

65. Users need to be aware of certain legal imperatives as well. SARs represent the reporters' suspicions. They are not evidence of crime, but can provide leads that may assist law enforcement in its task of preventing and detecting crime, and regulators in discharging their statutory duties. There may be, in cases where a suspicion has been reported, an innocent explanation of which the reporter was not aware. Not all suspicions will, therefore, be justified. A breach of confidence concerning a SAR, must, in consequence, risk maligning the innocent, and thus of falling short of the important Human Rights Act principle that the extent of the interference in an individual's

private life must be proportionate to the purpose it is sought to achieve[15]. In this context, this must mean that initial investigation of SARs needs to be undertaken discreetly to determine whether the suspicion is well founded and there are grounds for believing that criminal or terrorist property is indeed present. Wider disclosure of the suspicion is inappropriate, but where the conclusion of initial work is that the original suspicion was well founded, other more intrusive options become available. At that stage, so far as the SAR is concerned, the proper course would be to secure the information reported (as well as any other details available to the reporter) as evidence through a production order. Exceptionally, a SAR may be so informative and compelling in its own right as to provide sufficient grounds for a production order on its own, but that does not invalidate these general principles.

66. It is also worth noting that unauthorised disclosure of information in a SAR to a third party would risk committing a criminal offence by breaching s.55 of the Data Protection Act 1998 (DPA), which requires that a "person must not knowingly or recklessly, without the consent of the data controller…disclose personal data or the information contained in personal data."

67. Against this background, it seems abundantly clear that end users have a duty to ensure that the confidentiality of SARs is maintained throughout their operations. The only exception to this approach must be where a court has ordered disclosure of a SAR in the interests of justice. Even in those situations, there will be a duty on the Crown to explain to the court the countervailing public interest in non disclosure. **I recommend (Recommendation 13)** that all end users should accept these obligations as a condition of access to ELMER data.

68. There is an unwelcome, but unavoidable, consequence of this important requirement to sustain the confidentiality of SARs that may not be readily apparent outside law enforcement. In the normal course of events, the easiest and most effective way for an investigator to resolve a suspicion is to put the allegation to the suspect and to test the response against what is already known. Since in this regime that approach cannot be available, it needs to be recognised by everyone involved, inside and outside Government, that the task of law enforcement in resolving the suspicions raised and thereby securing the maximum benefit possible from SARs is made significantly more difficult and time consuming.

69. There has been pressure from some in the reporting sectors to introduce a statutory code of practice enforcing the confidentiality of SARs. That possibility should be kept under review, but for the time being I believe that better direction, guidance and support from the centre should have the desired effect. In December 2005, the Home Office issued new, strengthened, instructions on the confidential nature of SARs and how they should be used. This required the disclosures on receipt to be classified, for the first time, as "Restricted" within the Government's protective marking system. This not only means that they are now brought within a widely understood public sector security regime; it also means that individual investigators could be subject to disciplinary sanctions if there is misuse.

70. While such Home Office circulars are addressed only to the police service, both the CPS and the Revenue and Customs Prosecution Office have agreed in writing to abide by the instructions as well, and the circular has also been made available to other users, including HMRC and ARA. This should address the inconsistency of approach that has occasionally been evident in relation to proceedings, both civil and criminal, involving SARs. Further, it has been agreed that the Home Office and SOCA should in due course jointly review the impact of this change through the MLAC Reporting

[15]For the importance of proportionality in assessing the legitimacy of measures which interfere with Article 8 rights, see, for example, Smith & Grady v United Kingdom (2000) 29 EHRR 493.

and Feedback sub-group. That review should assess whether the circular has had the desired effect, or whether further formal measures are required. However, **I recommend (Recommendation 14)** in the meantime that the Home Office circular should be reinforced through the following new arrangements. SOCA should:

- establish a means (probably a hot line) for the reporting sectors to raise any concerns about the inappropriate use of SARs, and should pursue those concerns with the end users involved;
- issue more detailed guidance to all end users on the appropriate handling of the information in SARs, including on sharing with international partners and record keeping aspects; and
- include in the SARs Annual Report an account of the number of breaches of SARs confidentiality and of the action taken to prevent repetition.

The ELMER database

71. Issues about the management of the ELMER database and improvements to its functionality were addressed in Part IV of this report (paragraphs 41-44) and about the volume and quality of SARs in Part V (paragraphs 51-54). Here we focus on the use of the information in the database by the regime's end users and on the service that SOCA should provide to facilitate and support it.

