Title: Money Laundering Regulations 2017 **IA No:** RPC17-HMT-3972(2) **RPC Reference No:** RPC17-HMT-3972(2) **Lead department or agency:** HM Treasury **Other departments or agencies:** Home Office, HM Revenue & Customs, Financial Conduct Authority, Gambling Commission	**Impact Assessment (IA)** **Date:** 13/04/2017 **Stage:** Final **Source of intervention:** EU **Type of measure:** Secondary Legislation **Contact for enquiries:** katherine.newall@hmtreasury.gsi.gov.uk

Summary: Intervention and Options

RPC Opinion: Green

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANDCB in 2014 prices)	**One-In, Three-Out**	**Business Impact Target Status**
£-53.49m	£-50.33m	£5.2m	Not in scope	Qualifying provision

What is the problem under consideration? Why is government intervention necessary?

These regulations transpose the 4th EU Money Laundering Directive (4MLD), which seeks to bring European legislation in line with the latest revision of the Financial Action Task Force (FATF) standards. The Directive seeks to restrict the flow of illicit finance by setting minimum common regulatory standards for Member States.

Note - the vast majority of the Directive is non-qualifying. One provision is qualifying (explained below) and it has a total net present value of -£0.1m and an EANDCB of £0.0m (included in summary boxes above).

What are the policy objectives and the intended effects?

The policy objective is to make the financial system a hostile environment for illicit finance whilst minimising the burden on legitimate businesses. The intended effect is that relevant businesses will update their money laundering controls in line with the latest international standards, improving their ability to detect and prevent illicit funds flowing through the financial system. Reducing the ability of criminals to gain from the proceeds of crime provides a disincentive to crime, thus reducing the estimated £24bn annual social and economic cost of serious and organised crime on the UK economy.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Option 0: 'Do Nothing'. Under this option, the UK's AML regulations would not be updated. This would lead to infraction proceedings by the European Commission and the UK would be judged non-compliant with FATF standards, damaging the UK's reputation as a legitimate and trustworthy place to do business.

Option 1: Transpose the Directive. This is the preferred option. This will ensure that we meet our legal obligations to the EU and that we are well-prepared for our FATF assessment in 2017-2018. We will also ensure that the UK benefits from potential exemptions where possible so that burdens on business are minimised.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** 07/2022

Does implementation go beyond minimum EU requirements?		Yes		
Are any of these organisations in scope?	**Micro** Yes	**Small** Yes	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)		**Traded:** 0	**Non-traded:** 0	

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible minister  Date: 15/06/2017

Summary: Analysis & Evidence

Policy Option 1

Description:

FULL ECONOMIC ASSESSMENT

Price Base Year: 2017	PV Base Year: 2017	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	**High:** Optional	**Best Estimate:**-53.5

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	-9.1	1	-2.6	**-31**
High	-26.8		-10.4	**-114.4**
Best Estimate	-17.9		-6.5	**-72.7**

Description and scale of key monetised costs by 'main affected groups'

The key monetised costs are the additional costs for estate agents in undertaking due diligence checks on buyers as well as sellers; the additional cost to financial institutions of undertaking enhanced due diligence measures on politically exposed persons; the cost of the criminality test being introduced for accountants, lawyers and estate agents; and the cost of the fit and proper test being extending to include agents of money service businesses.

Other key non-monetised costs by 'main affected groups'

The key non-monetised costs are the cost to e-money providers of doing customer due diligence on additional customers following introduction of a lower threshold; the cost of pooled client accounts not being automatically subject to simplified due diligence; the cost to financial institutions if they do enhanced due diligence on a higher number of correspondent relationships; and the cost of retaining data.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0.6	1	0.6	**5.5**
High	3.2		2.9	**27.3**
Best Estimate	2.2		2.0	**19.2**

Description and scale of key monetised benefits by 'main affected groups'

The key monetised benefit is the saving to firms that offer a financial activity as an ancillary activity to their main business (such as hotels that offer a currency exchange service), where the turnover from that ancillary activity is between £64,000 and £100,000. These firms will no longer need to comply with the Regulations.

Other key non-monetised benefits by 'main affected groups'

The key non-monetised benefits are the benefits to maintaining confidence in the UK's financial system with associated benefits to inward investment and access to foreign markets by UK corporates, and the benefits in deterring serious and organised crime, by reducing the ability of criminals to gain from the proceeds of crime.

Key assumptions/sensitivities/risks — **Discount rate (%)** 3.5%

This analysis assumes the cost of undertaking customer due diligence ranges from £3-£15 per customer, and the cost of undertaking enhanced due diligence ranges from £6-£30 per customer. It also assumes that relevant businesses covered by the regulations have the same level of employee turnover as the national average of 15%.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			Score for Business Impact Target (qualifying provisions only) £m:
Costs: -7.0	**Benefits:** 1.8	**Net:** -5.2	£0.0m (NB - qualifying provision has NPV of -0.06m)

Evidence Base

Problem under consideration

1. These regulations transpose an EU Directive on money laundering[1], which seeks to bring European legislation in line with the latest revision of the Financial Action Task Force (FATF) standards. The FATF is an inter-governmental body responsible for setting and promoting effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system. The UK has been a member of FATF since its creation in 1989.
2. The EU 4th Money Laundering Directive ("4MLD" or "the Directive") on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing (2015/849/EU) is due to be transposed into domestic law by 26 June 2017. The Money Laundering Regulations 2017 will do this.
3. The Directive seeks to restrict the flow of illicit finance by setting minimum common regulatory standards for Member States. It provides an update to the EU 3rd Money Laundering Directive which was transposed into UK law through the Money Laundering Regulations 2007. In general, the money laundering regulations focus on ensuring that relevant businesses assess risks; take appropriate measures to identify and monitor their customers; and report suspicious activity. This update introduces a number of new requirements on relevant businesses and changes to some of the obligations found under the current regime, which are detailed in the subsequent sections of this impact assessment.

Rationale for intervention

4. It is a European requirement that 4MLD must be transposed into domestic law by 26 June 2017. Transposition will ensure that the UK meets its EU obligations and has common AML / CTF regulatory standards to the rest of the EU. This will minimise the compliance costs of UK businesses that operate in other EU countries, as well as help protect the integrity of the UK's financial system.
5. The scale of the money laundering threat is significant. The National Crime Agency (NCA) believes that billions of pounds of illicit finance flow through the UK each year and the UN has found that in a study of 150 'grand corruption' cases, almost 1 in 5 corporate vehicles used to launder money were UK-related. Money laundering is also a key enabler of serious and organised crime, the social and economic costs of which are estimated by the Home Office to be £24bn a year (*2013 figure).*
6. Effective AML/CTF regulations will serve to make the UK a hostile environment for illicit finances, protecting the UK's reputation as a safe place to do business and maintaining confidence in the financial system with associated benefits to inward investment and access to foreign markets by UK corporates. By updating the regulations, we will also aid the detection and prosecution of crime. Reducing the ability to gain from the proceeds of crime provides a disincentive to crime, thus reducing the £24bn social and economic cost.
7. The UK's money laundering controls will also be assessed by FATF from October 2017 and a final report will be produced by the end of 2018. If FATF were to find the UK's regime to be substantially deficient it would have implications for the UK's reputation as a global leader on anti-corruption and as a well-regulated international financial centre. Depending on the deficiencies, it could also have an impact on the business environment. The UK's final report by FATF, known as the Mutual Evaluation, will be a public document and this will be extensively by global companies and law enforcement when deciding where to do business and how to interact with entities in other jurisdictions.

