

**EXPLANATORY MEMORANDUM TO  
THE MONEY LAUNDERING REGULATIONS 2007**

**2007 No. 2157**

1. This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of Her Majesty.

**2. Description**

2.1 These Regulations implement, in part, Directive 2005/60/EC of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing (the Third Directive). The Regulations require the financial, accountancy, legal and other sectors to apply risk-based customer due diligence measures and take other steps to prevent their services being used for money laundering or terrorist financing.

**3. Matters of special interest to the Joint Committee on Statutory Instruments**

3.1 None

**4. Legislative Background**

4.1 The Third Directive builds on the obligations imposed on member states by the First Directive (91/308/EEC) amended by the Second Directive (2001/97/EC). Its aim is to update European legislation on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing so that it better reflects the 40 Recommendations on money laundering made by the Financial Action Task Force<sup>1</sup>. These Regulations (which are made under the power conferred by section 2(2) of the European Communities Act 1972 and specific powers contained in the Financial Services and Markets Act 2000) define the persons on whom obligations to carry out customer due diligence will be imposed, set out those obligations, allocate supervisors for persons in the regulated sector and provide the necessary enforcement powers for certain supervisors.

4.2 Provision for anti-money laundering and terrorist financing controls is also made under Part 7 of the Proceeds of Crime Act 2002 and Part 3 of the Terrorism Act 2000, and by means of the licensing requirement in the Gambling Act 2005 and disciplinary rules made by the professional bodies.

4.3 The Government submitted an explanatory memorandum dated 17 September 2004 on the draft Third Money Laundering Directive (doc. 11134/04). The House of Commons Select Committee on European Scrutiny reported on the draft Directive in reports 32 (2003-04), para 13 (13 October 2004), 1 (2004-05), para 14 (1 December 2004) and 1 (2005-06), para 50 (4 July 2005), clearing it after Ministerial correspondence. The House of Lords European Union Committee considered the draft Directive in Sub-Committee E (Law and Institutions) and cleared it from scrutiny on 22 June 2005 after Ministerial correspondence (see

---

<sup>1</sup> [www.FATF-GAFI.org](http://www.FATF-GAFI.org)

report 45 (2005-06)). A Transposition Note is attached as an Annex to this memorandum.

## **5. Extent**

5.1 This instrument applies to all of the United Kingdom.

## **6. European Convention on Human Rights**

6.1 The Economic Secretary to the Treasury has made the following statement regarding Human Rights:

In my view the provisions of the Money Laundering Regulations 2007 are compatible with the Convention rights.

## **7. Policy background**

### *Objectives*

7.1 The principal policy objective behind the Third Directive is to update and enhance European legislation to bring it in line with the international standards on combating money laundering and terrorist financing set out in the Financial Action Task Force's (FATF) 40 Recommendations.

7.2 The Money Laundering Regulations implement the main preventative measures of the Directive, namely requiring risk-based customer due diligence measures, including requiring firms to identify the beneficial owner of customers that are legal entities or arrangements, allowing firms to rely on other firms in meeting their customer due diligence obligations, and putting in place measures so that all sectors subject to the Regulations are supervised for their compliance with the Regulations. Producing the Money Laundering Regulations was also one of the key commitments in the Government's financial crime strategy "The Financial Challenge to Crime and Terrorism", published in February 2007.

### *Approach to implementation*

7.3 The Treasury considered that the best way to implement the Directive in the Regulations would be to follow, so far as possible, a 'copy-out' approach – an approach in which the legal framework is closely based on the provisions in the Community legislation. A copy-out approach helps to ensure that the United Kingdom does not 'gold plate' Community legislation and avoids costly burdens on UK industry. The Treasury consulted on this basis twice and consultation respondents broadly supported the Treasury's approach. The only significant departure from the copy-out approach has been in the definition of "beneficial owner". Following representations from stakeholders requesting changes to the definition to reflect trust law in the UK, the Government wrote to interested stakeholders proposing a number of changes to the definition in order to clarify how the provision would operate. These changes were supported by those who responded.

### *Preventative measures*

7.4 The Third Directive and the Money Laundering Regulations apply to financial services, including money service businesses, and to those sectors that are seen as

gatekeepers to the financial system such as legal advisers, accountants, trust and company service providers and estate agents. The Directive and the Regulations also apply to casinos and high value dealers.

7.5 A key part of the UK's Financial Crime strategy is to entrench the risk-based approach. Just as criminal and terrorist threats are both diverse and dynamic, so our approach must be both flexible and responsive in order to target the changing threat effectively. The risk-based approach therefore requires active management, with policy makers, firms and supervisors working closely together to identify and address key risks. The Third Directive for the first time required firms to vary identification and monitoring of their customer on a risk-sensitive basis. The Money Laundering Regulations 2007 implement this. The Directive and the Regulations also require firms to apply enhanced customer identification and monitoring measures in situations of higher money laundering and terrorist financing risk. In order to support the risk-based approach the Government, supervisors and law enforcement will ensure that firms have information on the threats and vulnerabilities that they face. Guidance will be provided to industry on practical steps on implementing the risk-based approach.

7.6 As well as effectively targeting higher risk situations to ensure that the Regulations are proportionate, the Government has also taken advantage of the derogations offered by the Third Directive. Firms are allowed to reduce the level of customer identification in specified lower risk situations, and may rely on the customer identification measures already undertaken by certain other firms and so reduce duplication of effort.

#### *Supervision*

7.7 The Third Directive requires that all sectors subject to the Regulations be supervised for their compliance with them. Part 4 of the Money Laundering Regulations lists the supervisors for the different sectors. In choosing supervisors for each of the sectors the Government has followed the Hampton Principles. It has also taken advantage of self-regulatory options in Article 37(5) of the Third Directive. Under Part 4 high value dealers, money service businesses and trust and company service providers will be required to register with a supervisor. In addition the Financial Services Authority, the Office of Fair Trading, the Commissioners of Her Majesty's Revenue and Customs have the power to register the other sectors they are supervising, if they so wish.

7.8 Part 5 of the Regulations provides enforcement powers for the Financial Services Authority, the Office of Fair Trading, the Commissioners of Her Majesty's Revenue and Customs and the Department of Enterprise, Trade and Investment in Northern Ireland in respect of the persons they supervise. The Government believes that these supervisors should have the powers to require information, undertake onsite inspection and impose administrative penalties for those firms that do not comply with the Regulations. Decisions by a supervisor whether or not to register a person or impose a civil penalty are subject to review and appeal according to the particular legislative framework applying to that supervisor.