72. It may be helpful, first, to describe in slightly more detail the arrangements that currently exist for the sharing of ELMER data by the FIU with end users. Nearly all law enforcement organisations now have direct access to the SARs database in their own organisations. There are over 1,000 officers across the country who are trained and authorised to use that access. The training is, however, focussed on the use of the IT rather than on techniques for extracting maximum value, and is delivered by NCIS to one person only in each organisation, and then cascaded internally. There are, moreover, limitations in the current implementation of ELMER on the ways in which the data can be accessed, which makes effective analytical work and overall exploitation more difficult than it could be. Interim measures to address these shortcomings have included the sharing with certain forces of a monthly CD-ROM containing all the SARs for their postcode areas. This arrangement now continues with only one force, but it has enabled recipients to use their own internal systems to manipulate the data to better effect. Once improved IT tools are available on ELMER, this interim measure will no longer be necessary.

73. As already indicated, major development of, and enhancement to, the ELMER database is necessary. The aim of such enhancement would be to enable SOCA to provide a value added service to end users, so that those users can concentrate their efforts to where they are most likely to prove effective. **I recommend (Recommendation 15)** that the SOCA service should, in due course, have the following features:

- <u>active use of the data in SARs on receipt</u>. SOCA should, with the users, build a database of names, addresses and key words of current operational interest to run against incoming SARs, so that prompt alerts can be issued when relevant new data arrives. SOCA should ensure that users can update their interest lists regularly;
- <u>facilitation of law enforcement exploitation of ELMER</u>. SOCA should take responsibility not only for ensuring that users can access ELMER data relevant to their responsibilities directly, but also for delivering training and guidance for law enforcement investigators and analysts in the use of new data mining tools designed to extract patterns and leads from the database. It should also provide facilities for investigators to record on-going interest in named

individuals or particular SARs (flagging), and should provide a clearing house arrangement to prevent overlapping investigations conflicting;

- provision of intelligence products and management reports. SOCA should provide to users intelligence reports on money laundering, criminal property and crime patterns derived from SARs and the other data in its possession, and also reporting on trends and volumes derived from the ELMER database as a whole. It should also offer a service to users of tasked reporting, where complicated data mining or manipulation of the data is required;
- use of ELMER in relation to all acquisitive crime. SOCA should facilitate the use of the ELMER database to support the detection and prevention of all acquisitive crime. The definition of criminal property in POCA, and thus of money laundering, effectively covers all such crime. While it will, no doubt, continue to be appropriate for law enforcement to concentrate resources on SARs-based investigations of the more serious offences, value could also be added to the investigation of other crimes through a routine record check on the ELMER database. This might, for example, provide additional addresses for investigation, or previously unknown details of connected individuals or details of dubious business activities; and
- cross matching of SARs against other databases. SOCA should seek to arrange the automated cross-checking of incoming SARs not only against its own in-house databases and the Police National Computer (PNC), but also against other relevant databases to which access can be secured, with the aim of identifying anomalies or hitherto unknown connections. The purpose would be to help law enforcement to concentrate investigative effort quickly to where it would be likely to be most productive.

74. Since it may be thought contentious, it is worth expanding on this last point briefly. Government already maintains a number of separate non law enforcement databases which contain information that could have a bearing on criminal property, money laundering and terrorist finance. The main ones are those concerned with direct and indirect taxes, with records of births, marriages and deaths, with benefit and state pension payments, with the issuing of passports and with driver and vehicle licensing. A cross check of SARs against those databases might, for example, identify a business with significant revenues, but no VAT record; a wealthy citizen who was not paying tax or was claiming benefit; or an apparent UK national with no birth certificate, no passport, and no driving licence nor licensed vehicle; and thereby focus investigative efforts onto what could well be examples of tax evasion, benefit fraud and identity fraud respectively. Similar benefits might be secured from comparable access to private sector databases, such as those managed by CIFAS, the industry anti-fraud body, or the insurance industry POLARIS system which is designed to detect insurance fraud.

75. There would, of course, be complicated legal and practical issues to resolve before a fully functioning system able to compare and contrast these databases automatically could be introduced. It is SOCA's contention that the gateways created by SOCAP would allow it to receive and share information to that end in a way that would satisfy the requirements of the gateway in DPA s.29. For various reasons, other Government data owners are not all so helpfully placed in law, but the potential benefits in terms not only of better focussing the exploitation of SARs, but also of bearing down more generally on identity and public and private sector frauds would be considerable. The issue is already under active consideration within Government. In the context of this review, it is appropriate to do no more here than to look hopefully for early progress.

Feedback

76. The importance of effective dialogue between all participants in the SARs regime was discussed in Part IV of this report. Here we consider one particularly important aspect of that dialogue, the requirement for end users of SARs to provide feedback to the FIU for passing on to the reporting sectors on the use that has been made of the information provided. Although some in law enforcement already talk directly to reporters, what is proposed here may be seen by some as introducing new and unwelcome obligations. It may, therefore, be helpful to explain why such feedback is so important.

