Backbench Business Debate Briefing – Illicit Finance and the War in Ukraine

This briefing has been prepared ahead of the backbench business debate scheduled for Thursday 13th July, relating to the Foreign Affairs Committee's Report: *The cost of complacency: illicit finance and the war in Ukraine.* The Government response to the report can be found here.

We commend the Foreign Affairs Committee's continued work on illicit finance and its recognition of it as a problem of national and international security. The Second Report has played a key role in putting presure on the government during the development of recent legislation, especially regarding increased corporate transparency, Anti-SLAPPs legislation, Corporate Criminal Liability, Asset seizure, and whistleblowing.

1. **Context**
2. **Remaining gaps in the Economic Crime and Corporate Transparency Bill (ECCTB)**
    a. **Lords Amendments to support**
    b. **What the ECCTB doesn't cover**

The Coordinator for the Coalition is also happy to discuss this further and can be reached at the following email address: **Peter Munro, peter.munro@transparency.org.uk**

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1. Context

Against the backdrop of increasing Russian pressure on Ukraine ahead of its full-scale invasion, in February 2022, the Foreign Affairs Committee launched an inquiry on responding to illicit and emerging finance, publishing key findings in June 2022.

Since the inquiry began, the UK Government passed emergency legislation in response to Russia's invasion of Ukraine - **The Economic Crime (Transparency and Enforcement) Act 2022** – which, among other things, created a register of overseas entities that own UK property assets.

The ECCTB is still undergoing the legislative process. Its next stage, which has not been scheduled, is Commons Consideration of Lords Amendments (Ping-Pong).

This briefing highlights key Lords Amendments we recommend the Commons supports , as well as key areas which the Bill has failed to address.

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2. Remaining Gaps within the ECCTB

Within the last month, the House of Lords passed the following amendments to the ECCTB. With Consideration of these amendments expected in the House of Commons, our group urges support for the following 5 amendments.

a) Lords Amendments to Support –

I) Secure the integrity of UK Companies House– Require nominees to declare

This Lords Amendment requires a person or firm holding shares as a nominee to make a declaration, and to provide the details of the person or persons on whose behalf, or under whose control the shares are held. This would assist the company in identifying Persons of Significant Control, and would introduce an offence for a nominee who did not declare themselves as such.

The Financial Action Taskforce (FATF), the global money laundering and terrorist financing watchdog, specifically recommends that countries which allow nominee arrangements should take effective measures to ensure they are not misused for money laundering or terrorist financing – including the disclosure of the nominator to the registry.[1]

Investigations by the BBC and the Times have found that Viktor Fedotov, a Russian-born former oil executive accused of benefiting from an alleged $143 million contracting fraud in Russia, owns two properties in the UK via offshore trust structures administered by the wealth management firm JTC. However, due to this nominee loophole, Mr Fedotov is not named as a beneficial owner of the corporate trustees that hold his properties for him.[2]

II) Secure the Integrity of UK Registers – Close exemptions for Trusts

This Lords Amendment would help to prevent Trusts in the Register of Overseas Entities being used as an opaque vehicle for illicit finance by enabling Companies House to publish information about parties to trusts in this Register. The Register was introduced last year to prevent high-end money laundering through UK property, but only the name of the trustee is currently published, which restricts public access to who owns and controls the underlying properties.

The government's amendment in relation to trusts in the Register of Overseas Entities is a welcome recognition of this loophole, but is itself insufficient for closing it. The government's amendment provides the Secretary of State with the power to require the registrar to disclose some information about trusts upon application, but does not state a) that the Secretary of State will use this power b) what information can be acquired upon application or c) who can apply to acquire that information.

Failing to close this loophole undermines the spirit of the legislation and the intentions of this Bill. Lord Agnew's alternative amendment closes this loophole, enabling investigators to analyse the Register for criminal activity while preventing additional burdens being placed on Companies House.

III) 'Failure to Prevent' Money Laundering

Alongside the government's new identification doctrine amendment and 'failure to prevent' fraud law, which we welcome, two related amendments passed through the Lords that we urge MPs to support.

The first amendment introduced a failure to prevent money laundering offence. This in effect brings forward the power to create this offence which is already in the current government amendment, and puts it in primary rather than secondary legislation. This would help bring the UK in line with emerging best

[1] https://www.fatf-gafi.org/en/publications/Fatfrecommendations/Guidance-Beneficial-Ownership-Legal-Persons.html#:~:text=10%20March%202023%20%2D%20In%20March,the%20true%20owners%20of%20companies.
[2] https://www.thetimes.co.uk/article/pandora-papers-143m-mystery-chelsea-octagon-pgxcqzz0t?utm_medium=Social&utm_source=Twitter#Echobox=1633779734

practice and allay concerns expressed by international bodies that the UK's prosecution of high-end money laundering is not commensurate with its risk profile.