#### *Consultation*

7.9 The Government consulted for 12 weeks on its policy proposals for implementing the Third Money Laundering Directive in July 2006, and it then consulted for a further 10 weeks on draft Regulations in January 2007. Around 100 responses

were received for each consultation. The Government has had continued engagement with stakeholders including alerting them if any significant changes are to be made, such as on beneficial ownership. A summary of the responses to each consultation is published on the Treasury's website (hm-treasury.gov.uk).

*Implementation of the Regulations and guidance*

7.10 The Government sees the Regulations as part of an implementation system that also includes supervisory rules (such as those in the FSA Handbook) and guidance to industry (for example the Joint Money Laundering Steering Group guidance for financial services). The Regulations enable firms that have followed Treasury approved guidance to use this as a defence against the imposition of civil penalties or prosecution for a criminal offence under the Regulations.

**8. Impact**

8.1 A Regulatory Impact Assessment is attached to this memorandum.

**9. Contact**

Lucy French at HM Treasury Tel: 020 7270 5794 or e-mail: lucy.french@hm-treasury.x.gsi.gov.uk can answer any queries regarding the instrument.

**Transposition note for Directive 2005/60/EC:  
Third Money Laundering Directive**

| <b>Articles of Directive 2005/60/EC</b> | <b>Objective</b>   | <b>Implementation</b>  | <b>Body Responsible</b> |
|---|--|--|-------------------------|
| 2.1                                     | Defines the scope of persons to whom the obligations apply   | Regulation 3 and Schedule 1  | HM Treasury             |
| 2.2                                     | Excludes from scope persons who engage in financial activity on an occasional or very limited basis  | Regulation 4(2) and paragraph 1 of Schedule 2  | HM Treasury             |
| 6                                       | Credit or financial institutions are prohibited from maintaining anonymous accounts or pass books and must apply CDD to those that exist   | Regulation 16(3) & (4)   | HM Treasury             |
| 7                                       | Specifies out when and how CDD should be applied   | Regulation 7(1) and (3), 8(1) and (3).   | HM Treasury             |
| 8                                       | Defines what CDD comprises of  | Regulation 5 and 8(2)  | HM Treasury             |
| 9.1-9.4                                 | Specifies the general rule for when verification should occur and provides three derogations   | Regulation 9   | HM Treasury             |
| 9.5                                     | Sets out what consequences should be if regulated sector fails to apply certain CDD measures   | Regulation 11  | HM Treasury             |
| 9.6                                     | Regulated sector must apply CDD to existing customers on a risk-sensitive basis  | Regulation 7(2)  | HM Treasury             |
| 10                                      | Imposes specific requirement for the identification and verification of casino customers   | Regulation 10  | HM Treasury             |
| 11                                      | Provides for simplified CDD for specified customers and products   | Regulation 13 and paragraphs 2 and 3 of Schedule 2   | HM Treasury             |
| 13.1-13.4                               | Provides for enhanced CDD for specified situations and customers   | Regulation 14 and paragraph 4 of Schedule 2  | HM Treasury             |
| 13.5                                    | Credit institutions are prohibited from maintaining correspondent banking relationships with shell banks   | Regulation 16(1) and (2)   | HM Treasury             |
| 13.6                                    | Regulated sector must pay special attention to threats that arise from products or transactions that might favour anonymity  | Regulations 20(2)(b) and 14(1)(b)  | HM Treasury             |
| 14                                      | Permits regulated sector to rely on third parties to do CDD  | Regulation 17(1)   | HM Treasury             |
| 15                                      | Requires members states to allow third parties outside a members state to be relied on if that category of person is allowed to be relied on within that members state even if the documents or data required there are different from in the member state to which the customer is being referred | Regulation 17(2).<br><br>(No specific documents or data are required to be obtained by the Regulations.) | HM Treasury             |
| 16                                      | Specifies which third parties may be relied upon   | Regulation 17(2)   | HM Treasury             |
| 18                                      | Third parties who are relied on must keep records and provide CDD information to persons who rely on them to do CDD  | Regulation 19(4), (5) and (6)  | HM Treasury             |

|      |   |  |                     |
|------|---|--|---------------------|
| 19   | Excludes from Articles 14-18 the situation where the regulated sector uses an outsourcing service provider or agent to apply CDD.   | Regulations 17(3) and 19(7)  | HM Treasury         |
| 20   | Regulated sector to pay special attention to activity likely by its nature to be related to money laundering or terrorist financing   | Regulations 20(1)(a) and 14(1)(b)  | HM Treasury         |
| 25.1 | Supervisors who discover facts that could be related to money laundering or terrorist financing must promptly inform FIU  | Regulation 24(2)   | HM Treasury         |
| 25.2 | Supervisors of stock, foreign exchange and derivatives markets to inform FIU if they discover facts that could be related to money laundering or terrorist financing  | Regulation 49(1)(a)  | HM Treasury         |
| 30   | Imposes record-keeping obligations on the regulated sector  | Regulation 19  | HM Treasury         |
| 31.1 | Credit and financial institutions must require their branches and subsidiaries to apply, to the extent permitted by local law, measures equivalent to those in the directive and, where not permitted, inform their competent authority | Regulation 15(1) and (2)(a)  | HM Treasury         |
| 31.3 | Credit and financial institutions must take additional measures where the legislation of a third country does not permit the application of equivalent measures.  | Regulation 15(2)(b)  | HM Treasury         |
| 32   | Credit and financial institutions must have systems in place to respond fully and rapidly to enquiries from the FIU   | Regulation 20(4)   | HM Treasury         |
| 34.1 | Regulated sector must establish policies and procedures   | Regulation 20(1)   | HM Treasury         |
| 34.2 | Credit and financial institutions must communicate their policies and procedures to their branches and subsidiaries   | Regulation 20(5)   | HM Treasury         |
| 35.1 | Regulated sector must train relevant employees  | Regulation 21  | HM Treasury         |
| 36.1 | CEOs and TCSPs must be registered or licensed and casinos licensed.   | Regulation 26<br>Gambling Act 2005   | HM Treasury<br>DCMS |
| 36.2 | C.A.s must refuse registration / licensing to MSBs, TCSPs and casinos if they are not satisfied that they are run by fit and proper persons   | Regulation 28<br>FSMA 2000<br>Gambling Act 2005  | HM Treasury<br>DCMS |
| 37.1 | C.A.s must effectively monitor the regulated sector   | Regulation 24(1)   | HM Treasury         |
| 37.2 | C.A.s must have adequate powers including the power to compel the production of information, perform checks, and have adequate resources  | Regulations 27(1), 37-41<br>FSMA 2000<br>Gambling Act 2005<br>Powers of SROs<br>Powers of SoS (Insolvency Service)<br>Powers of DETI | HM Treasury         |
| 37.3 | C.A.s for credit and financial institutions and casinos must have enhanced supervisory powers including on-site inspections   | Regulation 38<br>FSMA 2000<br>Gambling Act 2005  | HM Treasury         |