77. Effective and timely feedback is needed because there is a requirement on the FIU in MLD3 to provide such feedback to the reporting sectors, and because it can:

- provide assurance to those expending effort and resources to disclose the information that it is being put to good use;
- produce examples of success to help encourage continued effective co-operation;
- help reporters develop an accurate view of the risks to their business from laundered money and terrorist financiers;
- enable the tracking of outcomes in relation to specific types of SARs or different reporting sectors, thus allowing lessons to be learnt about what should be reported in future;
- provide evidence on the relative merits of different methodologies used to identify leads from the database, thereby assisting with future database design;
- aid continuous regime improvement, enabling insights into not only the quality of SARs inputted, but also the support SOCA is providing to users;
- enable SOCA to disseminate examples of good practice throughout the user community; and
- contribute to SOCA's ability to build the overall serious organised crime intelligence picture.

78. Some feedback could be provided by SOCA itself, both from its own operational exploitation of SARs and, once improved data handling tools are available, from its management of the ELMER database. It could thus report on the use of SARs in some organised crime contexts, on different standards and patterns of reporting between and within reporting sectors, on the number and type of searches conducted on the database, and on SARs received which tie in with existing operational interests of other end users. But more than this will be required to meet the need identified. **I recommend (Recommendation 16)**, therefore, that all end users should now commit to reporting twice yearly to the FIU on the use made by them of SARs and SARs-derived reporting, and on the outcomes already delivered and those anticipated in the months ahead. This should enable SOCA to generate performance data on SARs use and provide typologies and other information to assist the reporting sectors. Exactly what information and in what detail would be needed should be discussed and agreed with different groups of end users, but what would be necessary from all at this stage is a recognition that this contribution is essential to the effective operation of the regime, and a commitment to deliver what is required in a consistent and timely manner. It is worth emphasising that these arrangements would not be intended to get in the way of the existing bilateral contacts between SARs reporters and end users which are also important, nor to preclude routine contact between the FIU and users, or between the FIU and reporters.

The End Users

79. The needs and interests of the various end users of SARs differ. For clarity, it may, therefore, be helpful to address them separately, as follows:
    - SOCA itself as an investigator of organised crime;
    - certain other national law enforcement agencies (HMRC, ARA, the Department for Work and Pensions (DWP) and the Serious Fraud Office (SFO));
    - the UK intelligence community;
    - the police service;
    - statutory regulators;
    - departmental users; and
    - the reporting sectors themselves.

80. It is worth, first, making a general point about the role of HMIC in monitoring the quality of law enforcement activity, not just in the police service, but now also in both SOCA and HMRC. HMIC could have an important part to play in quality assuring much end user performance in relation to the SARs regime. In their recent "Payback Time" report, referred to earlier, HMIC undertook a detailed review of law enforcement efforts on proceeds of crime, which included a comparative analysis of different police forces' efforts. They are, therefore, in a good position to inspect law enforcement work in this area, and **I recommend (Recommendation 17)** that the quality of SARs work (including the confidentiality and feedback aspects mentioned earlier), as well as proceeds of crime work more generally, should feature routinely in their inspection programmes. The Chief Inspector has indicated that he would be prepared to arrange this. Such an approach should help reinforce best practice, and identify issues about which further central guidance could usefully be provided.

SOCA as User

81. SOCA will be both the owner of the FIU and an investigator of organised crime and associated money laundering in its own right. It intends to brigade the FIU and its own proceeds of crime investigative work under the same management. It will be doing this to secure appropriate synergies and efficiencies and the sharing of knowledge and understanding. It will, however, as envisaged by the Egmont Group, retain the FIU as a distinct unit reflecting its equally important responsibilities to others outside SOCA.

82. SOCA's Board has concluded that the recovery of criminal property represents a strategic priority for the new Agency, and Ministers have endorsed that judgement. Further, the Home Secretary has already indicated that he will be assessing SOCA's performance over its first three years of operation in part on the quantity of criminal assets it recovers and the consequent impact on the viability of criminal businesses in the UK. The information in SARs will make an important contribution to this work, which will be reinforced by the full range of investigative and intelligence collection capabilities at SOCA's disposal. As a significant user of SARs as well as the owner of the FIU, SOCA will, as its experience grows, be well placed to support others involved in securing operational benefits from the regime, in a way that has not been possible for NCIS as an intelligence only organisation.