The second amendment removes the current exemption for SMEs in the government's failure to prevent fraud offence. The Law Commission did not recommend any exemption in failure to prevent offences in its 2022 options paper on Corporate Criminal Liability. The two existing failure to prevent offences – for bribery and facilitation of tax evasion – have no SME exemptions. Including an exemption for SMEs would raise some serious risks, including:

- **The fair application of the law**: it is essential for respect for the rule of law that legislation applies equally to all, and that it is as consistent as possible.
- **Failure to raise standards across the board**: the government acknowledges in its impact assessment that the exclusion of SMEs from the scope of the offence "will reduce the possible benefits and the potential for culture change."[3] The failure to include SMEs will make it harder to change business culture across the country, given that SMEs account for 99.9% of UK business.
- **Tackling professional enablers**: the amendment has been touted as an offence that will address enablers of economic crime. However, many legal and accountancy sectors who are at risk of fraud will fall outside of scope. In the context of the legal sector, it is likely that only around 100 law firms out of the UK's 10,400 law firms are likely to be in scope.[4]

IV) COST CAPS

In response to the high costs faced by law enforcement agencies when making unsuccessful UWOs, the government introduced a new Costs Order in March 2022 in the Economic Crime (Transparency and Enforcement) Act. Before the new order, the eye-watering court costs had a chilling effect on law enforcement from pursuing cases. Enforcement authorities are exposed to significant costs in High Court proceedings, where the general rule is that the unsuccessful party pays the legal costs of the successful party – skewing their efforts towards low-hanging fruit and easier targets. Separately, the Law Commission has found that there is a similar issue with restraint orders where the cost regime has a "disincentive effect".

This Lords Amendment extends cost-caps beyond Unexplained Wealth Orders to all civil recovery cases involving economic crime, while retaining robust safeguards for improper action taken by authorities. This measure has the potential to ensure significantly more stolen assets and proceeds of fraud and corruption are recovered in line with government commitments made in the new Economic Crime Plan 2023-26.

b) What the ECCTB doesn't cover -

I) Progress in the ECCTB will be undermined if government fails to provide the necessary resources to enforce new measures.

The lack of resourcing for tackling economic crime in the UK has drawn the criticism of our allies. The Atlantic Council's Issue Brief on Global Britain described the UK's efforts to tackle kleptocracy as "in severe danger of being shown as a paper tiger" and that "Britain must summon the political will and resources needed to massively strengthen enforcement of its own existing laws."[5]

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[3] https://www.gov.uk/government/statistics/business-population-estimates-2022/business-population-estimates-for-the-uk-and-regions-2022-statistical-release-html#:~:text=The%20UK%20private%20sector%20comprises,million%20UK%20private%20sector%20businesses
[4] https://www.pirical.com/blog/heres-the-uk-legal-market-in-numbers-infographic
[5] https://www.atlanticcouncil.org/in-depth-research-reports/issue-brief/global-britain-an-american-review/

There can be no doubt new capacity is desperately needed. Economic crime costs the UK around £350 billion (equal to 17.5% of the UK's GDP). In 2022, 64% of UK businesses experienced fraud, corruption or other economic crime, much higher than the global average of 46% and second only to South Africa. Public sector bodies in the UK meanwhile lose £33-58 billion a year from fraud.

The government has announced a package of £400 million to fund the three year Economic Crime Plan (ECP2), which runs from 2023-2026, including £200 million from the new £100 million a year Economic Crime Levy on the private sector beginning in 2023/24. This is insufficient compared to what it needed. In 2019 former head of the National Crime Agency (NCA) Lynne Owens said that the law enforcement system needed £2.7 billion to tackle serious and organised crime, of which economic crime is a significant part.

In 2022, the Social Market Foundation estimated that the UK needs 30,000 more police officers and civilian staff for fraud alone to tackle the scale of the problem. The Royal United Services Institute meanwhile argued for an annual investment of £250 million to fund a minimum of 2,000 additional new police officers working on economic crime by 2030. There is no mention in the ECP2 of any uplift for policing or any increase in the number of police officers tackling economic crime.

In addition, there is as yet no transparency about what calculations Companies House has made on the level of resourcing it needs to proactively exercise its new powers which would help establish what a sensible registration fee should be. The government has indicated that it will set a fee of £50, half of what the Treasury Select Committee recommended in its 2022 report on Economic Crime.[6]

Government resisted amendments to the ECCTB to establish an Economic Crime Fighting Fund based on the reinvestment of economic crime enforcement receipts back into law enforcement agencies on top of core budgets and after victim compensation. **As a first step, government should bring forward the review announced in ECP2 of how more assets recovered can be reinvested in law enforcement and report by the end of 2023.**

II) The UK lacks a specialist economic crime enforcement career path

The government's ambition announced in ECP2 to recruit 475 new financial investigators may be hard to achieve. The Serious Fraud Office is running vacancy rates of between 20-25%, the NCA of around 20%, while Companies House staff costs in 2021/22 were underspent by a total of £6.2m due to a "*large number of unfilled staff vacancies*".

The UK currently lacks a dedicated training programme for economic crime. The College of Policing for instance has no professional programme for fraud, corruption and economic crime. For many law enforcement officers in the NCA, training can consist of just one week.

Meanwhile, rather than useful career rotations between different public agencies, some public bodies in effect poach the best staff by paying higher salaries, and rotation between the police and national enforcement agencies like the NCA is minimal.

Until the UK establishes financial investigation and economic crime enforcement as a specialist career path across law enforcement and invests in training, it isn't clear how it's going to create the stream of new investigators to match the ambition of the ECP2. **The commitment in ECP2 to develop a people and skills strategy for economic crime enforcement will therefore be critical to the UK's fight against economic crime.**

[6] https://publications.parliament.uk/pa/cm5802/cmselect/cmtreasy/145/summary.html