|      |   |                     |             |
|------|---|---------------------|-------------|
| 37.5 | SROs may supervise auditors, external accountants and tax advisers, notaries and independent legal advisers   | Regulation 23(1)(c) | HM Treasury |
| 39   | Regulated sector must be liable for infringements of provisions adopted, administrative measures or sanctions imposed and penalties must be effective, proportionate and dissuasive | Regulations 42-48   | HM Treasury |

**Transposition note for Directive 2006/70/EC:  
Implementing Measures Directive**

| <b>Articles of Directive 2006/70/EC</b> | <b>Objective</b>   | <b>Implementation</b>                                    | <b>Body Responsible</b> |
|---|--|--|-------------------------|
| 2                                       | Defines “politically exposed person”   | Regulation 14(4) and (5) and paragraph 4 of Schedule 2   | HM Treasury             |
| 3                                       | Defines the customers and products for which simplified due diligence may be applied | Regulation 13 and paragraphs 2 and 3 of Schedule 2       | HM Treasury             |
| 4                                       | Defines “financial activity on an occasional or very limited basis”                  | Regulation 4(1)(e) and (2) and paragraph 1 of Schedule 2 | HM Treasury             |

# 1

## REGULATORY IMPACT ASSESSMENT

### TITLE OF PROPOSAL

---

**1.1** The Money Laundering Regulations 2007, implementing the Directive on the Prevention of Money Laundering and Terrorist Financing (2005/60/EC). This instrument will be called the “Regulations” for the rest of this Regulatory Impact Assessment (RIA).

**1.2** This is the final RIA, and updates the revised version published in January 2007.

### PURPOSE AND INTENDED EFFECT

---

#### Objectives

**1.3** This proposal updates UK legislation in line with the newly adopted Third Money Laundering Directive. It ensures that

- UK legislation is in line with European legislation and international best practice for preventing money laundering and terrorist financing, and
- the UK has the most appropriate and proportionate measures to deter, detect and disrupt money laundering and the financing of terrorism.

**1.4** The proposal will impact on the following persons to whom its provisions will apply. These are:

- Credit institutions and other financial institutions;
- Auditors, external accountants and tax advisers;
- Notaries and other independent legal professionals when performing certain activities;
- Trust and company service providers;
- Estate agents;
- Money service businesses, including bureaux de change;
- Dealers and auctioneers in high-value goods, whenever payment is made in cash, and in an amount of €15,000 or more; and
- Casinos

**1.5** All these sectors have been under the UK Money Laundering Regulations since the entry into force of the primary and secondary legislation, which implemented the Second Money Laundering Directive. The Money Laundering Regulations 2003 (Statutory Instrument 2003 No. 3075 - the secondary legislation that implemented the preventative requirements of the Second Money Laundering Directive) came into force on 1st March 2004.

**1.6** In addition to the above sectors the Regulations impact upon existing supervisory bodies and new supervisory bodies responsible for ensuring compliance with anti money laundering legislation. These bodies are:



- The Financial Services Authority;
- The Gambling Commission;
- Her Majesty's Revenue and Customs (HMRC);
- The Office of Fair Trading together with Local Authority Trading Standards Services and Department of Trade, Enterprise and Investment in Northern Ireland;
- Department of Trade, Enterprise and Investment in Northern Ireland; and
- The Insolvency Service.

The following professional bodies:

- The Law Society;
- The Law Society of Scotland;
- The Law Society of Northern Ireland;
- The Institute of Chartered Accountants in England and Wales;
- The Institute of Chartered Accountants of Scotland;
- The Institute of Chartered Accountants in Ireland;
- The Association of Chartered Certified Accountants;
- The Council for Licensed Conveyancers;
- The General Council of the Bar (ie The Bar Council of England and Wales);
- The Faculty of Advocates;
- The General Council of the Bar of Northern Ireland (ie The Bar Council for Northern Ireland);
- The Association of Accounting Technicians;
- The Association of Taxation Technicians;
- The Chartered Institute of Taxation;
- The Association of International Accountants
- The Chartered Institute of Management Accountants
- The Chartered Institute of Public Finance and Accountancy
- The Faculty Office of the Archbishop of Canterbury
- The Insolvency Practitioners Association
- The Institute of Certified Bookkeepers
- The Institute of Financial Accountants

**1.7** The Regulations will also affect law enforcement authorities such as Her Majesty's Revenue and Customs (HMRC) , the Police and the Serious Organised Crime Agency (SOCA). The Directive covers their powers and duties for the purposes of preventing money laundering and terrorist financing.

**1.8** The Regulations will indirectly affect some of the individuals and businesses that are customers of firms in the regulated sector.

**1.9** The Regulations will come into effect on the 15 December 2007, in line with the deadline for implementing the Third Money Laundering Directive. The Regulations will affect the United Kingdom of Great Britain and Northern Ireland but not Gibraltar or the other Overseas Territories and the Crown Dependencies.

## **CHANGES IN THE FINAL RIA**

---

**1.10** The figures in the final RIA have been updated to reflect the following

- Increase in labour market index (i.e. wages)
- Changes in estimates of the number of financial institutions, estate agents and trust and company service providers
- Changes in assumptions on the time taken to register and prepare for a supervisory visit.