[1] On 23 June, the EU referendum took place and the people of the United Kingdom voted to leave the European Union. Until exit negotiations are concluded, the UK remains a full member of the European Union and all the rights and obligations of EU membership remain in force. During this period the Government will continue to negotiate, implement and apply EU legislation. The outcome of these negotiations will determine what arrangements apply in relation to EU legislation in future once the UK has left the EU.

Policy objectives and options

It is an EU obligation that the UK legislates to implement 4MLD. While the UK remains a member of the EU, the government has committed to continue to meet our obligations as a Member State. In any case, the Fourth Money Laundering Directive was drafted to give effect to international standards set by FATF. The UK is a founding member of FATF and remains committed to ensuring that the standards are implemented globally.

Option 0: 'Do Nothing'. Under this option, the UK's AML regulations would not be updated. This would lead to infraction proceedings by the European Commission and the UK would be judged non-compliant with FATF standards, damaging the UK's reputation as a legitimate and trustworthy place to do business.

Option 1: Transpose the Directive. This will ensure that we meet our legal obligations to the EU and that we are well-prepared for our FATF assessment in 2017-2018. We will also ensure that the UK benefits from potential exemptions where possible so that burdens on business are minimised.

Option 1 is the preferred option.

The challenge of cost-benefit analysis work

8. The money laundering regulations are underpinned by a risk-based approach (RBA). This means that businesses are required to develop an understanding of the money laundering and terrorist financing risks to which their business is vulnerable and act accordingly.

9. Regulated entities must ensure that they know who they are doing business with. This means understanding who their customer is and verifying that what they are being told is true. The regulated entity must also understand what the nature of the business relationship is so that it can monitor transactions to make sure that they are consistent with its understanding of the relationship. Where business models are particularly complex or susceptible to money laundering risks, regulated entities will have to look more closely to satisfy themselves that the relationship is legitimate.

10. The lengths to which regulated entities must go in order to satisfy themselves of their customer's identity, the nature of the relationship, and money laundering risks are not set out in legislation. It is likely that two different entities dealing with a similar customer would devote different levels of resource to checks and monitoring depending on the nature of their business, their relationship with the customer, and other wider risk factors. As a result, it is extremely difficult to know exactly what actions regulated businesses will take in order to comply.

11. Businesses have noted that the costs of customer due diligence vary greatly between customers and between parts of the business. They also depend on the frequency with which a customer might change their information. Ongoing monitoring is also difficult to cost. Where the relationship conforms exactly to initial expectations, the cost may be negligible. But where unexpected transactions and behaviours are seen, considerably more may be spent in order to understand them and confirm that they are not suspicious.

12. Furthermore, businesses find it difficult to isolate the cost of the requirements in the money laundering regulations, particularly the requirements around identifying and verifying their customers, because prudent businesses would do many of these activities anyway, either for commercial reasons, to comply with UN or EU sanctions, or to protect themselves and their customers from fraud. Financial institutions in particular often gather data on customers in order to more effectively market other products to them.

13. Costs are also affected by international considerations. The US imposes strict requirements on businesses. Businesses that also operate in the US, or have dealings that may make them eligible to investigation in the US, may use systems designed for US compliance globally rather than operate discrete regimes in different jurisdictions for reasons of efficiency.

14. Throughout the preparation of this impact assessment, HMT has sought views from regulated businesses and industry representatives as to potential costs and how to reduce red tape. A large majority of those asked have told us that they are unable to isolate the costs of the

Regulations from other related costs and that they do not believe it is useful to do so, although they welcome continued efforts to identify costs and benefits of specific changes where feasible.

Monetised and non-monetised costs and benefits

15. Businesses will already be carrying out a number of the requirements in 4MLD, because they were already a requirement in the EU 3rd Money Laundering Directive and therefore the Money Laundering Regulations 2007.
16. This section will therefore discuss each area in which there are material changes in 4MLD which the Government is implementing through the Money Laundering Regulations 2017. This is broken down into chapters from the Directive.
17. Just over 100,000 businesses are currently within scope of the regulations. That represents fewer than 2% of businesses in the UK.

Chapter I – Scope

A. Gambling Service Providers:

18. Only the holders of a casino operating licence are captured under the scope of the current money laundering regulations. This is in line with the international FATF standards.

19. 4MLD extends this scope to include all gambling service providers, effectively bringing the entire UK gambling industry into scope. However, the Directive provides the option of exempting providers of gambling services (with the exception of non-remote and remote casinos) if they are low risk.

20. The government consulted on which, if any, gambling service providers should be exempted on the basis of low risk. Evidence received was consistent with the 2015 National Risk Assessment finding that risks are low relative to other regulated sectors. This is partly due to effective mitigation, including the licensing conditions set by the Gambling Commission. As a result, the government has decided to exempt all gambling service providers, with the exception of non-remote and remote casinos (which 4MLD requires to be in scope).

Monetised and non-monetised costs:

21. There are no changes for the gambling sector. The government has decided to exempt all gambling service providers, with the exception of non-remote and remote casinos, so there are no additional costs.

B. Setting the threshold for limited business activity:

22. 4MLD allows member states to exempt persons that engage in financial activity on an occasional or very limited basis from the requirements of the Money Laundering Regulations. All of the following criteria must be met:
    a. Financial activity is limited in absolute terms
    b. Financial activity is limited on a transaction basis
    c. The financial activity is not the main activity of such persons
    d. The financial activity is ancillary and directly relates to the main activity of such persons
    e. The financial activity is provided only to the customers of the main activity of such persons and is not generally offered to the public
    f. The main activity of such persons is not one of those covered in article 2(1) setting out the scope of the directive.
23. The current thresholds set out in existing MLRs are:

a. Annual turnover: no more than £64,000

b. Single or a series of linked transactions up to £1,000

24. The firms that are potentially affected by this option are those that offer financial services (such as bureaux de change) as an ancillary service to their main activity.

Options for setting the threshold for limited business activity:

25. 4MLD provides member states with the option to increase the annual turnover threshold (currently set at £64,000) to a 'sufficiently low' level. Following consultation with industry, the government has decided to **increase the threshold to £100,000.** This amount was considered a fair balance between reducing the administrative burden on business whilst retaining a "sufficiently low" figure as required by the directive. The current limit of £64,000, set in 2007, was based on the then VAT registration threshold. If the VAT link were maintained, this would lift the threshold to £82,000. However, the VAT threshold cannot be increased (except to take account of inflation) without the consent of the European Commission, making it an inflexible threshold. Removing the VAT link would give government the flexibility to adjust the threshold more easily in line with understanding of ML/TF risks.

