

Compliance Notice: Source of Funds and Source of Wealth

In force from: 12 June 2024

Background

It is currently estimated by the National Crime Agency that the scale of money laundering in the UK runs into the hundreds of billions of pounds and “...underpins and enables most forms of organised crime, allowing crime groups to further their operations and conceal their assets”.

Property transactions are recognised as a focal point of money laundering given that criminals can potentially launder a large amount of money in a single transaction. The 2020 National Risk Assessment (NRA) identified both residential and commercial property conveyancing as being at “high risk of abuse for money laundering due to the high value and large volume of transactions.”¹

The NRA also noted that, alongside conveyancing services, trust and company service providers (TCSPs) and client accounts are also at risk of exploitation for money laundering purposes. CLC practices can offer conveyancing services as well as probate (which can include a trust element) and there are specific permissions for trusts.

Given the nature and focus of the services which CLC practices offer and their risk profiles, as well as events such as the war in Ukraine which has highlighted the flow of suspicious money from high-risk jurisdictions into the UK property market, there is a heightened scrutiny in relation to the measures CLC practices implement to safeguard against being exploited by criminals.

Inspections and monitoring of CLC practices between 2021 and 2023 revealed consistent concerns about how source of funds and source of wealth are scrutinised, as well as how these concepts are understood and implemented. The purpose of this advisory note is to address those concerns and provide some clarity in this critical area.

Legislation and CLC Codes

The 2017 Anti-Money Laundering Regulations (MLRs) provide, under the area of customer diligence, that:

28 (11) The relevant person must conduct ongoing monitoring of a business relationship, including—

¹ National Risk Assessment 2020 – page 88.

(a) scrutiny of transactions undertaken throughout the course of the relationship (including, where necessary, the source of funds) to ensure that the transactions are consistent with the relevant person’s knowledge of the customer, the customer’s business and risk profile

The CLC has embedded the requirements of the MLRs within the Anti-Money Laundering & Combating Terrorist Financing Code (AML & CTF Code) which requires that all CLC practices must comply with AML legislation (Paragraph 2 and Code of Conduct Specific Requirement 1(m)). The AML & CTF Code also includes a specific requirement related directly to understanding source of funds, at paragraph 11(c):

c) be satisfied that the Client’s economic position, wealth and lifestyle correspond with the proposed transaction;

Key definitions

The CLC adopts the definition of **source of funds (SoF)** from the Legal Sector Affinity Group (LSAG) Guidance, which has been approved by the Treasury for the legal sector and has full standing under the MLRs. The LSAG Guidance sets out the definition as follows:

Source of Funds refers to the funds that are being used to fund the specific transaction in hand – i.e., the origin of the funds used for the transactions or activities that occur within the business relationship or occasional transaction. The question you are seeking to answer should not simply be, “where did the money for the transaction come from,” but also “how and from where did the client get the money for this transaction or business relationship.” It is not enough to know the money came from a UK bank account.

As is clear from this definition, merely obtaining a UK bank statement is not sufficient by itself. CLC practices must ensure that they are properly answering and obtaining evidence for the key questions articulated above.

With regards to **source of wealth (SoW)** the LSAG Guidance defines it as follows:

The source of wealth refers to the origin of a client’s entire body of wealth (i.e., total assets). SoW describes the economic, business and/or commercial activities that generated, or significantly contributed to, the client’s overall net worth/entire body of wealth. This should recognise that the composition of wealth generating activities may change over time, as new activities are identified, and additional wealth is accumulated. You should seek to answer the question: “why and how does the individual have the amount of overall assets they do – and how did they accumulate/generate these?”

Source of wealth is often overlooked by practices but it is a critical component of the obligation to understand the client’s economic position and it should be obtained alongside source of funds in respect of every matter.

The nature of the obligation

One of the key aspects of paragraph 28 of the MLRs is the qualification “where necessary”, which is not defined in the Regulations. The CLC’s position is that, in light of the high-risk nature of residential and commercial conveyancing, SoF and SoW checks are necessary for every relevant conveyancing transaction².

There may be limited exceptions to this approach, for example, if the transaction is one where simplified due diligence (SDD) can legitimately be applied under Regulation 37 of the 2017 AML Regulations. However, the CLC expects that these will very much be exceptions and practices should be prepared to fully justify this approach to the CLC and to ensure that their conclusion on risk is recorded on file. This risk conclusion **must** reference the factors in Regulation 37 if the practice considers that SDD can be applied.