## **BACKGROUND**

---

### **Current situation, the extent of money laundering and terrorist financing:**

**1.11** Home Office research has estimated that organised crime generates over £20 billion of social and economic harm in the UK each year. This represents not just the cost of prevention and insurance, but the cost of the impact of crime (such as theft or physical harm to victims) and the costs of the response, such as running the criminal justice system.

**1.12** All serious acquisitive crime is likely to involve money laundering. The other side of every money laundering offence is an act of criminality- for example, drug trafficking; handling stolen goods from domestic & commercial burglary and vehicle crime; trading stolen mobiles and credit cards from street robberies; excise fraud; human trafficking; trading illegal firearms; trading counterfeit goods; and theft from the public purse through false claims and corruption.

**1.13** The SOCA 2006/7 Threat Assessment<sup>2</sup> discusses the significance of money laundering to serious and organised crime and the sectors most at risk in the UK. Further assessment of trends in money laundering (typologies) can also be found on the Financial Action Task Force (FATF) website<sup>3</sup>.

### **Current Regulations**

**1.14** The following forms the current legislative framework:

- Money Laundering Regulations 2003: These set out the scope of the regulated sector and the preventative measures that they must take. They also set out the powers of the supervisor for money service businesses and high value dealers;
- The Proceeds of Crime Act 2002- as amended by the Serious Organised Crime and Police Act 2005: This sets out the principal money laundering offences and reporting obligations; and

---

<sup>2</sup> [http://www.soca.gov.uk/assessPublications/downloads/threat\\_assess\\_unclass\\_250706.pdf](http://www.soca.gov.uk/assessPublications/downloads/threat_assess_unclass_250706.pdf)

<sup>3</sup> [http://www1.oecd.org/fatf/FATFDocs\\_en.htm#Trends](http://www1.oecd.org/fatf/FATFDocs_en.htm#Trends)

- The Terrorism Act 2000 in relation to terrorism financing.

**1.15** Government anti money laundering and counter terrorist financing policy is to keep Regulations at a high level with support from industry led guidance and any guidance issued by supervisory bodies. If the guidance is Treasury approved then a firm can use the fact that it followed the guidance as a defence against a money laundering prosecution. The Government approved the Joint Money Laundering Steering Group (JMLSG) guidance for the financial services sector in February 2006 and the Guidance for Notaries in February 2007.

## **Who handles the policy and how effective has it been?**

**1.16** HM Treasury leads on the Money Laundering Regulations with Home Office leading on the Proceeds of Crime Act and the Terrorism Act. Indications as to how effective the policy has been so far include:

- Around 200,000 suspicious activity reports (SARs) made in 2006;
- Approx £165m of assets were recovered in 2005;
- A single SAR led directly to harm reduction, when an account was restrained and the holder arrested following enquiries which revealed that the account holder had defrauded a vulnerable person of approximately £50,000;
- A single SAR assisted officers to restrain significant sums from an overseas jurisdiction destined for property purchases in the UK, which were the proceeds of a complex fraud. One person was charged and several others arrested on suspicion of committing money laundering offences;
- A cash seizure opportunity as a result of a SAR, led to the law enforcement authorities identifying a cannabis factory and further money laundering offences. Several persons were arrested; and
- As a result of investigations USD20 million was restrained in a UK bank account on behalf of overseas authorities, who were conducting a bribery/corruption investigation into the affairs of a company linked to the UK. The funds represented bribe payments in relation to a USD540 million contract.

## **IMPACTS OF THE PROPOSED MEASURES**

---

**1.17** The Third Money Laundering Directive will mean a number of changes:

### **Customer Due Diligence Requirements**

- More detailed customer due diligence requirements including in specific situations of high and low risk. While much of this is already in guidance it will now need to be set out in Regulations.

### **Requirements on the public sector**

- Requirements to publish statistics on effectiveness and to feed back to the sectors covered by the Regulations on the threats and vulnerabilities of money

laundering and terrorist financing and on the Suspicious Activity Reports (SARS) made.

### **Monitoring of compliance**

- The establishment of a fit and proper test as part of the licensing or registration for trust and company service providers and money service businesses.
- Providing a monitoring regime for the all sectors under the Regulations not currently monitored for their compliance with the Regulations.

**1.18** The responses to the consultation confirmed that these were the areas of most impact. The cost and benefits section of the partial and updated RIA outlined the main parts of the Third Money Laundering Directive where the UK has flexibility over implementation. This final RIA now:

- provides a final estimate of the number of firms affected, following consultation responses and further research;
- confirms the policy choices made and the Governments view of the costs and benefits of those;

## **RATIONALE FOR GOVERNMENT INTERVENTION**

---

**1.19** Effective, money laundering and terrorist financing controls are important to:

- provide a disincentive to crime by reducing its profitability. Robust systems of controls to detect, intercept and confiscate criminal funds make it harder for individuals or groups to profit from their crimes;
- provide a disincentive to crime by reducing the pool of money available to finance future criminal activity. Robust systems of controls to detect, intercept and confiscate criminal funds make it harder for individuals or groups to fund their next crime;
- aid the detection and prosecution of crime. The intelligence provided from money laundering and terrorist financing controls may provide leads, which can be crucial in disrupting terrorism, money laundering and linked offences, in convicting criminals or for identifying criminal assets that can be recovered;
- protect the integrity of the financial system and reputation of UK business. The competitive position of UK business depends upon its reputation for integrity and honest dealing; and
- avoid economic and competitive distortions. Legitimate businesses are disadvantaged when competing against businesses controlled by criminals who may be willing to accept lower rates of return or even losses to maintain the appearance of being legitimate investments.

## **Rationale for intervention - The Third Money Laundering Directive**

**1.20** The Third Directive strengthens the existing regime in line with the global Financial Action Task Force (FATF) standard for anti money laundering/counter terrorist

financing controls. Without this the EU anti money laundering/counter terrorist financing defences would be less effective with criminals being able to take advantage of weaker regimes. The Third Directive also helps to ensure a level playing field for firms across the EU.

## **Rationale for intervention – The Money Laundering Regulations 2007**

**1.21** The Government considers that compliance with best practice anti money laundering and counter terrorist financing measures is important to reassure other Governments, the international financial institutions and those who do business in and with the UK that the UK has clean markets.