26. The vast majority of respondents to the consultation agreed with this new limit, particularly given that all other criteria listed in 22(a) to 22(f) must also apply.

Monetised and non-monetised costs:

27. **Costs** for changing this threshold are expected to be minimal and transitional only. They may include the costs for supervisors to publicise the higher threshold and identify which firms this would apply to. There will also be some cost in terms of increased risk of money laundering, but this is considered to be minimal given the thresholds and other criteria listed above which are required to be exempt from the regulations.

28. **Benefits** will depend on the number of firms with turnover between £64,000 and £100,000 who meet all the criteria in 22(a) to 22(f) and the cost saving they will each benefit from by not having to comply with money laundering regulations. The 2010 FSB annual survey shows that 5% of their membership have a turnover between £50,000 and £100,000. We use this as a proxy for the percentage increase in exempt businesses that might benefit from the increased threshold of £100,000. As around 100,000 businesses are supervised for AML/CTF purposes and ONS data shows that 99.3% of all private sector businesses are SMEs, we make an upper bound estimate of 100,000 x 5% = 5,000 businesses that might benefit from the increased threshold.

29. However, the 100,000 supervised business are unlikely to follow the broader business population demographic above given the nature of activities that are supervised. There are likely to be fewer small businesses represented. ONS figures show that 55% of businesses are registered for VAT, assuming that 55% of the supervised population are larger VAT registered businesses, then the 100,000 population eligible for exemptions falls to around 45,000. Using the 5% figure derived above, we estimate a lower bound of 2,250 businesses that might benefit from the increased threshold.

30. The main monetary benefits of this approach are the potential savings to firms through not needing to comply with the Regulations. The key requirements under the regulations are to conduct due diligence on customers, keep records and have effective controls, and report suspicious activity. Such firms are also required to register with HMRC and, if they are money service businesses, for their managers and owners to be Fit and Proper persons. It is difficult to estimate how much complying with the money laundering regulations costs firms with turnover between £64,000 and £100,000 (which meets all the other criteria listed above) because the type of business, customers and geography will vary.

31. However, modelling a simplified scenario, where such firms have financial activity of £82,000 (the mid-point between £64,000 and £100,000) or €94,000 (xe.com); and this financial activity is generated by 94 customers each transacting €1,000, the firm would be required to conduct customer due diligence on 94 customers.

32. This would give a potential benefit from not doing CDD of:

a. Lower estimate (based on CDD costing £3 per customer)
2,250 x 94 x £3 = £634,500

b. Mid estimate (based on CDD costing £9 per customer)
2,250 x 94 x £9 **=** £1,903,500

c. Higher estimate (based on CDD costing £15 per customer)
2,250 x 94 x £15 = £3,172,500

33. This estimate would overestimate the CDD such firms are doing if they reach their total financial activity through more transactions of lower value (because the CDD requirement is only incurred on transactions over €1,000 unless there is suspicion or a business relationship is being established). However, this estimate doesn't take into account the other costs that would be incurred such as from reporting suspicious activity and keeping records.

34. Firms would also avoid needing to register with HMRC. Firms registering for the first time are required to pay a £215 registration fee. They would also have to pay for Fit and Proper person tests on owners and managers (likely to be 2 people) costing £100 each so £200. Therefore, the total paid to HMRC when registering for the first time is £415. On an ongoing basis, firms are required to pay an annual £115 to continue to be registered and will pay for Fit and Proper tests where there are staff changes. Assuming the average UK employee turnover rate of 15%, this would be 15% x 2 x £100 = £30. So the total cost of being registered by HMRC on an ongoing basis is **£145**. This is the cost each firm which is no longer subject to the MLRs would save each year.

35. The central estimate is that each firm removed from the regulations will save £991 (£846 + £145), and when multiplied by the number of firms we expect to be removed (2,250), this totals a saving of **£2,229,750**.

Chapter II – General Provisions

A. Customer Due Diligence and E-Money:

36. Businesses subject to the money laundering regulations, such as financial institutions, accountants and estate agents (termed 'obliged entities') are required to apply customer due diligence (CDD) measures:
    a. identifying the customer and verifying identity,
    b. identifying the beneficial owner and verifying identity,
    c. assessing the purpose and intended nature of the relationship, and
    d. conducting ongoing monitoring of the relationship, including scrutiny of transactions and, where necessary, the source of funds.

37. 4MLD allows a potential exemption from points 31 (a), (b) and (c) for certain e-money products, where all of the following conditions are met:
    a. The payment instrument is not reloadable, or has monthly payment limits of €250;
    b. The maximum amount stored electronically does not exceed €250 (or for electronic money instruments only used in that Member State, €500);
    c. The payment instrument is used exclusively to purchase goods or services;
    d. The payment instrument cannot be funded with anonymous electronic money;
    e. The issuer carries out sufficient monitoring of the transactions to enable the detection of unusual or suspicious transactions.

38. The transposition of 4MLD and the new monthly payment limit represents a significant tightening of regulation for e-money. Previously, e-money holders could carry out one or many transactions up to a cumulative value of €2,500 in a calendar year, they will now be limited to €250 per month (€3,000 a year). Customers that wish to spend more than €250 in a single month will be required to undergo CDD checks.

Monetised and non-monetised costs:

39. There are currently 106 e-money firms registered with the FCA. Following strong support in the consultation, the government plans to apply the exemptions allowed by 4MLD (detailed above) and will allow low risk e-money products to continue to benefit from simplified due diligence (SDD) measures on a risk basis. For most e-money instruments, such as gift cards and vouchers, the new €250 threshold will not have any adverse impact because they are under this limit. The government is also implementing the €500 threshold for payment e-money instruments that can only be used in the UK, as allowed by 4MLD. This will increase the range of goods and services that can be purchased without significantly increasing the risk posed. It also supports financial inclusion, allowing the use of prepaid cards to purchase higher value goods and services domestically.

40. The cost to the e-money sector to ensure compliance with the directive varies from firm to firm due to different verification costs and firm sizes, and estimates of CDD costs are difficult to disentangle from fraud and other due diligence checks that firms carry out for different purposes. The new thresholds may also impact on the products offered by e-money firms and consumer's choice of payment method (for example, they could switch from e-money to cash).

41. There will likely be some initial cost in updating systems and processes and training staff. Some e-money firms replied to the consultation estimating that the cost of implementing changes to processes and legal requirements would be in the region of £50,000-£75,000 for some companies. This would only apply to firms that need to implement new systems to manage the new transaction thresholds. Some firms may choose to adapt their product range to avoid reaching the threshold.