HMRC, ARA, DWP and the SFO

83. HMRC is already a major stakeholder in the regime and a heavy user of SARs, which are particularly valuable in relation to tax evasion and tax and excise fraud. It has a team of 15 staff currently collocated with the FIU at NCIS. DWP also makes current use of SARs for its work tackling benefit fraud. Intelligence staff investigating serious fraudsters through civil or criminal proceedings have access to the ELMER database. In addition, DWP has a liaison officer based in NCIS. These mutually beneficial relationships should continue with SOCA after April 2006. In addition, both HMRC and DWP would benefit generally from the more powerful IT tools that it is proposed should be provided to assist exploitation of the ELMER database.

84. ARA is (in my view appropriately) in the process of securing access to the database. The SFO has not hitherto been a significant user of SARs, although it has in recent years received a quantity of reports from NCIS, for example bearing on the financial holdings in the UK of PEPs. However, it is, similarly, a national law enforcement agency with significant investigative responsibilities, and would also benefit from direct access to ELMER. **I recommend (Recommendation 18),** therefore, that the SFO should in future have on-line access to the ELMER database so that they can identify for themselves any SARs reporting that bears on the crimes they investigate or the individuals in whom they have an existing interest.

The UK Intelligence Community

85. Existing arrangements with NCIS which ensure that the UK's intelligence agencies obtain access to the information in ELMER that bears on their national security responsibilities should continue under SOCA.

The Police Service

86. As HMIC's "Payback Time" and the Jill Dando Institute reports have indicated and as explained in Part III of this report, the approach of UK police forces to SARs work varies widely. It may be that in future the police restructuring mentioned earlier may allow resources to be concentrated in strategic forces to enable SARs and other proceeds of crime work to be addressed more consistently. In the meantime, it is clearly important that the valuable information in SARs does not go to waste and that opportunities are taken to recover criminal or terrorist property and prosecute the associated offenders wherever in the UK they arise.

87. The provision of better guidance and training for police investigators, more powerful IT tools to assist exploitation of the ELMER database, and a better service of SARs-based analysis and lead generation from SOCA, discussed earlier in this report, should all help forces extract more from SARs. In addition, **I recommend (Recommendation 19)** that each force should nominate a senior officer to oversee all SARs and consent request work and to act as a contact point for the FIU and the reporting sectors as necessary. It may be that forces' existing POCA champions could most appropriately fulfil this role. Further, **I recommend (Recommendation 20)** that forces should explore how their SARs work could best be integrated into mainstream policing activities to:

- secure the "all acquisitive crime" benefits identified earlier (see paragraph 74); and
- increase the involvement of wider police investigative experience in this work thereby reducing reliance on the small number of fully trained and accredited FIs available.

In this context, and for the reasons set out earlier (paragraph 16), there is a clear imperative to increase the number of accredited FIs available to UK law enforcement. I, therefore, commend the work now being led by ARA through the CICFA machinery to explore the growth and overall management of this scarce resource.

Statutory Regulators

88. Statutory regulators in the UK have a variety of roles in relation to the SARs regime. All exercise, albeit differing, statutory powers of scrutiny, discipline and enforcement, but some have been reporters in their own right, such as the new Gambling Commission, while others, such as the Law Society and the Bar Council, are also representative bodies for their sectors[16]. It is in the first context here that the issue of access to, and exploitation of, the information in SARs arises.

89. Where a regulator has a duty to ensure that those it regulates behave within the law and according to rules and procedures laid down by the regulator itself, it needs access to information that bears on their performance in relation to those duties. The TA and POCA regime and the associated MLRs impose important duties and responsibilities on a number of regulated sectors, and the effectiveness with which the members perform in that regard is clearly a proper subject for regulatory scrutiny. Moreover, the terms of s.33 of SOCAP provide an appropriate gateway through which SOCA could provide such regulators with SARs information. The question at issue here, therefore, is not whether regulators have a need for relevant information, nor whether they should enjoy access to SARs type data directly from those they regulate (as some already do), but rather exactly what SARs information should be provided to them by the FIU.

90. Regulators need information about the performance of their members. In the SARs context, this means, in particular, that they need data that bears on the quality of the methodology used in reporting suspicions and the contribution made, on any reporting black holes, and on any indications of misconduct or of efforts at infiltration by criminals. On the face of it, they do not need access to every disclosure made to the FIU by their institutions, nor the details of the individuals or businesses on whom reports are made. Indeed, it might be thought to be disproportionate for SOCA to provide such personal data in this context. Accordingly, **I recommend (Recommendation 21)** that regulators should not have direct access to the ELMER database, but that instead SOCA should commit to providing a service of relevant information to each regulator, including analysis of their sector's SARs and consents, specific alerts concerning poor institutional performance, and performance data on the regime as a whole. As indicated earlier (paragraph 56), joint programmes of work to improve reporting performance could usefully be considered on the basis of this reporting. Since formal representations were, however, made during this review regarding direct access to the database by some regulators, **I recommend (Recommendation 22)**, in addition, that the proposed SOCA service should be the subject of formal agreement with each regulator, and that the efficacy of these arrangements should be reviewed after two years' operation.