**1.22** A further reason to implement the Directive is to avoid infraction proceedings by the Commission or be listed non-compliant with the FATF recommendations. Once a Directive is adopted, each Member State must take such action as is required to: a) give effect in national law to the rights and obligations created by the Directive; and b) ensure that the Directive is implemented in a transparent manner. Failure to implement the Directive properly runs the risk of the UK being infringed and fined by the Commission and assessed as non or partial compliant with the global standard set by the Financial Action Task Force<sup>4</sup>. This is the ‘do nothing’ option. The threat of infraction proceedings is important as the Commission has become increasingly active in recent years in its use of infraction powers<sup>5</sup>.

## **CONSULTATION**

---

**1.23** The Government has taken account of over 100 responses to the most recent consultation, and over 90 responses to its original consultation document, held specific working groups, spoken to a large number of firms and representative associations bilaterally and consulted at a number of conferences.

**1.24** This final RIA considers options and set out our final views on:

- Financial Activity on an Occasional and Limited Basis;
- Casinos;
- Simplified Due Diligence;
- Third Parties/reliance;
- Record Keeping;
- Monitoring of estate agents, accountants, non FSMA financial institutions; and
- Monitoring and fit and proper tests for trust and company service providers and money service businesses.

**1.25** The Government thanks those that responded to the consultation document and the partial and revised draft RIAs.

---

<sup>4</sup> The UK has recently been assessed for its compliance with FATF recommendations.

<sup>5</sup> For example, in 2003 the Court fined Spain €624 150 per year per percentage point that they fell below the Directive requirements for compliant bathing waters. At the time of the judgment, they were 20 % non-compliant, so the annual fine was £12 483 000. This will decrease as Spain improves its standards.

**1.26** The final Regulations and this RIA should be read together.

## **SECTORS AFFECTED BY THE THIRD MONEY LAUNDERING DIRECTIVE**

---

**1.27** Ongoing consultation yields the following estimate of the size of the affected sectors:

- Credit and financial institutions regulated by the FSA for money laundering purposes: approximately 10, 000 firms;
- Consumer Credit financial institutions: an estimate of 20,000 is being used;
- Other Annex I financial institutions: an estimate of 1000 is being used;
- Money service businesses (classified as a financial institution): there are currently approximately 3500 firms;
- Independent legal professionals, including lawyers and notaries: there are approximately 10, 000 firms and sets of chambers;
- External accountants: an estimated 25,000 firms belonging to recognised professional supervisory bodies and 40,000 that do not belong to such bodies;
- Trust and Company Service Providers: there is no existing estimate for such firms, with many professionals being counted as accountants and lawyers. An estimate of 5000-10,000 firms is being used;
- Estate Agents: there are approximately 14, 500 firms;
- High Value Dealers: there are approximately 1100 firms; and
- Casinos. There are currently 140 Casinos in Great Britain and for the purposes of this RIA we have estimated that a further 60 casinos will open over the next few years.

## **FINANCIAL ACTIVITY ON AN OCCASIONAL AND LIMITED BASIS: IMPLEMENTATION OPTIONS**

---

**1.28** The consultation document proposed removing legal or natural persons who engage in financial activity on an occasional and limited basis from the definition of a financial institution, where there is little risk of money laundering or terrorist financing. They can only be removed if they determine that they meet the criteria listed in Schedule 2 of the Regulations. This would effectively mean a reduction in the number of those subject to the requirements of the Regulations.

### **Sectors affected**

**1.29** 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 and that meet the Commission's criteria of low risk of money laundering and terrorist financing (set out in Schedule 2 of the Regulations). The Government estimates that this could be up to 2000 firms.

## Options

**1.30** There are two options for implementing the Directive:

**1.31** The do nothing option would be to not take up this derogation, continuing the current situation that firms that provide a financial activity on an occasional and limited basis are included in the scope of the regulated sector and therefore need to undertake the requirements of the Regulations (know your customer, record keeping and reporting of suspicious activity reports).

**1.32** The other option is to take advantage of the derogation in the Directive and clarified by Schedule 2 of the Regulations. Firms that meet the criteria would not be subject to the requirements of the Regulations.

## Discussion and risks

**1.33** Implementing this Article of the Directive will mean that some firms may be excluded from the Regulations if they meet the criteria. There is a risk that this could leave a loophole for criminals to take advantage of. This risk is very limited, however, as the activities that meet the Commission's strict criteria would, by their nature be unattractive vehicles to money launderers and terrorist financiers.

**1.34** To not take this opportunity, however, would not meet the overall objective to prevent money laundering and terrorist financing in a proportionate and targeted manner. Industry and law enforcement could concentrate their efforts on those activities remaining under the Regulations. On balance it seems sensible to try and reduce burdens on businesses where it is demonstrated that by the nature of the activity there is a minimal risk of money laundering and terrorist financing.

## Costs and benefits of the do nothing option

**1.35** The costs of the do nothing option would be equal to the costs of meeting the Third Money Laundering Directive's requirements that are applicable to these firms, including the ongoing costs that they already incur of meeting the current Regulations.

**1.36** The benefits of this option are the benefits of the money laundering regime in general, including the general benefits of the added measures of the Third Money Laundering Directive. These include preventative customer due diligence measures that deter criminals from using such services, information that can be provided to SOCA and law enforcement if there is suspicion. As the activities that could take advantage of this derogation are by their nature very low risk, the benefits are reduced.

## The costs and benefits of taking advantage of the derogation

**1.37** The costs of this approach are the potential reduction in preventative measures and information (through record keeping etc) that can help law enforcement in the prevention of money laundering and terrorist financing. Removing a sector from the scope of the money laundering regime in legislation can potentially alert money launderers to areas where

fewer checks take place and potentially create a loophole. The criteria, however, only allows firms to be removed from the Regulations if by nature their business is difficult to be used by money launderers and therefore severely unlikely to be taken advantage of. Further, POCA also requires all firms (whether they fall within the Regulations or not) to report suspicious activity if they have a nominated officer.

**1.38** There is also a small administrative cost to firms if they want to apply for this derogation and an indirect cost to the supervisor who will need to assess whether the firm meets the criteria and can take advantage of the derogation. However, this “policing the perimeter” should be less costly than full monitoring of the firms if they could not take advantage of the derogation.