42. There would also be an ongoing cost of conducting the additional CDD checks. One respondent to the consultation reported that the average transaction figure for their prepaid transactions is £44. E-money providers weren't able to provide estimates of how many transactions they do annually for over €250, but the average of £44 suggests it would not be very many. One provider also reported that they already do CDD on 91% of their prepaid cards so there isn't much scope for the number of CDD checks to increase. Firms may also adapt the products they offer to remain below the threshold and not do further CDD. The E-Money Association reports that the direct cost of carrying out CDD on a customer is estimated to be €1.4 – €5 per check. It has not been possible to estimate an aggregated figure given the lack of evidence on how many additional CDD checks will need to take place.

B. Application of Simplified Due Diligence:

43. The Directive sets out that Member States may allow the application of SDD in areas of lower risk, considering types of customers, geographic areas, and particular products, services, transactions or delivery channels. It provides a non-exhaustive list of factors that should be considered when deciding whether SDD is appropriate.

44. This represents a change from 3MLD where a number of customers and products (such as companies whose securities are listed on a regulated market, and life insurance policies with low premiums) were specifically listed as being subject to SDD. This focus on a risk-based approach is in line with revised FATF principles.

45. Whilst the application is no longer automatic, the list of factors to consider will likely mean that obliged entities continue to do SDD on similar types of customer or products, albeit with a clearer assessment of risk. Some categories, such as companies whose securities are listed on a regulated market, pension schemes, life insurance, and public authorities are specifically listed as low risk factors. Our expectation is that firms will continue to do SDD in these instances, and so there will be no change in terms of costs to business.

46. Two additional products have been added to the list of services that may be considered lower risk in 4MLD and the MLRs: financial products or services that provide appropriately defined and limited services to certain types of customers, so as to increase access for financial inclusion purposes; and products where the risks of money laundering and terrorist financing are managed

by other factors such as purse limits or transparency of ownership (e.g. certain types of electronic money). This provides additional areas where businesses will be able to benefit from using SDD rather than CDD measures on a risk basis.

47. There was no clear consensus in the 4MLD consultation response on any other additional factors which should be set out in the regulations.

48. **Pooled client Accounts:** The exemption automatically allowing simplified due diligence on pooled client accounts (PCAs) has been removed in 4MLD. The government consulted on whether SDD should continue to be allowed on PCAs. Some consultation responses argued that pooled client accounts are low risk, both because the funds are overseen by regulated sectors (such as lawyers), and because checks are carried out on clients before funds are deposited. These respondents also highlighted the administrative burdens of not allowing SDD on PCAs, which would arise from banks duplicating checks that lawyers do on their clients. As an example, one firm suggested that they held client money for up to 10,000 clients, and another estimated that they have around 2,000 client transactions every day. If CDD were required on each and every transaction from a pooled client account, this would result in significant increases in cost. However other firms explained that they would proceed under letters of reliance between banks and legal professionals, preventing the duplication of CDD checks.

49. Others, however, highlighted that the risks were as high or low as the quality of the firm, and that PCAs could potentially be exploited for money laundering. Examples included the combining of tainted and clean money, or sending money to the account and then reclaiming it, claiming an erroneous transfer. This is supported by findings in the last National Risk Assessment, which highlighted that law enforcement agencies in the UK have seen cases where client accounts have been used to provide personal banking facilities to criminals, to move and store large sums of criminal proceeds and to obscure the audit trail of criminal funds.

50. In the new money laundering regulations, the government will allow SDD on PCAs when the holder of the PCA presents a low risk of money laundering, and information on who holds funds in the PCA is available on request (for example, if the bank holding the account requests information from the law firm holding the account). Some cost will arise from the bank providing the account needing to assess the risk of the firm holding the PCA, though the bank should already be assessing the risk of their client under the risk-based approach.

Monetised and non-monetised costs and benefits:

51. It is difficult to assess the costs and benefits of these changes. There is little change between the low risk factors in the new regulations and the list of products and services subject to SDD in previous legislation.

52. **Costs** are likely to result from businesses having to undertake more detailed risk assessments. These costs are likely to vary between individual firms depending on size of firm and the type of product.

53. Whether there is an additional cost, or a cost saving, from undertaking due diligence will depend on whether the list of risk factors, instead of the list of products, results in businesses doing SDD on more or less of their customers. On balance, since the lists are similar, the central estimate is that businesses will continue to do SDD and CDD on the same proportions of customers and therefore the cost of this change is considered to be neutral (£0 cost).

54. There will be an additional cost to those offering pooled client accounts if banks do not consider them to be sufficiently low risk to allow simplified due diligence. In terms of the number of firms affected, there are around 12,000 solicitors' firms covered by the MLRs, and around 20,000 chartered accountants who may hold pooled client accounts. This gives an estimated 32,000 firms who may be affected in some way by the removal of automatic entitlement to SDD for pooled client accounts.

55. This could range from the cost of providing the details of clients holding funds in the PCA (which the firm with the PCA should have) to the cost incurred by the firm if a bank will no longer provide them with a PCA at all.

C. Application of Enhanced Due Diligence and PEPs:

56. The Directive requires Enhanced Due Diligence to be applied when dealing with entities in high risk third countries, cross border correspondent relationships with third-country respondent institutions, and Politically Exposed Persons (PEPs) (who are individuals that are entrusted with prominent public functions).

57. The changes from the existing regulations are that:

    - Domestic PEPs, their family members and close associates are now included where previously only foreign PEPs were included. This goes further than the FATF recommendations. The Government has consulted on interpreting this in a proportionate and risk-based way. EDD is a sliding scale and it is possible and right for firms to apply less stringent measures to low-risk PEPs than high-risk ones. Respondents strongly supported this approach.

    - A definition of correspondent relationships has been added which is consistent with FATF's definition, including both credit and financial institutions offering similar services.

    - The European Commission has taken a new power to define their own list of 'high-risk third countries', rather than relying on FATF's public list. While the list of countries might diverge from FATF's list, the requirement to conduct EDD in relation to high-risk countries remains the same.

Monetised and non-monetised costs:

58. With respect to relationships with PEPs under the new regulations, obliged entities will be required to evaluate the risks posed by the customer and, in proportion to these risks, take the following measures:

    a. Obtain senior management approval for establishing or continuing business relationships with such persons;

    b. Take adequate measures to establish the source of wealth and source of funds that are involved in business relationships or transactions with such persons; and

    c. Conduct enhanced, ongoing monitoring of those business relationships.

59. Firms will be required to tailor the EDD measures they apply based on the perceived risk. The Financial Conduct Authority (FCA) and the Joint Money Laundering Steering Group will publish detailed guidance on how firms should establish and manage risks associated with PEPs, but the Government expects that the following measures would be proportionate and appropriate in low-risk cases:

    a. When deciding whether a person is a known close associate, a firm need only have regard to information that is already in its possession or credible information that is publicly known;

    b. The firm should take less intrusive and less exhaustive steps to establish the source of wealth and source of funds, including by making full use of information that is already available to the institution (such as transaction records or credible publicly available information) and they should not make further inquiries of the individual unless anomalies arise;

    c. The person conducting EDD only needs to gain approval from a superior with sufficient authority and understanding of the businesses' risk appetite to take such a decision, rather than (for example) the Board or an individual director;

    d. "Enhanced, ongoing monitoring" means that the business relationship is subject to formal review, but that this should take place less frequently than the monitoring of a high-risk PEP; and

    e. After the firm becomes aware a PEP has left office, it should promptly cease to apply any enhanced measures to family members and known close associates.