The CLC would remind practices that you must be able to answer the key questions noted above in the LSAG guidance about SoF and SoW. The answers must be (a) recorded and (b) evidenced in that the relevant documents and information must be retained on file such that anyone reviewing the file can reconstruct the transaction.

Practices have an obligation to demonstrate to the CLC as their supervisory authority under Regulation 28(16) that the measures that are taken under Client Due Diligence (CDD), which includes SoF and SoW, are “appropriate” bearing in mind the risk assessments which have been conducted by the practice and also the CLC’s own sectoral risk assessment.

The level of scrutiny and the extent of the information/documentation obtained for verification will vary depending on the risk profile of the client and/or matter. For a high-risk matter that requires Enhanced Due Diligence (EDD), the CLC would expect to see a higher level of scrutiny (ie more evidence obtained, a more detailed explanation on file) than a medium or low risk transaction.

Evidence to be obtained

The nature of the evidence to be obtained will vary with the circumstances of the particular transaction. The CLC has developed a source of funds and source of wealth checklist which we would encourage practices to consider carefully and provides a guide to the kind of evidence which would be expected in a range of situations and can be found [here](#).

It is important that the evidence should be complete, in that it encompasses all of the source of funds required to fund the transaction. So, for example if Client A purchases a property for £250,000 and is contributing £100,000 towards it (with the remainder a mortgage), the CLC would expect to see source of funds evidence for the whole £100,000 and any SDLT that needs to be paid.

² A purchase conveyancing transaction where the client and/or a giftor is contributing money towards the acquisition of property. This also includes remortgage work where there is a shortfall that the client or a giftor needs to contribute to.

If that £100,000 were to be split between £35,000 of savings and £65,000 from a property sale we would expect to see:

1. Evidence of savings: This would typically take the form of bank statements which show the accumulation of savings over a period of time (either the period of time which the savings accrued or a sufficient period of time). It would also be prudent to record what the client's income is and obtain a payslip to cross reference the income deposited to their account and verify that the savings are plausible and fit the client's economic profile.
2. Evidence of property sale: The CLC would expect a property completion statement and bank statement showing the deposit from another conveyancer to evidence that the money legitimately came from this source. Practices should be cautious when accepting evidence of foreign property sales (particularly if the key document is in another language) and ensure that appropriate due diligence, including independent translation if required, is undertaken.

Typical questions which are asked are:

Q. How far should the practice go to verify the source of funds?

- A. You should go as far as necessary until you are satisfied that you understand the source of funds and source of wealth. A blanket policy of obtaining 3 months or even 6 months of bank statements in every scenario is inadvisable as it can lead to practices only obtaining proof of funds as a tick box exercise, rather than establishing and verifying the source of funds.

Q. How far should the practice go to verify the source of wealth?

- A. The evidence necessary to establish source of wealth can also vary but in most instances it will be straightforward. In low/medium risk situations, establishing and recording a client's job role and salary and checking this is consistent with the income shown as deposited in their bank statements, may be sufficient. In more complex or high-risk situations, such as with a very wealthy individual with multiple income streams, it may be necessary to undertake further work to ensure that their source of wealth is legitimate and not derived from the proceeds of crime.

Acting for the seller in a conveyancing transaction

The primary responsibility to check SoF and SoW rests with the lawyers acting for the purchasing client. Despite this, CLC practices should be cautious of accepting funds from a conveyancing transaction into their client account, particularly where it is known that the ID or SOF checking was inadequate.

Although the CLC would consider acting on the selling side to be lower risk than on the purchasing side, there remains a possibility that the practice could facilitate money laundering by accepting tainted money into their client account.

In circumstances where the CLC practice has any knowledge or suspicion that the CDD conducted by the other side (or another organisation such as an auction house who are regulated by HMRC for AML) in relation to a transaction where client money will be paid into their client account, there is an ethical issue with proceeding. The CLC's position would be that it would also be inconsistent with the spirit of the MLRs.

Probate/estate administration

CLC practices with the appropriate licence permission may offer estate administration services on behalf of executors of estates. This involves gathering in the assets of an estate which can derive from a wide range of sources, from bank accounts to cash. These and other assets which are liquidated will pass through the practice's regulated client account and then be distributed to beneficiaries in accordance with the wishes of the deceased, or the intestacy rules.

