

AML ALERT: Family Offices And Their Role In Laundering The Proceeds Of Crime

Extract from NCA Intelligence Assessment – September 2020 (Reference NAC(20)212)

Overview

This alert provides an understanding of the role Family Offices (FOs) play in laundering the proceeds of crime, including signposting key vulnerabilities.

FOs are a method for “high-end money laundering” as they may enable money laundering using corporate structures, or by concealing the beneficial ownership of assets or the source of wealth or funds. High end money laundering doesn't mean the laundering of significant values – it refers to any money laundering that is not cash-based.

Some accountancy firms will provide part, or all, of the services provided by FOs. Accountancy firms should think carefully about the services they do provide to consider the risk that potential clients could use these services to launder money and document this assessment as part of their firm-wide risk assessment.

The alert addresses the following questions:

- What are FOs and what are the different forms they can take?
- How are FOs used to launder money?
- What are the vulnerabilities in the regulatory framework?

This alert is devised with the aim of promoting awareness and bringing about preventative action. We recommend you use this Alert to complement existing knowledge and support on-going improvements to your business processes and procedures.

Key Points

- FOs provide a range of services, such as wealth and property management, legal, accountancy and concierge services to ultra-high-net-worth individuals (UHNWIs) and their families.
- There are likely to be at least 1000 FOs in the UK managing more than GBP 700 billion in assets. These include Single Family Offices (SFOs) who work for one individual or family, and Multiple Family Offices (MFOs), who work for a number of individuals or families. There is no obvious indicator of a FO serving an UHNWI or family who has made their money legitimately or not.
- FOs increasingly appear as enablers in law enforcements money laundering investigations. A FO is likely to coordinate the management of companies in charge of a portfolio of investments adding an extra layer of privacy to further distance the true owners.
- FOs appeal to criminals as they offer high-levels of privacy in relation to wealth management and administration, as well as offering a veneer of legitimacy through the obfuscation/legitimation of sources of funds and wealth.
- Many FOs that operate in the UK are not required to be regulated. FOs and their employees will not necessarily be compelled by law to monitor and report wrong-doing.

Definition of FOs

- There is no legal definition in the UK of a FO. They are generally understood to be organisations that provide a range of primarily wealth management services to UHNWIs or families, e.g. financial and tax planning, investment services, property management, legal and accountancy services. FOs can also provide lifestyle

management and concierge services to UHNWIs and families. For example, booking hotels, restaurants, holidays and identifying appropriate schools or universities for their clients' children.

- Typically, FOs are defined as Single FOs (SFOs) or Multiple FOs (MFOs). SFOs serve one UHNWI or family, whereas a MFO will serve more than one UHNWI or family. There are two main models for MFOs: they can operate on behalf of one family, but also have other 'clients', or there is a less contractual model where they operate on behalf of a number of families who require a pool of professionals to access as needed with overhead costs shared.
- Media reports state that the number of SFOs increased by 38% between 2017 and 2019 with an estimated 7,300 SFOs worldwide. In the UK, there are likely to be at least 1,000 FOs managing more than GBP 700 billion in assets. Having a FO is a growing trend for the UHNWI community and is likely seen as an outward measure of wealth and status.
- Many FOs are established in the UK as an advisory function, but with ownership of assets held abroad. This provides access to the financial expertise in London, but also allows families who are not UK citizens (although they may be tax residents), to take advantage of the UK tax system; this allows income earned outside the UK to avoid UK taxes unless brought into the country. The UK is also seen as a desirable jurisdiction to base a FO as it has a mature and robust legal system, with laws that respect and protect private property in all its forms.
- There is no set amount of wealth needed to create a FO, but given the operating costs involved, it is estimated that at least GBP 30 million in investable assets is required; even a relatively small team of in-house experts can cost a UHNWI or family over GBP 1 million annually. There is not a full understanding of who uses a FO in the UK, but they are likely to be a mix of UK nationals, those domiciled in the UK and those based overseas, but holding investments in the UK.
- FOs appeal to UHNWIs by offering an extensive range of services and professional experts in a convenient one-stop-shop, consolidated service. For UHNWIs or families with complex finances and investment setups, FOs can support the daily running and wider strategy, as the individuals and families are often unable to manage all these finances without assistance. FOs also offer a degree of privacy and put an extra layer between the UHNWI and their assets. When financial institutions deal with UHNWIs, they often only engage with that individual's FO.
- FOs vary in structure and form dependent upon the specific needs of the client(s) they work for. Anecdotal evidence suggests that FOs usually operate from within a mix of corporate and trust structures. For example, a UHNWI or family might sit over a Trust, a Private Trust Company (PTC) and several Limited Liability Companies (LLCs). The FO may then sit under one of these structures but would also be responsible for co-ordinating the management of companies in charge of a portfolio of investments. As well as offering UHNWIs the potential for anonymity, these different multi-layered legal structures can limit liability if required and may protect the owner from financial penalties.
- Whilst the vast majority of FOs are not suspected of being involved in money laundering, they have increasingly appeared as enablers in law enforcements investigations. UHNWIs who have acquired their wealth either legitimately, through criminal methods or a mix of both, find FOs effective vehicles for centralising, consolidating and professionalising the management of extreme wealth. There is no obvious indicator of a FO serving a UHNWI or family who has made their money legitimately and those that have not. FOs could operate for a legitimate family wealth, but separately accept criminal funds to launder in the mix of legitimate activity.