60. Firms must form their own view of the risks associated with individual PEPs on a case-by-case basis, but the Government would expect that PEPs entrusted with prominent public functions by

the UK should generally be treated as lower-risk. Part of the rationale for looking more closely at foreign PEPs is the need to look closely at why such an individual is doing business in another jurisdiction, which does not apply to domestic PEPs.

61. To help firms distinguish between low- and high-risk PEPs and identify what measures are appropriate in each case, the Government has legislated for the FCA to publish detailed guidance on these issues. The FCA consulted on draft guidance from 16 March to 18 April and intends to issue final guidance this summer.

62. Carrying out EDD on PEPs is likely to be more expensive than CDD measures, but it is currently unclear to what extent. For example, the measures taken to establish source of wealth for a domestic PEP will depend on the degree of ML/TF risk perceived by the business: they might range from simply checking their own records to investigating several independent data sources to asking the customer to confirm the source as a last resort. The Government expects that, by applying less intense and intrusive measures to low-risk PEPs, firms will be able to reduce their compliance costs when compared to a uniformly high-risk approach.

63. This approach is expected to reduce burdens on customers as well. There have been numerous public reports of financial institutions pre-emptively applying EDD to UK PEPs, their family members and their known close associates. In many cases, firms have done this in a manner that is disproportionate to the ML/TF risks posed, including by making intrusive requests for information about a customer's relationships and their source of wealth or funds. In some cases, firms have withdrawn banking services from these customers: this has impacted financial inclusion and created additional costs for these consumers. The anecdotal nature of these reports makes it extremely difficult to consistently quantify the costs to consumers, but it is clear that the disproportionate application of EDD has created avoidable burdens. The Government expects to reduce the number of these incidents and their cost to consumers by requiring firms to treat low-risk PEPs in a proportionate manner. The Government has also clarified that withdrawing financial services from a PEP simply because they are a PEP is contrary to the spirit and the letter of the law.

64. Respondents to the consultation agreed that estimating costs for EDD (or, indeed, CDD) is extremely difficult since the nature and extent of checks varies according to perceived risk and, as is happening at present, an institution may go well beyond what is required by law if it has decided to take a blanket approach to checks. An institution's risk appetite, customer base and access to software (there are a number of software solutions on the market) will all influence the cost of carrying out checks and monitoring. Our central estimate of the cost to firms is £7,920,000 in year 1 and £1,188,000 in future years. However, a number of domestic PEPs have also already been subject to EDD checks by international financial institutions which have adopted a single, global approach to AML/CTF compliance so this is likely to be an overestimate.

65. The inclusion of a definition of correspondent relationships has been interpreted as an expansion of the commonly used definition set by FATF, as it covers credit and financial institutions offering similar services. However, the definition is consistent with FATF and is simply more explicit in the requirement to cover both credit and financial institutions, rather than just credit institutions. In its consultation, the government sought views on the impact of this measure. Responses were mixed, with some suggesting that there would be minimal impact. However, others view the impact as potentially significant, as a higher number of relationships with non-EEA credit and financial institutions would now require EDD measures to be applied. Respondents have not been able to quantify the impact of these changes and how many correspondent relationships might be captured. The government intends to work with industry to ensure the effective and proportionate implementation of these requirements, in line with a risk-based approach to the money laundering risk.

66. The Commission's list of high-risk countries is likely to mirror the FATF list. However, the Commission will have the power to diverge from the FATF list by either de-listing countries or adding additional countries. As a result, the regulated sector would need to conduct EDD on these relationships. While the Commission did not have this power in 3MLD, there has always been a requirement to conduct EDD on countries that are high-risk (taking in to account geographical and political context) therefore the government does not consider this to be an additional requirement and therefore this will not add any additional costs.

D. Beneficial Ownership Information:

67. Article 30 of the Directive requires member states to introduce a register of the beneficial ownership of companies incorporated in their territory. The UK has an existing beneficial ownership register and so already meets the majority of the requirements of Article 30. However some amendments to the UK's existing regime are required to ensure full compliance. These changes are covered separately in the (green-rated) impact assessment produced by BEIS on 13 January 2017, and therefore costs are not included in this analysis.

E. Trust Beneficial Ownership

68. The Directive requires the trustees of any express trust governed under the Member State's law to obtain and hold adequate, accurate and up-to-date information on the beneficial ownership of that trust. Under common law, trustees are already required to understand the terms of their trust in order to discharge their fiduciary duties, including the identities of the beneficial owners. Whilst the Money Laundering Regulations will formalise this requirement, the Government does not anticipate this to carry any costs to business or trustees.
69. The regulations will require the trustees of any trust that generate tax consequences to register this beneficial ownership information with HMRC. To minimise the burden of registration on trustees, the Government has built the new reporting requirements onto existing tax reporting mechanisms.
70. Trusts with tax liabilities already file tax returns and the Government has proposed to define "tax consequences" through reference to the taxes they already pay: these are income tax, capital gains tax, non-resident capital gains tax, inheritance tax, stamp duty land tax or stamp duty reserve tax. UK resident trusts with UK tax liabilities will be required to register, as will trusts that are resident outside of the UK but have a UK tax liability. Trustees will be required to report beneficial ownership information to HMRC in any year in which the trust incurs a liability for one of these taxes.
71. Information will be provided to HMRC through a new digital on-line service that will allow customers to register new trusts and to confirm that their details are up to date or amend them as required. This new system will be launched in summer 2017. It is expected that existing data on HMRC's Self-Assessment system will be migrated over to the new digital platform to make the best possible use of existing data.
72. Trustees will be required to provide HMRC with information on the identities of the settlors; other trustees; beneficiaries; all other natural or legal persons exercising effective control over the trust; and all other persons identified in a document or instrument relating to the trust, such as a letter or memorandum of wishes. This information will include:
    a. their name
    b. their date of birth
    c. if they are resident in the UK, their National Insurance Number (applies to individuals only) or their Unique Taxpayer Reference (applies to non-individuals only)
    d. if they are not resident in the UK, their passport or ID number with its country of issue and expiry date, along with their correspondence address.
73. If a trust has a class of beneficiaries, not all of whom have been determined, then it will not be necessary to report all of the above information. Instead, trustees will need to provide a description of the class of persons who are entitled to benefit from the trust. The Government expects this to reduce compliance costs compared to the alternative approach of separately registering every individual in a class of beneficiaries.
74. Trustees will also be required to provide general information on the nature of the trust. These include its name; the date on which it was established; a statement of accounts describing the assets; the country where it is resident for tax purposes; the place where it is administered; and a contact address.
75. When considering what information to collect, the Government has aimed to strike the right balance between minimising the administrative burdens on trustees and giving law enforcement

and compliance officers the data they need to combat the misuse of trusts. By collecting the information outlined above, HMRC and law enforcement will, for the first time, be able to draw links between all parties related to an asset in a trust. This would deliver a marked change in their ability to identify and interrupt suspicious activity involving the misuse of trusts.