[16]As of January 2006, the Law Society has effectively separated its representative and regulatory functions.

Departmental Users

91. Government Departments have policy and operational responsibilities that bear on the UK's CTF and AML arrangements and on the financing of crime more generally. They accordingly have a need for information that illuminates the effectiveness of those arrangements, and enables them to represent the UK effectively on such matters in international fora. The MLAC machinery currently provides one means by which relevant Departments can access such data, but information flows from the FIU have been patchy and not always tailored effectively to their needs. **I recommend (Recommendation 23)**, therefore, that SOCA should be responsible for ensuring that Departments receive the intelligence reporting and SARs regime performance data they need in these contexts. Discussion and agreement on individual Departmental needs would be required.

Reporters as End Users

92. Finally, it needs to be recognised that the reporting institutions themselves would also have a proper requirement for SARs derived information from SOCA on the performance of the regime as a whole and on analysis which illuminates any criminal risks to their businesses.

Part VII: Implementation

93. The proposals in this report would depend on the right resources being available to take forward the work. Here we look at the skills and resources that SOCA would need to fulfil the duties and responsibilities recommended, outline the consultations that would be necessary to give effect to a number of those recommendations, and propose a timetable for implementation. First, it is worth noting that there are other skills and resources issues, including the requirement for business to continue to invest in detecting what is suspicious, and the need for the police service to increase the availability of appropriate investigative skills, which fall outside the terms of reference for this review, but which would also self evidently be of importance to the future success of the regime.

SOCA Resources

94. The FIU at NCIS currently has a total of 80 directly employed staff (working on both AML and CTF disclosures) and up to nine contractors who input paper SARs, at an overall 2005-06 staffing cost of £3.2m (plus a further £0.5m in running costs). SOCA management have considered the recommendations in this report and judge that approximately 200 directly employed staff, as well as the contractors, would be needed, at a 2006-07 staffing cost of over £6m (plus about £1m in running costs), to discharge the resulting duties effectively. These figures, however, are based on three assumptions. The first is that SOCA would be able to secure some efficiencies by combining certain of the functions hitherto discharged by the FIU at NCIS with work undertaken elsewhere in SOCA, such as relationship management, staff training and guidance preparation. The second is that the existing attachments to the FIU from HMRC and the Financial Services Authority (FSA) would continue under SOCA, and the third is that the offers of secondments (SOCA pays) and attachments (employer pays) received from reporting institutions during this review result in at least a further ten experienced staff being made available to work in the FIU.

95. This last point is particularly important. SOCA will inherit from NCIS considerable experience of the regime and of management of the ELMER database, but it will not have relevant skills in its workforce at launch in sufficient numbers to meet all the needs identified here. The loan of relevant experience from elsewhere, therefore, would help the new agency build up the competencies required over the first year to eighteen months of operation, as well, of course, as bringing longer term benefits of mutual understanding and appreciation. On this basis, and assuming that staffing of the FIU could be built up gradually over that eighteen month period, SOCA management have concluded (if the recommendations in this report are accepted) that it could and should fund and staff the work at the levels envisaged. The longer term costs of the expanded operation would, however, need to be considered in the forthcoming spending round.

96. NCIS will have spent in excess of £1m during 2005-06 in improvements to the ELMER database. As indicated earlier, I judge that significant further investment and development here is required. The proposals outlined in Part IV of this report might require expenditure by SOCA of in excess of £3m over the next year, perhaps £2m the following year, and ongoing technology refresh thereafter. However, as mentioned previously, SOCA has already let a contract to test the desirability of outsourcing of the delivery of the enhanced features required and the management of ELMER itself. The outcome of that exercise is needed before any realistic estimate of the longer term costs of a fully effective database can be determined or the necessary business cases for change prepared. In any event, the costs are likely to be significant and beyond what would be available to SOCA from the former NCIS baseline.

Consultations

97. A number of the recommendations in this report would require further consultation and discussion before implementation, and it would, in any event, be good practice for SOCA to consult more widely with the aim of seeking to carry the AML and CTF community with it as changes were introduced. The particular points at issue range from questions of detail, such as who should sit on the SOCA Board Committee or be involved in the vetted consultation group, to issues of substance requiring detailed further work. The latter category would include the details of the following:

- mechanisms for improved dialogue **(Recommendation 7)**;
- arrangements for providing training support and guidance by SOCA to other participants **(Recommendation 8)**;
- the design of a performance measurement framework for the regime **(Recommendation 9)**;
- the devising of joint programmes of work between SOCA and regulators for addressing weaker reporters **(Recommendation 12)**;
- the design of the service to regulators that SOCA should provide from SARs **(Recommendations 21 and 22)**; and
- the design of the service to Departments that SOCA should provide from SARs **(Recommendation 23)**.