**1.39** The main monetary benefits of this approach are the potential savings to firms through not needing to comply with the Regulations (including the additional requirements of the Third Money Laundering Directive). The Government has estimated that this could lead to a total saving of up to £600,000

## Small firms impacts test

**1.40** Taking advantage of this derogation could benefit both small and larger firms, The Commission’s criteria for taking advantage of the derogation includes a maximum proportion of business that the financial activity can be. This could potentially advantage larger firms (who by definition would have the financial activity as a smaller proportion of their business) but the other cumulative criteria, however should negate this.

## Competition Assessment

**1.41** The markets affected could potentially include firms with bureaux de change activity, or with safe custody services. It is unlikely that any of the firms affected have a greater than 10% market share of the activity. And it is unlikely that the savings of the deregulatory option would affect some firms more than others.

**1.42** Taking advantage of the derogation could have a positive competition effect in that those firms which previously had been deterred from setting up the ancillary financial activity, face less disincentive to adding such activity that meets the criteria for the derogation.

**1.43** If the UK did not take advantage of the derogation there is a small chance that firms might choose to locate in other countries that have taken advantage of it.

## Consultation results and conclusion

**1.44** The vast majority of responses supported the proposal to take advantage of the derogation. The Government therefore has included this derogation in Regulation 4(2) and in Schedule 2 to the Regulations.

## CUSTOMER DUE DILIGENCE REQUIREMENTS ON CASINOS

---

**1.45** The previous consultation document consulted on whether the Regulations should:



- require casinos to identify customers on entry;
- require casinos to identify customers when they gamble over a threshold of over 2000 Euros; or
- leave the option open as to which of the above two options a casino can take.

## Sectors Affected

**1.46** This measure applies only to the casino sector. There are currently 140 casinos in Great Britain and for the purposes of the RIA we have estimated that a further 60 casinos will open over the next 3 years.

## Options

**1.47** Option 1 is keeping the requirement to identify customers on entry to the casino. As this is the current situation, this is the do nothing option. Option 2 is to change the identification requirement to when customers gamble over 2000 Euros. Option 3 allows both options.

## Discussion and risks

**1.48** The risks of option 2 and 3 are that law enforcement will not have access to all data on customers entering the casino area. However, international best practice as established by the Financial Action Task Force favours a threshold approach on the grounds that casinos should be able to link customer due diligence information for a particular customer to the transactions that the customer conducts in the casino. Moreover, in the view of law enforcement, money laundering in casinos below the sum of €2,000 is not an extensive problem.

## Costs and benefits of option 1

**1.49** If the size of the casino sector did not change then the costs of option 1 would be minimal as they are already operating identification on entry. The changing shape of the casinos sector, however, means that costs of option 1 could increase if the new casinos were required to identify all customers. We have estimated that this cost would fall on the newer rather than existing casinos and would cost around £2m across the sector. The benefits of option 1 would be that all customers were identified.

## Costs and benefits of option 2

**1.50** We have estimated that around 50,000 customers will gamble over £1350 (equivalent to 2000 Euros) per average casino per year. This option would produce savings to existing casinos who are operating on a membership scheme (and therefore currently identifying more customers) but new costs to new casinos. There are also costs for all casinos in engaging with the Gambling Commission to ensure that any new system works. Overall we believe this will balance out as savings of £2.5million. The indirect costs are that the casinos would not hold information on all customers, only those that gamble over 2000 Euros.

## The costs and benefits of option 3

**1.51** These are largely similar to the costs and benefits of option 2. However, firms who already operate identification on entry and lack the systems to adopt a threshold approach will continue their current practice. As their current practice is slightly more costly this reduces the savings from option 2 to about £1.5million.

## Small firms impact

**1.52** A number of casinos are small businesses, including 14 single casino operators.

## Competition assessment

**1.53** The sector affected by these measures is small. The costs of requiring identification on entry would be higher for larger casinos than for smaller casinos. However, the impact is unlikely to affect either the size of the sector or the number of firms in the sector.

## Consultation results and conclusion

**1.54** The Government is of the view that casinos should identify their customers when they reach a threshold of €2,000 of chips exchanged or gambled. A threshold approach is recommended as international best practice by the Financial Action Task Force, which suggests a level of €3,000. The Third Money Laundering Directive provides for a stricter application of this standard, involving a threshold of €2,000, and it is this approach that the Government is taking. In the view of law enforcement, money laundering in casinos below the sum of €2,000 is not a material risk provided proper checks are in place to ensure that this threshold is not exceeded without appropriate due diligence through the consecutive exchange of smaller amounts. Casinos should also be able to link customer due diligence information for a particular customer to the transactions that the customer conducts in the casino.

**1.55** Those casinos that are able to demonstrate to the regulator that they have the systems in place for tracking and identifying higher risk individuals and for ensuring that criminals are not able to circumvent the threshold by gradually exchanging or gambling chips should therefore follow a threshold approach. The Government has rejected the blanket application of a threshold system for all casinos, as some may not have the systems in place to deliver it effectively. For those that do not, the default position should continue to be that casinos identify their customers on entry. This will enable those casinos that presently operate a membership system to continue with their current practice of identifying, and verifying the identity of, customers at the point of application for membership. However, the Government encourages all casinos to develop the systems necessary for tracking and identifying higher-risk individuals in line with the threshold approach.

**1.56** Regulation 10 sets out the identification requirements on casinos. The threshold will apply per 24 hours for casinos and internet casinos. If it transpires that there are systemic problems with operating on a threshold basis, then checks on entry will be required.

**1.57** Regulation 10 is drafted so that all gaming machines within a casino are included within the scope of the identification requirements. And that therefore casinos must identify customers using these machines either on entry or when they reach the threshold.

**1.58** The consultation responses to draft Regulations repeated the views expressed to the previous consultation. Some of the responses requested that a third option should be explicitly allowed in the Regulations, that is identification not on entry to the casino but to the gaming area. The Government has decided not to draft such a provision as it is of the view that casinos should identify their customers when they reach a threshold of €2,000 of chips exchanged or gambled. The Financial Action Task Force recommends a threshold approach as international best practice. While the Government accept that those casinos that presently operate a membership system can continue with their current practice of identifying, and verifying the identity of, customers at the point of application for membership, the Government wishes to keep incentives on casinos to pursue the effective threshold approach and believes that a third option would reduce such incentives.