Criminal Appeal

- Analysis of case studies, intelligence and open-source by law enforcement highlights that FOs have four main appeals for those seeking to launder money:
 - Privacy, i.e. assets can be concealed in many corporate layers to disguise the beneficial owner;
 - offering a veneer of legitimacy for illicitly-gained proceeds through the obfuscation/legitimation of sources of funds and wealth;

- allowing criminals to exploit regulatory and legal loopholes/vulnerabilities; and
 - allowing criminals to exploit vulnerabilities in the UK's corporate structures regime.
- With multi-professional staff acting on their behalf, FOs can offer the outward impression of legitimacy to criminals wishing to launder the proceeds of crime. A FO may have a number of professionals such as accountants, lawyers or financial specialists who have previously worked for reputable companies in the private sector. The criminal use of well-placed individuals such as this can vary. The individuals may be used unwittingly, wittingly (due to blackmail etc.), or actively work on behalf of the criminals in return for rewards (often financial).
- FOs suspected of facilitating money laundering by law enforcement display the following features:
 - They are highly likely to feature a professional enabler (e.g. accountant, legal professional or financial specialist).
 - Some of the professional enablers are registered with a professional body.
 - It is a realistic possibility that some staff are complicit in money laundering. This is most likely to be the more senior staff members.
 - It is likely that the criminally-complicit FOs assist in the placement, layering and integration of criminal proceeds, including smuggling illicit cash into the UK via holdalls and moving funds between different accounts for no apparent legitimate reason.
- FOs have been identified as involved in inter-company lending. For example, FOs have given and received loans from non-financial institutions and other third parties (such as other UHNWI or their FOs), which may not be subject to the same due diligence process as conventional credit sources. These loans make client due diligence even more challenging especially when complex layers of corporate structures are used. The rationale for why the transactions take place is also not always clear. This may be due to transactions being informal, i.e. a gentleman's agreement, with no distinct reporting, governance or documentation, making oversight difficult.
- FOs are frequently involved in investment services which present two main money laundering risks. First, if a FO conducts investment services on behalf of itself it does not have to be regulated. Second, even where a FO's investment operations might be regulated, they have been seen to choose investments where it is difficult to conduct due diligence. For example, direct private equity (DPE) in non-listed private technology companies, is one of the most popular high-yielding forms of investment for legitimate FOs. Whilst most of these private technology companies are legitimate, they often operate in an opaque environment which can be exploited by criminally-complicit FOs to provide a legitimate cover for laundering the proceeds of criminality.
- A criminally-complicit FO might enter into an arrangement to invest in fake companies which then become bankrupt allowing the lost investment to be diverted elsewhere (though to the outside it will appear as a legitimate investment loss). Alternatively, a criminally-complicit FO might invest in a start-up that was established solely to provide a veneer of legitimacy for receiving payments from bribes and corruption.
- It is likely that any money laundering, sanctions evasion or other illicit finance activity takes place via other means (e.g. vehicles such as a portfolio of regional assets under the LLCs or investment portfolios under the Trusts) held in the name of third parties.

Exploitable Vulnerabilities in the UK's regulatory landscape

- Depending on the type of services provided by a FO, many in the UK will not be regulated as UK financial services legislation only covers those undertaking activity 'by way of a business'. This is mainly due to FO staff being directly employed by the UHNWI. Therefore some financial roles do not meet the criteria for regulation as most are designed to cover business and not activity. For example, an ex-investment banker directly employed by a FO does not need to be regulated by the Financial Conduct Authority (FCA), but their bank work would have been heavily regulated through FCA compliance regimes.