I envisage that this work would be carried forward by SOCA management with relevant interlocutors over the summer.

Implementation Timetable

98. If the earlier recommendations in this report are accepted, **I recommend (Recommendation 24)** adoption of the following implementation timetable:

March 2006	SOCA lets contract to test desirability of outsourcing ELMER database operations.
1 April	SOCA takes over the FIU from NCIS and starts build up of staffing and skills.
April-September	SOCA consultation with stakeholders on implementation of recommendations, including governance arrangements.
Summer	Secondments and attachments to the FIU arranged.
September	Consultants report on outsourcing of ELMER, leading to recommendations to Ministers on the way forward.
1 October	SOCA assumes overall responsibility for the regime with new governance arrangements, performance measurement regime, confidentiality hot line, and end user feedback arrangements in place.
October	Decision taken on future of ELMER and on database tools to be provided.
January 2007	New dialogue arrangements, training support, and services to regulators and Departments begin. Consultations on extension of electronic reporting begin.
Spring	Testing of new tools for accessing ELMER database.
May	FIU fully staffed. Longer term secondment and attachment arrangements agreed with stakeholders.
Summer	Launch of some new ELMER tools and of new data entry arrangements and extension of electronic reporting.
October	First regime Annual Report to Ministers, setting out progress and prospects.

Conclusion

99. The proposals in this report presume a degree of collaboration and mutual visibility between SARs regime participants that has not previously been apparent. Moreover, any regime which depends for its effectiveness on the performance of a wide range of public and private sector individuals and organisations, which operates under such a wide variety of different arrangements for monitoring and rewarding performance, and whose participants live with rather different resource and staffing pressures, is bound to experience problems of consistency and cohesion. Furthermore, the practical difficulty for law enforcement of turning large numbers of SARs and consent requests, some of which inadvertently concern innocent activity, quickly into enforcement outcomes, needs to be remembered. A dose of realism is, therefore, required in judging what is deliverable in terms of improvement to the operation of the SARs regime and over what timescale.

100. The recommendations in this report are predicated on the assumption that if SOCA delivers what is envisaged here, that of itself should make it easier for other participants to deliver of their best. SOCA management is prepared to take on the responsibilities and programmes set out on that basis, but as long as there is a wider recognition that it has no power to direct other participants, and that success will depend equally on their efforts. That said, I judge that the room for improvement in the overall operation of the regime is so large that my proposals have a good chance, over time, of making a real difference to performance, and thus to the success of the UK's AML and CTF arrangements.

Appendix I: Summary of Recommendations

Part IV: SOCA as the FIU

1. SOCA should take overall responsibility for the effective functioning of the SARs regime.

2. The governance arrangements for the regime should have the following features:

   - a published Annual Report to Ministers on the operation of the regime;
   - supervision of SOCA's discharge of its responsibilities by a committee of SOCA's Board, comprising members from the reporting sectors, from among the regulators and from end users as well as the SOCA FIU management;
   - a vetted group of representatives of the reporting sectors, of law enforcement and of the key policy departments, to discuss sensitive casework and reporting issues, and to clear the distribution of SOCA guidance; and
   - quarterly, sector specific, seminars for MLROs and their senior management.

3. There should be significant further investment to improve the timeliness of operation of the FIU and to secure more effective exploitation of the information as it arrives at, and when stored in, the ELMER database.

4. The FIU should press ahead with administrative changes to the operation of the ELMER database in consultation with other participants.

5. Consideration should be given to outsourcing the operation of the ELMER database to a service level agreement that would address necessary new requirements and meet participants' reasonable performance expectations.

6. There should be a greater volume of routine reporting by SOCA from the FIU designed to share perspectives on the operation of the regime as a whole.

7. SOCA should build up bilateral dialogue between the reporting sectors and the FIU, and should extend such dialogue to the main end users of SARs.

8. SOCA should accept responsibility for producing guidance on the regime and for supporting other participants in the training they provide for their own staff.

9. SOCA should develop and propose to other participants a performance measurement framework for the regime as a whole.

Part V: The Role of the Reporting Sectors

10. It would be inappropriate for SOCA as the FIU or for Government more generally to seek to suppress the overall numbers of SARs.

11. SOCA should commit effort to identifying problems of uneven volumes and mixed quality of reporting and to helping reporters address them.

12. A risk-based approach to supporting the weaker (reporting) performers should be the subject of further discussion with regulators with the aim of devising joint programmes of work going forward.

PART VI: Exploitation of SARs by End Users

13. All end users should accept obligations of confidentiality in the handling of SARs as a condition of access to the ELMER database.