## **SIMPLIFIED CUSTOMER DUE DILIGENCE REQUIREMENTS**

---

**1.59** The Third Directive allows Member States the option of not performing certain customer due diligence requirements for certain low risk customers and products. Some of these derogations already exist in the current Regulations but some are new. In particular, the Government has the option not to require full customer due diligence measures to be performed:

- where the customer is a listed company whose securities are listed on a regulated market in a Member State or situated in a third country with disclosure requirements consistent with community legislation.
- where the customer is a beneficial owner of pooled accounts held by notaries and other legal professionals from Member States or from third countries with equivalent money laundering standards and the information on the beneficial owner is available, on request, to the institutions that act as a depository institution for pooled accounts.
- where the customer is a domestic public authority.
- where the product/transaction is e-money as defined, where (a) if the device cannot be recharged then the maximum amount stored is Euro 150 and (b) if the device can be recharged, the maximum limit is Euro 2500 on the total transacted in a calendar year, except when an Euro 1000 is redeemed in that same calendar year by the bearer as referred to in The e-Money Directive.
- the draft Regulations also include other criteria that firms can apply simplified due diligence. These are included in Schedule 2 to the Regulations.

## **Sectors affected**

**1.60** In principle all sectors covered by the Regulations can take advantage of the derogations but in practice not all sectors do significant business with such customers or have such products. Credit and financial institutions such as those regulated by the FSA and a small proportion of non FSA regulated financial activities could benefit from all derogations, small emoney issuers can benefit from the emoney derogation and lawyers and accountants could take advantage of some of the derogations as they may have customer that are listed companies or domestic public authorities, or meet some of the Commission's criteria. For the purposes of this regulatory impact assessment it is estimated that around 22,000 firms who would be likely to take advantage of the derogations has been used.

## **Options**

**1.61** Option 1 is to only take advantage of those derogations in the Money Laundering Regulations 2003. This would mean full, rather than simplified, customer due diligence for the above list of customers and products. This would be the do nothing option.

**1.62** Option 2 is to take advantage of all of the derogations provided including those that are in the criteria provided by the Commission. That is to state in the Regulations that the customers and products above should not be subject to full customer due diligence requirements.

**1.63** Option 3 could be to only take advantage of some of the derogations, based on information that some customers or products were not sufficiently low risk as to benefit from the derogation.

## Discussion and risks

**1.64** The policy intention is to give firms specific examples of low risk situations that they can apply reduced due diligence to. There is the risk in taking advantage of these derogations that criminals may use products that qualify for reduced due diligence, although by their nature these products are low risk because they are not attractive vehicles for money laundering or terrorist financing. In addition firms will still be obliged to conduct full customer due diligence if there is a suspicion and report that suspicion. Moreover, to take advantage of the simplified due diligence derogations would help firms to target their resources away from products or customers that are unattractive to money launderers.

## Cost and Benefits of option 1

**1.65** The direct cost of this option is minimal as it is the status quo. All sectors will need to apply full customer due diligence in a risk based manner to all customers and products except those that are already derogated from identification and verification in the current Regulations.

**1.66** The opportunity costs compared with taking advantage of derogation are that firms will need to spend more money on low risk activities and consequently not on other preventative measures.

**1.67** The benefit is that all customers and products must undergo some form of customer due diligence which ensures that measures to prevent money laundering and terrorist financing are undertaken even in low risk situations.

## Costs and Benefits of option 2

**1.68** The direct costs of implementing this measure will be the time taken to read and understand whether the derogations apply.

**1.69** There are direct quantifiable savings of taking advantage of such derogations. As described above it is estimated that around 22,000 firms would be able take advantage of this derogation, each saving up to 4 hours a year. The total savings would be around £2.5m in total.

## Costs and benefits of option 3

**1.70** If there was reason to believe that some of the products or customers listed in the Directive, or that meet the comitology criteria are not sufficiently low risk that they should

be granted simplified due diligence, the Government may restrict the list. The costs and benefits would fall between those listed in option 1 and 2 depending on how many products or customers are to be listed.

## Small firms impact test

**1.71** Given the nature of the products and customers listed as low risk, the derogation is likely to benefit larger firms rather than smaller firms. This is because larger firms are more likely to have customers that are regulated businesses or specialised low risk products.

## Competition assessment

**1.72** In the sectors no one firm has market share greater than a 10% share. It is therefore unlikely the derogation will have any significant competition effects.

**1.73** To not take advantage of the derogation could, however, have a negative competition effect in that firms may choose to be based in an EU country where the derogation exists. Existing UK multinational firms may also be disadvantaged when competing against EU firms with lower customer due diligence costs for the same customers and products.

## Consultation responses and conclusion

**1.74** The vast majority of the consultation responses supported the proposal to take advantage of all derogations. The Government therefore proposes to do so and this is reflected in Regulation 13.

## RELIANCE ON A THIRD PARTY

---

**1.75** The current Money Laundering Regulations only allow reliance between firms for one off transactions with a firm introduced by a third party (who must be a financial institution) and who has provided a written assurance that the identification and verification has been undertaken. The Third Money Laundering Directive allows more sectors to be relied upon as long as they meet the following conditions:

**1.76** They are subject to the requirements of the Directive, or are equivalent firms/persons in a third country which imposes equivalent requirements and:

- are subject to mandatory professional registration recognised by law: and
- apply customer due diligence and record keeping requirements in line with this Directive and their compliance is supervised.

**1.77** The Government has considered what is meant by mandatory professional registration and believes it at least includes those that are subject to a fit and proper test and therefore includes the following sectors:

- Credit and Financial Institutions licensed/authorised and supervised by the FSA or OFT
- Certain legal and accountancy professionals that are members of a professional body listed in Part 1 of Schedule 3
- Money Service Businesses

- Trust and Company Service Providers
- Casinos

## Sectors affected

**1.78** All of the sectors under the Regulations can rely on any of the sectors listed above to carry out the customer due diligence requirements. In practice certain credit and financial institutions, lawyers, accountants, estate agents, high value dealers, money service businesses and trust and company service providers would be best placed to take advantage of such derogations.

## Options

**1.79** Option 1 is to not take advantage of the reliance provisions. All sectors would need to undertake full customer due diligence in all situations (except in a one off transaction between firms authorised and supervised by the FSA). This is the do nothing option.

**1.80** Option 2 is to take advantage of the reliance options. All sectors would be exempted from customer due diligence if a customer has been introduced to them by a firm that meets the conditions above and they choose to rely on that third party. However, the final responsibility for customer due diligence remains with the firm that ultimately accepts the customer.