76. HMRC will also be able to compare the Unique Taxpayer References and/or National Insurance Numbers of the parties to a trust and factor these into its wider understanding of those persons' tax liabilities. This will be particularly important in the longer term as part of the implementation of HMRC's digital strategy. For example, when HMRC can see that a payment out of a trust and a payment to an individual are both the same payment, it will be better able to ensure that the right amount of tax is paid at the right stage of the process. Collecting tax information will also help HMRC to make the best possible use of data it already holds. The register will use a UK resident's National Insurance Number to automatically retrieve their correspondence address from other systems held by HMRC, such as Self-Assessment or PAYE. This is expected to reduce costs for both beneficial owners and HMRC.

Monetised and non-monetised costs:

77. HMRC have modelled the cost of building the register and they expect it to cost approximately **£3.5 million** to build and maintain over 5 years. This cost is predominantly incurred in year 1 and is a cost to government. Approximately 170,000 trusts submit tax returns to HMRC each year. As such, HMRC expect the register to hold details for 170,000 trusts following the first full year of operation, with this number increasing slightly in each subsequent year (as new trusts incur a tax consequence for the first time). The Money Laundering Regulations require trustees to hold accurate and up-to-date written records relating to the trust. This obligation on trustees exists regardless of whether or not the trustee is also required to submit such information to HMRC for inclusion on the register. Since any such information will be submitted to HMRC via a free-to-use online service, there will be no direct costs to trustees arising from the establishment of the register.

F. Policies and Procedures

78. The 2007 Money Laundering Regulations required firms to establish and maintain appropriate and risk-sensitive policies and procedures relating to customer due diligence, reporting obligations, record-keeping, and internal controls to prevent money laundering and terrorist financing.

79. The requirements in the Directive are similar to those set out in the 2007 Money Laundering Regulations. They require obliged entities to take steps to identify and assess the ML/TF risks in their business, taking into account risk factors including those relating to their customers, countries or geographic areas, products, services, transaction or delivery channels. Those steps must be proportionate to the nature and size of the obliged entities and any risk assessments shall be documented, kept up-to-date and made available to the relevant supervisory authority.

80. There are however a number of new requirements in the Directive which have been included in the 2017 Money Laundering Regulations. These additional measures include:
    - A requirement for a compliance officer to be appointed at management level;
    - To carry out screening of relevant employees and agents appointed by the firm, both before the appointment is made, and at regular intervals during the course of the appointment;
    - To obtain approval from senior management for the policies, controls and procedures put in place and to monitor and enhance the measures taken, where appropriate.
    - An independent audit function to test the internal policies, controls and procedures, where appropriate with regard to the size and nature of the business.

Monetised and non-monetised costs and benefits

81. In the consultation on 4MLD, the Treasury asked for views on how to implement these new requirements, specifically asking whether we should set thresholds for when internal audit should be required. The majority of responses argued that the regulated sector should be able to apply a

risk-based approach, which is allowed under the Directive. Therefore, the Regulations 2017 note that the size and nature of the business must be taken into account in the application of internal controls. This provides a degree of flexibility for firms and should reduce the burden on small businesses.

82. There was limited feedback from the consultation responses on the costs related to the new requirements in the Directive. Those that did respond explained that they do not anticipate additional costs as they already have an internal audit function. In addition, larger firms who are likely to fall into the category requiring these additional measures already appoint an MLRO from management and consider compliance at board level. There was a limited response on employee screening, with most respondents unable to provide any costings for these new procedures.

G. Reliance

83. The Directive allows Member States to permit obliged entities to rely on third parties' customer due diligence checks, though they retain the ultimate responsibility for meeting customer due diligence requirements.

84. The Government considered introducing a deadline by which entities being relied on must provide information to entities requesting the information. However feedback from obliged entities suggested that this would could introduce a disincentive and as such, the deadline has been removed.

85. There is a potential benefit in the new regulations in that it is now possible to rely on the CDD checks done by anyone in the regulated sector (including, for example, casinos and money service businesses), whereas previously reliance was limited to financial institutions, legal professionals and accountants. Evidence in the consultation suggested that the reliance provisions are not used much in practice so this potential benefit has not been quantified.

Monetised and non-monetised costs and benefits:

86. There are no costs associated with the reliance regulation. It provides an option to firms and could present a saving for firms who avoid duplicating CDD checks. However, feedback suggests the reliance provisions have not been used much by obliged entities, and therefore we are not claiming a cost saving from these changes.

H. Data Retention

87. The Directive requires Member States to require obliged entities to retain customer due diligence information and transaction data for a period of five years following the end of the relationship. The Directive provided Member States with the flexibility to require retention of data for an additional five-year period, taking the total period to 10 years. This could be included if justified as necessary for the prevention, detection or investigation of money laundering or terrorist financing. The UK has chosen not to require obliged entities to retain data for this additional period as it was not deemed necessary by law enforcement and would have increased the burden on obliged entities. The Directive as written had the potential to require obliged entities to retain multiple decades' worth of transaction data, which would result in significant data storage costs. The UK has therefore introduced a cut-off period of 10 years to ensure that the burden on obliged entities is not increased unnecessarily.

88. Other than the above decisions, the Government has not made changes to the Directive in its transposition.

89. An additional requirement has been added requiring firms to delete data once the five-year period has elapsed. This is consistent with changes that will be introduced as part of the General Data Protection Regulation.

Monetised and non-monetised costs and benefits:

90. The cost of record keeping varies by firm, as this depends on the IT solutions that are introduced to manage these changes and how this interacts with the current practices of the business. It is

therefore difficult to come up with an exact figure for the monetised costs of data retention. In consultation responses, obliged entities have not provided figures for how much the change in Regulations will cost. However, feedback from obliged entities suggested that without a maximum limit for transaction data, the costs had the potential to be significant.

91. The requirement to delete data after the five years have expired will also require updates to obliged entities record keeping processes and therefore may also come with a cost. As above, it is difficult to estimate a figure for this cost as it will vary significantly by organisation.

I. Customer Due Diligence in the Estate Agency Sector

92. The government sought views on whether the Directive's requirement on estate agents to carry out customer due diligence on their customers should be clarified. While the Directive intends that due diligence is carried out on both the buyer and seller, in the UK, estate agents tend to act only for one of the parties to a transaction, usually the vendor, and therefore, they sometimes do not undertake due diligence on the buyer. Estate agents in the UK do however act as a key facilitator of the transaction and may be the only regulated professional whom the buyer encounters when purchasing a property. Even where a financial institution or legal professional is involved, given the high value transactions taking place in the property market and the low level of suspicious activity reporting in the sector, the estate agent conducting additional checks is considered to be necessary to address money laundering risks.

93. The government has therefore clarified the Directive's requirement that, for the purposes of the regulations, an estate agent is to be considered as entering into a business relationship with a purchaser as well as with a seller. This means that estate agency businesses must apply CDD to both contracting parties in a transaction.