Although the risk of exploitation of such services is likely to be less than conveyancing, the fact that the client account is being used does expose CLC practices to a degree of risk and accordingly appropriate measures should be taken to assess the risk and to understand the source of the funds which are deposited into the client account. A comprehensive client/matter risk assessment is crucial and will establish what steps should be taken.

The CLC recommends undertaking source of funds checks on unexplained assets or particularly large/complex estate assets to ensure that they are not the proceeds of crime and minimise any risk of exploitation. A file note evidencing what checks have been undertaken in higher risk situations should be retained on the file³.

Trusts

CLC practices with the appropriate licence permission engage in creating and/or managing trusts, or transferring assets into trusts (most typically property). We would remind practices that the LSAG Guidance in this area is clear in that 1) the source of funds of assets being placed into trust and 2) the source of wealth of clients (particularly if they have a **trust funding** role⁴) should be checked in accordance with the risk profile. The nature and extent of the assets in the trust should also be properly understood.

This applies even if the only asset being placed into a trust is property. The LSAG Guidance states that the source of funds used to acquire assets that are being contributed to the trust must be checked properly. The CLC would expect practices to be clear as to whether, for example, the property was purchased with a mortgage or with the client's own savings and to make sure that appropriate evidence is requested and retained on file.

³ The CLC's sector wide risk assessment, which assesses the AML risks in probate/estate administration matters can be found [here](#).

⁴ The LSAG Guidance states at 6.14.12.2: "...you must, where your client has had a trust funding role, understand your client's source of wealth and the source of funds which were contributed (or which were used to acquire assets which were contributed) to the trust;"

Where the practice's client has a trust funding role, the CLC recommend the following approach:

Low risk/medium risk trust matters: It would be sufficient to enquire of the client as to their SoW and the SoF specifically used to purchase the property (this could be done by having them complete an instruction questionnaire at the outset). If the answers are satisfactory and consistent with your knowledge of the client, this would likely be sufficient. The answers should be recorded on file and fed into the risk assessment.

High risk trust matters: If the matter is assessed as high risk (for example if the client has been identified as a Politically Exposed Person) and EDD is required then further SoF/SoW checking should be undertaken where appropriate, including, obtaining documentation relating to SoF/SoW from the client, in a similar way as outlined above for conveyancing transactions, and reviewing these documents. This may also include obtaining documentation from the firm/practice who handled the purchase and relying on the due diligence conducted by them in accordance with regulation 39 of the MLRs.

In some instances, it may be very difficult to obtain documentation or information relating to SoF for certain older properties which are being placed into trust. Practices may wish to set a timeframe limit but should bear in mind that 10 years is the maximum length of time that AML records should be retained under the AML Regulations (40(4)).

Common issues and problems

1. Requesting and obtaining *proof* of funds instead of the *source* of funds

A common misunderstanding which the CLC has seen in its monitoring work stems from confusing these two distinct concepts. The former refers to having funds in a bank account (which can be evidenced by a bank statement) however the latter refers to understanding where the money actually came from, which can be from various sources such as a related property sale or lottery winnings, for example.

Practices who only request proof of funds from clients initially would then need to undertake considerable further work to establish the source of funds. The language used is very important in such time sensitive transactions and we would advise reviewing policies and procedures (and client communications) to ensure that this is clear.

2. Inadequate timing of the source of funds checks

Requesting SoF/SoW evidence at a late stage in the transaction, such as just prior to exchange, can lead to considerable pressures and can compromise a practice's ability to discharge its obligations under the 2017 AML Regulations. It is also not in clients interests to leave such important work to late in the transaction where it may cause delays or additional associated costs for clients.

SoF/SoW should be conducted as early in the process as possible to remove pressure on the transaction in later stages which may lead to incomplete or less comprehensive evidence being obtained. The earlier that a practice knows of issues, the quicker they can be in responding and risk assessing the transaction appropriately.

Although the timeliness of disclosure of information is in the hands of the client, practices can structure their requests in such a way that the necessary information is obtained such as by using a SoF checklist or questionnaire which the client must complete.

One way to establish what the SoF/SoW is as early as possible is to make sure that a source of funds questionnaire or a purchase questionnaire (with a SoF/SoW section) is included in the client care pack.