- UK corporate structures are open to abuse as the barriers to setting up a company are very low. It is unlikely that a FO would have to register as a Trust and Company Service Provider (TCSP) if only setting up companies for their own use.
- This lack of regulation has consequences with a potential lack of internal scrutiny and due diligence as the FO and its employees are not compelled by law to monitor and report wrong-doing. FO employees will be dependent on the UHNWI for their salaries and may have a conflict of interest if they identify suspicious activity. This vulnerability contrasts with when a third party is engaged to provide a service, as the third party may have other clients and less to lose if they refuse the request.
- When a FO does meet the criteria for regulation it could be with a number of different UK regulators. Therefore, there is no one body providing oversight, limiting the likelihood that relevant information will be shared when suspicious activity or wrong-doing is identified.
- FOs are frequently staffed by individuals who are themselves FCA-qualified and regulated and those who have worked as private bankers in the regulated sector with an in-depth awareness of UK banking controls. They are well placed to identify how the UK banking system can be abused, but operate in an environment where there is typically no independent compliance function or regulator. The burden to prevent these issues lies with the internal controls of the financial institutions with which the FO engages.
- FOs frequently have large amounts of money to invest with UK banks. It is therefore a risk that some FO staff will use their position of influence for personal gain. As FO staff are often former private bankers, they may be aware of how to seek favours from the banks who are keen to secure their custom creating a potential risk of corruption and bribery.
- Legal and accountancy professionals, as well as financial advisors working within FOs, may be registered with their respective regulators/professional bodies and abide by their profession's relevant ethical principles and codes of ethics. However, this can pose a conflict of interest if these individuals are solely employed by a family and balancing their regulated status with providing the most lucrative solutions for their clients.
- Where FOs do outsource parts of their business to third party providers, for example in relation to tax issues, this can add a layer of complexity that further obfuscates the audit trails around the sources of wealth. Criminally-complicit FOs can use such outsourcing to help purposefully conceal illegally-secured wealth.

Future Look

- As the number of UHNWIs continues to increase, it is highly likely that many will look to establish FOs as a means to ensure greater and more beneficial control over their finances and further professionalise their wealth management practices.
- Two cases of fraudsters referencing FOs to potential investors have been identified by law enforcement. It is likely this is done to appear legitimate and enhance the credibility of their scams. It is a realistic possibility that as FOs become more mainstream fraudsters will increasingly reference FOs.
- Media reports suggest FOs increasingly deal directly with each other for investment opportunities, cutting out the regulated entities that would traditionally be involved in such deals. This reduces the likelihood that client due diligence takes place and increases the opportunities for criminally-complicit FOs to operate.
- DPE investments into non-listed private technology companies are highly likely to remain a popular area for FOs to invest. The associated risks around these investments and the opportunities for money laundering are likely to remain.
- It is a realistic possibility that criminally-complicit FOs will seek to 'invest' in projects in non-transparent jurisdictions as a way to facilitate bribery/corruption payments. Social and environmentally responsible projects are likely to be popular with FOs, either as legitimate investments or cover for illicit payments.

Annex A: Types of Family Offices

Embedded FOs (EFOs): Typically an informal structure that exists within a business owned by an individual or a family. The family considers private assets as part of their family business and allocates private wealth management to trusted employees of the family business. Usually the CFO (Chief Financial Officer) of the family business and his/her department's employees are entrusted with the FO duties. As this is a generally less efficient structure, increasing numbers of entrepreneurial families are separating their private wealth from their business wealth and are considering taking the FO functions outside the family business, not least for privacy and tax compliance reasons.

Single FOs (SFOs): This will typically be a separate legal entity serving only one family. The family owns and controls the office that provides the dedicated and tailored services to meet the needs of family members. Typically, a fully functional SFO will engage in all, or part of, the investments, fiduciary trusts and estate management of a family; many will also have a concierge function.

Multiple FOs (MFOs): These entities will typically manage the financial affairs of multiple families, who are not necessarily connected to one another. As with an SFO, an MFO might also manage the fiduciary interests, trusts and estate business of multiple families as well as their investments. Some MFOs will also provide concierge services. Most MFOs are commercial, as they sell their services to other families. A very few MFOs are private and are exclusive to a few families. Over time, SFOs often become MFOs, with this transition often due to the success of the SFO, prompting other families to push for access. Economies of scale are often easier to achieve through an MFO structure, promoting some families to accept other families into their FO structure. MFOs will often be directed by the 'lead' family running the risk that not all the families receive personalised advice.

Businesses offering FO-style services: These businesses fall into two main types. The first is companies that specialise in offering to establish FOs, both physical and virtual, for interested individuals or families. This includes offering to administer the FO and/or provide specific functions such as appointing/acting as a trustee/director/shareholder. The second is accountancy and legal firms or banks (and other such pre-existing service providers) that offer FO-style services either to interested FOs or individuals/families.

Suspicious Activity Reporting

If you know/suspect ML or terrorist financing activity you should make a SAR and include the reference **NAC(20)212** within the text *in addition* to the ongoing use of the Glossary of Terms.

Guidance on reporting is available at: www.nationalcrimeagency.gov.uk.

Data Protection Considerations

Please consider your obligations under the relevant data protection regulations and where necessary remove any related personal data from your systems securely and within a satisfactory timeframe.

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