94. Most respondents who were not estate agents welcomed the proposed clarification, stating that estate agents are well-placed to act as gatekeepers for both parties because they have a relationship with both sides of the transaction, and they encounter the buyer at an early stage in the transaction. The estate agency sector however raised concerns around duplication of CDD checks and complications in deciding at what point to actually carry out the checks. The NRA stated that the purchase of real estate is attractive for money laundering purposes, and found that law enforcement cases show that UK criminals invest proceeds in property, with property representing the most valuable asset type held by UK criminals against whom a confiscation order is made.

Monetised and non-monetised costs and benefits

95. It is difficult to assess the costs and benefits of these changes. Where estate agents have already been carrying out due diligence on buyers and sellers (in line with business best practice), no new costs will be incurred. Costs will result from businesses carrying out CDD on buyers where they have not done so previously. These costs are likely to vary between individual firms, based on their customers, products and geography. The precise actions required under CDD are not laid down and businesses are expected to vary them according to the risk in each specific circumstance.

96. There are approximately 9,000 estate agency businesses in the UK. Between 2006 and 2014, there were on average 1,115,027 residential property transactions per year and 63,343 non-residential transactions per year, so a total of 1,178,370 transactions (Annual UK Property Transaction Statistics, latest available). Assuming that 50% of estate agency businesses currently carry CDD on both sides of the transaction and 50% carry out CDD on one side of the transaction, and therefore need to do an additional check per transaction:

    a. Lower estimate (based on CDD costing £3 per customer)
    1,178,370 x 0.5 x £3 = £1,767,555

    b. Mid estimate (based on CDD costing £9 per customer)
    1,178,370 x 0.5 x £9 **= £5,302,665**

c. Higher estimate (based on CDD costing £15 per customer)
1,178,370 x 0.5 x £15 = £8,837,775

97. The middle estimate of £9 for the cost of CDD is considered reasonable because in more complicated situations, where the estate agency business has a suspicion, they should already be taking more thorough measures to prevent AML/CTF under the existing requirement for them to report suspicious activity. They may also be doing some of the relevant checks already for commercial reasons, for example, ensuring the buyer has the funds. HMRC intend to clarify in guidance when estate agency businesses should carry out the due diligence checks. This should be late enough in the property transaction to prevent multiple CDD checks being done on potential buyers who do not go through with the transaction. However, this cost estimate may still under-estimate the cost because there will inevitably be some checks that go ahead on buyers that do not end up completing the transaction.

Chapter III – Supervision

A. Fit and Proper Test:

98. The current money laundering regulations require that a "person who effectively directs" a trust or company service provider (TCSP) or a money service business (MSB) is a fit and proper person.

99. The Directive amends this to require that "persons who hold a management function" in TCSPs and MSBs, or are the "beneficial owners" of such entities, should be fit and proper persons.

100. The key change in the latest regulations is that we have considered this to apply to MSB agents. The MSB sector operates through a network of more than 50,000 agents. The 2015 National Risk Assessment identified the use of agents as an AML/CTF vulnerability because they present a fraud risk and can be vulnerable to exploitation by criminals. Currently, HMRC good practice guidance encourages principals to carry out fit and proper tests on MSB agents. In the latest regulations, MSBs are required to take appropriate measures to ensure their agents are fit and proper. This decision was supported by responses to the government's consultation, with several respondents stating that this would "bring uniformity in fit and proper tests across the sector, ensuring consistency and a level playing field"

Monetised and non-monetised costs and benefits:

101. HMRC already supervises 2,085 MSBs principals and 2,594 TCSPs. HMRC's experience is that each regulated business currently has just over two individuals subject to fit and proper tests. They believe that the change in focus to individuals with a "management function" or are "beneficial owners" will not significantly change this. Responses to the consultation also reflected this view.

102. Consultation responses indicated that a single fit and proper test costs £100.

103. HMRC already carries out fit and proper tests on their TCSPs and as a result there will not be additional costs to those TCSPs already on their register. The additional cost will be through the fit and proper test of an MSB principal being more thorough to include a review of that principal's checks on its agents. HMRC are in the process of determining their operational approach. Assuming that HMRC need to double the charge to MSB principals for the fit and proper test, this will increase costs by **£417,000** in year 1 (this is 2085 businesses * 2 individuals * £100 additional cost). Then, assuming the UK average employee turnover rate of 15% applies to those who hold a management function or are the beneficial owners of MSBs, the additional ongoing cost will be **£62,550.**

B. Supervisors Information:

104. The 2007 Money Laundering Regulations, require each supervisor to "effectively monitor the relevant persons for whom it is the supervisory authority and take necessary measures for the purpose of securing compliance by such persons with the requirements of the Money Laundering Regulations." Furthermore the Regulations provide supervisors with the ability to "disclose to another supervisory authority, information it holds relevant to its functions under these Regulations"

105. The Directive continues this requirement by placing an obligation on supervisors to effectively monitor their supervised entities and to share information with relevant authorities.

106. Neither the Directive nor the current Regulations stipulate what type of information needs to be collected and be readily available to share. However ensuring information flows among supervisors, between supervisors and law enforcement, and between supervisors and the businesses they supervise, is a key feature of a robust AML/CTF framework.

107. The government has sought to clarify the types of information it expects to be collected and shared by supervisors. This puts into legislation existing practices, which supervisors have been carrying out in order to respond to the Treasury's Annual Supervision Return. The Directive now means that the collection of regulatory information must be a legislative requirement. Therefore the new Regulations place a duty on supervisors to take appropriate steps to collect and share relevant information.

Monetised and non-monetised costs and benefits:

108. The requirement to share information between supervisors, law enforcement and regulated businesses is not a new provision. Neither is the type of information required to be collected by supervisors. The new Regulations reflect what is required at a minimum from supervisors for the Treasury's Annual Supervision Return. The government has legislated for this to ensure consistency amongst all supervisors.

109. As a result, there are no additional costs on businesses for this requirement.

C. Criminality Test

110. The Directive introduces a new criminality test for:

a. auditors, external accountants and tax advisors;

b. notaries and other independent legal professionals;

c. estate agents.

111. Supervisors will be required to take necessary measures to prevent criminals convicted in relevant areas or their associates from holding a management function in, or being the beneficial owners of, these entities. This means supervisors must take steps to find out whether someone holding a management function, or seeking to hold one, has been convicted of a relevant offence.

112. The Directive does not set out what is meant by 'relevant areas', so the government has taken the most proportionate view that this means convictions in areas relevant to money laundering and terrorist financing. The government consulted on a proposed list of relevant offences, and a final list has been included in a Schedule to the Regulations. This provides clarity to both supervisors and applicants.