3. Not obtaining sufficient evidence due to knowledge of the client

Some practices have unsuccessfully asserted that their knowledge of the client means that SoF/SOW doesn't need to be scrutinised with the same level of rigour as regular clients or even at all. Several Adjudication Panel decisions have since made it clear that there are no exceptions in the MLRs which allow practices to avoid conducting robust SoF and SoW checks. These decisions also confirm that even having personal knowledge of the client (such as family relationships), does not mean that a practice will have the necessary knowledge of that client's source of funds or source of wealth to exempt them from conducting SoF and SoW verification.

If you are of the view that your knowledge is sufficient you must be prepared to explain to the CLC why you have arrived at this conclusion, explain the SoF/SoW of the client in question and back it up with evidence. The CLC would expect this to occur very rarely.

4. Failing to manage client expectations

Managing the client's expectations is key to ensuring that sufficient evidence is obtained in a timely and appropriate manner. The CLC would recommend that the client care letter sets out clearly and unambiguously what the practice's obligations are in the following terms:

“Under the Money Laundering Regulations (MLRs) the practice is obliged to not only obtain and verify evidence of your identity, but also to scrutinise the source of funds⁵ being contributed towards the transaction and your source of wealth⁶. This means that you will not only be asked to provide the practice with bank statements to show where the funds are but also other related documents such as payslips, evidence of related sales or documents relating to inheritances. It is vital that you provide this evidence to

⁵ Source of Funds refers to the funds that are being used to fund the specific transaction in hand – i.e., the origin of the funds used for the transactions or activities that occur within the business relationship or occasional transaction.

⁶ The source of wealth refers to the origin of a client's entire body of wealth (i.e., total assets). SoW describes the economic, business and/or commercial activities that generated, or significantly contributed to, the client's overall net worth/entire body of wealth.

the practice as quickly as possible and also that you are fully open and transparent with the practice.”

“If the source of funds changes during the transaction then you must let us know immediately and confirm what the alternative source will be, along with relevant evidence to demonstrate this. To assist with our understanding of how you are funding your transaction, please complete the enclosed purchase questionnaire/source of funds/wealth questionnaire and return it with the terms of business.”

5. Giftors contributing funds

In many conveyancing transactions, a giftor contributes funds to assist with the purchase. The most recent LSAG addendum⁷ makes clear that a third party’s SoF/SoW should be checked and that this should be “dependent on the risk profile of the matter.” In higher risk situations, such as in conveyancing transactions, the third party’s overall wealth should also be considered carefully.

The CLC’s position is that to effectively combat money laundering in conveyancing transactions, giftors must be subjected to the same level of scrutiny as clients without exception. As with regular SoF/SoW for clients you should ensure that any giftors are identified quickly and go through the same processes and procedures. Any standard communication which goes out to giftors (for example requesting a gifted deposit letter) should include wording outlining the requirement to verify the source of funds and wealth.

6. Lack of risk assessments

Client/matter risk-based risk assessments are the foundation for deciding what CDD measures should be adopted in each transaction. For example, in high-risk matters the practice will need to apply Enhanced Due Diligence (EDD) and potentially obtain extensive information regarding the source of funds and source of wealth.

Practices which do not risk assess adequately are unlikely to be able to discharge their obligations properly as it will lead to them either treating every transaction and client as the same, and thereby neglecting higher risk situations, or applying measures in an inconsistent manner. Practices may decide to treat everything as high risk however the CLC would still expect to see an individual client/matter risk assessment for every matter to ensure that any unusual nuances or red flags are considered.

A client/matter-based risk assessment must include details relating to the source of funds and source of wealth and best practice is to ensure that both are considered in the overall assessment of risk. A risk assessment which does not include these fundamental aspects of CDD is likely to be deficient.

⁷ <https://www.clc-uk.org/wp-content/uploads/2023/12/Addendum-to-the-LSAG-guidance-2.1-November-2023.pdf>



Enforcement action

The CLC has noted that the 2017 AML Regulations have been in place for a significant period of time and, when taken together with the levels of non-compliance that the CLC finds, represents a cause for concern.

Failure to comply with this compliance notice may lead to disciplinary and/or enforcement action. You can use this link to access the CLC's AML Enforcement Policy and Procedure [here](#) and the CLC's AML supervision arrangements [here](#).