14. The Home Office circular (on SARs handling) should be reinforced through the following arrangements. SOCA should:

    - establish a hot line for the reporting sectors to raise any concerns about the inappropriate use of SARs, and should pursue those concerns with the end users involved;
    - issue more detailed guidance to all end users on the appropriate handling of the information in SARs, including on sharing with international partners and record keeping aspects; and
    - include in the SARs Annual Report an account of the number of breaches of SARs confidentiality and of the action taken to prevent repetition.

15. SOCA should provide a service of information, intelligence and leads to end users which in due course should have the following features:

    - active use of the data in SARs on receipt;
    - facilitation of law enforcement exploitation of ELMER;
    - provision of intelligence products and management reports from the ELMER database;
    - use of ELMER in relation to all acquisitive crime; and
    - cross matching of SARs against other databases.

16. All end users should now commit to reporting twice yearly to the FIU on the use made by them of SARs and SARs-derived reporting, and the outcomes already delivered and those anticipated in the months ahead.

17. The quality of SARs work, as well as proceeds of crime work more generally, should feature routinely in HMIC's inspection programmes.

18. SFO should have on-line access to the ELMER database so that they can identify for themselves any SARs reporting that bears on the crimes they investigate or the individuals in whom they have an existing investigative interest.

19. Each police force should nominate a senior officer to oversee all SARs and consent request work and to act as a contact point for the FIU and the reporting sectors as necessary.

20. Forces should explore how their SARs work could best be integrated into mainstream policing activities to:

    - secure "all acquisitive crime" benefits; and
    - increase the involvement of wider policing experience thereby reducing reliance on trained and accredited FIs.

21. Regulators should not have direct access to the ELMER database, but instead SOCA should commit to providing a service of relevant information to each.

22. The service SOCA shall provide should be the subject of formal agreement with each regulator, and the efficacy of these arrangements should be reviewed after two years' operation.

23. SOCA should have a responsibility for ensuring that Departments receive the intelligence reporting and SARs regime performance data they need.

PART VII: Implementation

24. The implementation timetable proposed, covering the eighteen months from April 2006, should be adopted.

Appendix II: List of Terms and Abbreviations

AML	anti-money laundering
ARA	Assets Recovery Agency
CICFA	Concerted Inter-agency Criminal Finances group
CPS	Crown Prosecution Service
CTF	counter-terrorist financing
DPA	Data Protection Act 1998
DWP	Department for Work and Pensions
Egmont Group	International Group of FIUs
ELMER	The FIU database that stores SARs
FATF	The Financial Action Task Force
FIs	Financial Investigators
FIU	The Financial Intelligence Unit
FSA	Financial Services Authority
HMCE	Her Majesty's Customs and Excise
HMIC	Her Majesty's Inspectorate of Constabulary
HMRC	Her Majesty's Revenue and Customs
HMT	Her Majesty's Treasury
JARD	Joint Asset Recovery Database
JMLSG	Joint Money Laundering Steering Group
MLAC	Money Laundering Advisory Committee
MLD3	The Third Money Laundering Directive
MLROs	Money Laundering Reporting Officers
MLRs	Money Laundering Regulations 2003
NCIS	The National Criminal Intelligence Service
NCPE	National Centre for Policing Excellence
NTFIU	National Terrorist Financial Investigation Unit
PNC	Police National Computer
POCA	Proceeds of Crime Act 2002
SARs	Suspicious Activity Reports
SCDEA	Scottish Crime and Drug Enforcement Agency
SFO	Serious Fraud Office
SOCA	Serious Organised Crime Agency
SOCAP	Serious Organised Crime and Police Act 2005
TA	Terrorism Act 2000
UK	United Kingdom

Appendix III: Regulatory Impact Assessment

The Policy Objective

1. The objective of this review was to maximise the effectiveness of the existing SARs regime, in the context of the transfer of responsibility of the FIU and its database to SOCA. The purpose of the regime is to provide opportunities for the authorities to recover criminal and terrorist property and thereby to reduce the harm to the UK caused by crime and terrorism.

Consultation with Stakeholders

2. This report follows extensive and detailed consultation with regime stakeholders. The process of consultation is set out in the Introduction and a list of those consulted in Appendix IV.

The Recommendations

3. This report makes 24 recommendations designed to improve the operation of the regime. They are summarised in Appendix I. Most focus on what SOCA, as the agency responsible centrally, should do differently, and in particular how it should better support other participants in their responsibilities for disclosing suspicions (the reporting sectors) and using the information supplied (the end users). The report makes no recommendations for changes in legislation or regulation.