113. The Directive does not define associates. The government sought views on the definition of "associates", and has taken a proportionate approach which is strictly limited to the intent of the directive. "Associates" is intended to mean criminal associates, i.e. those associates of criminals that are participating in, or are demonstrably connected with criminal enterprise. "Associates" therefore only includes those known to have committed a relevant criminal offence. The government will not permit supervisors to take into account spent convictions when assessing whether a person should be prohibited from being a beneficial owner, officer or

manager of a supervised business. This recognises that the rehabilitation period of relevant convictions and cautions provides proportionality and appropriate safeguards.

114. The government also sought views on extending the criminality test to High Value Dealers (HVDs). Law enforcement and HMRC evidence noted an increased number of organised crime groups having been involved in large scale criminality using trade-based money laundering involving high value goods. In light of the strong evidence provided to the consultation, the government has extended the criminality test to HVDs.

115. The government must introduce a criminality test in order to comply with the Directive. The flexibility arises from the definition of what constitutes a management position, what constitutes a relevant offence, the definition of associates and the possibility of bringing HVDs into scope. The government has consulted on these issues in order to more fully understand the costs and benefits.

116. The government realises that this requirement will mean that a large number of criminality tests will need to be administered. Therefore, based on the responses to the consultation, a one-year transition period has been provided to allow the currently regulated population to go through these tests.

Monetised and non-monetised costs and benefits

117. **Costs** will flow from the application of the criminality tests. These cost £25 when carried out through a disclosure agency. This would likely be charged to the business in question.

118. Based on supervision reports, we know that there are around 64,000 audit, external accountant and tax advisor businesses; 12,000 notaries and independent legal professional firms; 9,000 estate agency businesses; and 1,000 registered HVDs falling within the Money Laundering Regulations (though the number of HVDs that register with HMRC may increase now that an HVD is defined as a firm accepting or making cash payments of €10,000, rather than a firm accepting cash payments of €15,000).

119. The beneficial owner and manager of each of these will need to undergo a criminality test. Based on the estimates used in the Fit and Proper test estimates above, the government expects that 2 people from each business will need to undergo a criminality test in the transition period, with 15% of the population needing to be tested annually on an ongoing basis to take account of new businesses and changes in ownership/staff. The initial cost during the transition period would be (86000x2) x £25 = **£4,300,000** with the annual cost (assuming the UK average employee turnover rate of 15%) being **£645,000** ((86,000x2x15%) x £25)**.**

D. TCSP register

120. The current regulations require authorised persons to inform the Financial Conduct Authority (FCA) where they carry out TCSP work so they can be registered. HMRC must register those relevant persons not captured by the FCA register who are TCSPs.

121. The Directive requires all TCSPs to be registered. From 26 June, HMRC will act as the registering authority for all TCSPs that are not supervised by the FCA. This means HMRC will continue to register those relevant persons who are TCSPs but not on the FCA register, but will also expand their register to include TCSPs who are supervised by professional body supervisors.

122. The new regulations will require professional body supervisors to inform HMRC of their members who carry out TCSP activity so that they can be added to the HMRC register. A requirement is placed on professional body supervisors to inform HMRC if relevant members have passed fit and proper tests and to inform HMRC if the fit and proper status of their members has changed.

Monetised and non-monetised costs and benefits

123. Given that HMRC and the FCA already have to register TCSPs under their supervision, there will be no transitional costs associated in meeting that requirement.

124. A cost will be borne from HMRC acting as the registering authority for all TCSPs that are not supervised by the FCA.

125. A one off set-up cost for HMRC setting up the TCSP register is estimated by HMRC to be **£97,100** while the on-going cost is expected to be **£104,000.** These are costs incurred by government. A breakdown of these costs is illustrated below:

One – Off Cost

Item	Total Cost
Shared Workspace set-up	£17,000
Data Input	£100
Terms of reference and/or MoU	£12,000
CONNECT	£68,000

On-Going Cost

Item	Cost (£ p.a.)
Registration team staffing	£36,000
Disclosure and knowledge management	£68,000

126. Professional body supervisors will be given operating licences by HMRC to access and use the register. They will not have to pay for these licences. There will be some cost to them in passing data to HMRC.

Business Impact Target

127. The Secretary of State for Business, Innovation and Skills, Business Impact Target: Written Statement (March 2016) states that, "regulatory provisions that implement new or changed obligations arising from European Union Regulations, Decisions and Directives, and other changes to international commitments and obligations, except in cases of gold- plating" are regulatory provisions to be excluded from the Business Impact Target.

128. The Money Laundering Regulations amend existing European obligations, as set out in 4MLD. As a result the provisions within the regulations will be classified as "non-qualifying" for the Business Impact Target.

129. However, the government has also opted to require managers and owners of High Value Dealers (HVDs) to undergo a criminality test (as detailed in section 3 (c)). This is considered to be proportionate to the risk in the sector, and is supported by consultation evidence.

130. The extension of the criminality test to the HVD sector will qualify for the Business Impact Target. As outlined in the Criminality Test chapter, we estimate that there are around 1,000 registered HVDs. The beneficial owner and manager of each of these will need to undergo a criminality test. The government expects that 2 people from each business will need to undergo a criminality test in the transition period. The Business Impact Target Cost will therefore be (1000 x 2) X £25 = £50,000 in year 1. In ongoing years, assuming the national average employee turnover rate of 15%, the ongoing cost will be £7,500. This equates to a net present value of -£0.1m and an EANDCB of £0.0m.

Small and micro-businesses assessment (SaMBA)

131. The global standards set out by FATF and the EU Directive do not allow for the exemption of micro-businesses or any exemptions based on firm size. Money laundering and terrorist financing risks do not disappear in smaller businesses, rather experience shows that criminals often target smaller businesses. Consequently, micro-businesses will be in scope of transposition of the Directive. However as per the guidance provided in the Better Regulation Manual, EU measures do not require a mandatory SaMBA, bar where going beyond the Directive.

132. As stated, the government is extending criminality tests to the HVD sector. HMT have engaged with supervisors to enquire how many HVDs are classified as SMEs. Supervisors have estimated that there are 800 registered HVDs that are SMEs.

133. As a result, the SaMBA cost for implementing the policy of applying criminality tests on HVDs equates to (800 x 2) X £25 = £40,000.

Equalities Impact

134. The Government expects the equalities impact of this measure to be neutral. Age, religion, gender, pregnancy and maternity, race and sexual orientation do not generate significant issues in terms of preventing money laundering and terrorist financing.

Conclusion

135. The government takes threats from money laundering and terrorist financing very seriously and is committed to tackling it domestically and internationally. The National Risk Assessment of Money Laundering and Terrorist Financing found that the same factors that make the UK an attractive place for legitimate financial activity – its political stability, advanced professional services sector, and widely understood language and legal system – can also make it an attractive place through which to launder the proceeds of crime.

136. The government seeks to mitigate AML/CTF risks through the Anti-Money Laundering regime. The clear aim is to make the UK financial system a hostile environment for illicit finances, whilst minimising the burden on legitimate businesses.

137. The Directive represents an important step in bringing the EU into line with the internationally agreed standards laid out by FATF which will be assessed during the UK's review by FATF ('Mutual Evaluation'), which is scheduled to begin in autumn 2017.