Costs and Benefits

4. The costs and benefits of the current regime are examined in Part III of this report. The recommendations, if agreed and implemented, would result in the following, albeit limited, additional expenditure:

   a) within SOCA, where costs might double from previous analogous NCIS expenditure (see Part VII of the report);

   b) in law enforcement, where a requirement for a twice yearly report on use of SARs would be new, and there could be costs from the more widespread use of SARs proposed; and

   c) within the reporting sectors, if enhanced efforts by law enforcement led to additional production orders or requests for assistance.

5. So far as SOCA and law enforcement more generally are concerned, these additional costs would have to be met, for the current period, by adjustment of expenditure with existing provision. For the reporting sectors, the additional costs envisaged would not be direct costs flowing from the review, but a consequence of the regime working more effectively and as Parliament intended. Those in the reporting sectors consulted during the review expressed confidence that increases could be absorbed without undue difficulty, and that any increased costs would be modest and an acceptable price to pay for more successful use of the information disclosed in SARs. Going forward, the cost to SOCA of proposed enhancements to the IT that supports the regime would exceed the relevant provision inherited by SOCA from NCIS. These additional costs could only be met by additional grant in aid from the Home Office or by making hard choices about SOCA's other programmes.

6. The room for improvement in the operation of the SARs regime was judged by those consulted to be large. The recommendations in this report are designed, at limited cost, to secure such improvement through new governance arrangements, better dialogue between regime participants, more effective IT and value-added activities by the FIU.

Environmental, Social and Economic Effects

7. The recommendations in this report are unlikely to have any environmental or social impacts. Their economic effect would depend on the extent to which an improved regime was able to divert criminal profits into the legitimate and productive economy. Since the harm caused to the UK by organised crime alone is assessed to exceed £20bn in value, the room for such diversion is large.

Implementation

8. Delivery of the recommendations in this report is covered in Part VII. The first Annual Report to ministers, proposed for October 2007, would include an account of progress at implementation. Further consultation with stakeholders is proposed in relation to certain recommendations, in particular in relation to a performance measurement framework for the regime. Such a framework would generate information which would demonstrate whether the improvements to the regime sought were being delivered.

9. The main risks to implementation are the failure of a wide range of organisations both inside and outside Government to deliver what is expected of them in this report. Since SOCA would have no power to direct either reporting institutions or end users, mitigation of this risk could only be through monitoring, encouragement, exhortation and support.

Appendix IV: Those Consulted during the Review

Abbey
ABN Amro
Association of British Insurers
Association of Chief Police Officers
Anti-Money Laundering Practitioners Forum
Anti-Money Laundering Professionals Forum
Assets Recovery Agency
Arbuthnot Latham
Aviva
AXA
Baker and Mackenzie
Bank of Ireland
Barclays Bank
BCL Burton Copeland
British Bankers' Association
Building Societies Association
Cameron and Ball
Centrex
Citigroup
City of London Police
CMS Cameron McKenna
Crown Prosecution Service
Deloitte
Derbyshire Constabulary
Department of Work and Pensions
DLA Piper Rudnick Gray Cary
Egg
Eversheds
Financial Action Task Force
Foreign and Commonwealth Office
Field Fisher Waterhouse
Financial Investigators Working Group
Freshfields
Financial Services Authority
Gambling Commission
Geldards LLP
Gloucestershire Constabulary
Grant Thornton
Hassan Khan Solicitors
HBOS
Herbert Smith
Her Majesty's Inspectorate of Constabulary
Her Majesty's Revenue and Customs
Her Majesty's Treasury
Home Office
Hoodless Brennan and Partners
Horwath Clark Whitehall
HSBC
Institute of Chartered Accountants for England and Wales
Irwin Mitchell
Jill Dando Institute of Crime Science, University College, London
JP Morgan Chase
Kingsley Napley
KPMG
Large Groups Forum
Law Society
Leicestershire Constabulary
Legal and General
Lloyds TSB
Lord Mayor of London
Lupton Fawcett
Macfarlanes
Mazars
Metropolitan Police
Morgan Stanley
Murdochs
National Crime Squad
National Criminal Intelligence Service
National Terrorist Financial Investigation Unit
NIBA Capital Bank
Northern Ireland Office
Norton Rose
Pinsent Masons
Proceeds of Crime Working Group
Prudential
Police Service of Northern Ireland
Regional Asset Recovery Team (London)
Revenue and Customs Prosecution Office
Royal Bank of Scotland
RSM Robson Rhodes
Saffery Champness
Scottish Crime and Drug Enforcement Agency
Serious Fraud Office
Sharp and Partners
Silk and Co
Serious Organised Crime Agency Programme Team
Slaughter and May
Secret Intelligence Service
Security Service
Taylor Wessingravers Smith
UBS
West LB
West Midlands Police
Zurich Financial Services

SOCA

SERIOUS ORGANISED CRIME AGENCY