**1.81** Option 3 is to allow reliance on FSA authorised firms, and certain accountants, tax advisers and lawyers currently supervised by professional bodies for anti-money laundering controls, but not money service businesses, casinos, trust and company service providers and professionals new to supervision for anti-money laundering controls until the new supervision regime (including a fit and proper test) is effectively running and there is evidence of compliance.

## Costs and benefits of option 1

**1.82** The direct costs of option 1 are minimal as it means continuing the status quo. The opportunity cost, however is the time and money spent on customer due diligence requirements that could be better spent on other preventative measures.

**1.83** The benefit of this option is a reduced risk of firms relying on other firms which are not fulfilling its customer due diligence obligations.

## Costs and benefits of option 2

**1.84** There are minimal direct costs of taking up the reliance provision, apart from reading and understanding the terms on which these provisions can be taken advantage of. There is a risk that the firm relied upon has not undertaken sufficient due diligence. This risk would be greater for firms relying on trust and company service providers, money service businesses, consumer credit financial institutions, certain accountants and tax advisers belonging to professional bodies and casinos as these firms will be subject to a relatively new supervisory and fit and proper regime. It should be noted, however, that the

firm that is ultimately accepting the customer must weigh up this risk of relying on another firm based on the information it has on the firm. The Third Money Laundering Directive also requires that the third party must produce, on request of the firm receiving a customer, the customer due diligence information.

**1.85** The previous regulatory impact assessment estimated savings ranging of between £11 and 17 million. Using new labour market figures and new estimates for sectors the new estimate of savings is £13-15 million

### **Cost and benefits of option 3**

**1.86** The costs and risks of option 3 are similar to those of option 2. There is a reduced risk, however that the firm being relied upon has not undertaken customer due diligence as only those firms that are subject to an established and effective supervisory regime (which includes a fit and proper test) may be relied upon. The benefits under option 2 will be reduced in terms of direct savings as initially firms cannot rely on trust and company service providers, casinos, consumer credit financial institutions, certain accountants or money service businesses either in the UK or abroad. Once these firms are judged to be able to be relied upon however, the full benefits of option 2 can be accrued.

### **Small firms impact test**

**1.87** The sectors affected comprise of firms of all sizes, including small firms,

### **Competition Assessment**

**1.88** The sector that can take advantage of the reliance provisions is potentially large, without one firm having a market share of 10% or greater.

**1.89** The only potential competition effects would arise in the wider market place if the UK chose not to take advantage of the same reliance provisions (as in option 1 or option 3) but other EU countries did (therefore having lower costs/savings for customer due diligence).

### **Consultation Responses and conclusion**

**1.90** Respondents supported option 3. Therefore, in relation to the UK, credit and financial institutions currently authorised and supervised by the FSA for anti-money laundering compliance, and legal and accountancy professionals that are members of a professional body that currently regulates them and supervises them for their anti-money laundering controls will both be able to be relied upon when the Directive comes into force. Casinos, money service businesses, trust and company service providers, legal and accountancy professionals that are members of professional bodies that are taking on the role of anti money laundering supervision, and consumer credit firms will be able to be relied upon once supervisory arrangements are well established and there is widespread evidence of compliance. Regulation 17 outlines the reliance provisions.

### **RECORD KEEPING**

---

**1.91** The Third Directive allows either copies or references of identity (such as passport numbers) to be kept as records. The consultation document asked whether firms should be

allowed to choose whether to keep copies or references of evidence as records, or whether, in line with current guidance and law enforcement views, copies should be kept whenever practicable.

## Sectors affected

**1.92** All sectors under the Money Laundering Regulations will be subject to the record keeping requirements.

## Options

**1.93** Option 1 is to require firms to keep copies of identity but allow them to keep references of identity if copies are not practicable.

**1.94** Option 2 is to allow firms to keep either copies or references of identity.

## Costs and benefits of option 1

**1.95** The direct costs of option 1 are minimal as many firms are operating this system under the current Regulations. The opportunity cost however is the time and money spent (compared with option 2) on keeping copies of records.

**1.96** The previous consultation set out the benefits of this option to law enforcement. When following up an investigation, having copies of identity records is useful in tracking criminals, especially if photo identification is used.

## Costs and benefits of option 2

**1.97** The direct costs of option 2 are minimal and include time taken reading and understanding the new requirements. There are likely, however to be considerable savings in time taken to photocopy identity and file it (either electronically or in paper form). Responses to the previous consultation document have also pointed out that keeping copies creates higher storage space costs, therefore removing this requirement would generate further savings.

**1.98** The previous RIA estimated that this option would save firms around 5 minutes per week of work hours, with total savings of £10-14million including £1.5m in storage savings. This assumed that around 75% of firms benefit from this option as some firms have stated that they will keep copies for reasons other than the Money Laundering Regulations. Using new labour costs and new estimates for numbers of firms the RIA now estimates the savings to be £11-12m

**1.99** The risk of option 2 is the reduced amount of information that law enforcement can use if needed as part of an investigation. This could add extra time or impair an investigation, especially if fraudulent identification is used.

## Small firms impact test

**1.100** The sectors affected comprise firms of all sizes, including small firms.

## Competition assessment



**1.101** All sectors are subject to the record keeping obligations, without one firm having a market share of 10% or greater.

**1.102** The only potential competition effects would arise in the wider market place if the UK chose to have different record keeping requirements from the European and international standard as outlined in the Third Directive.

## **Consultation Responses and conclusion**

**1.103** The consultation responses confirmed the proposal in the draft Regulations. In line with better regulation principles the Government has decided to allow an open choice of references or copies of the evidence obtained. It will, however, keep this matter under review. Regulation 19 sets out the new requirement.

## **MONITORING OF THE REGULATED SECTOR**

---

**1.104** The Third Money Laundering Directive introduces the requirement that all sectors under anti money laundering legislation are monitored for their compliance. Many of the sectors are already monitored for their compliance either by Government agency or a self-regulatory organisation but there are gaps that need to be filled in implementation.

**1.105** The RIA for the previous consultation document considered the costs of these requirements. Following consultation responses this final regulatory impact assessment updates that work.

## **Sectors affected**

**1.106** The following table sets out those that are currently not monitored for their compliance with Regulations.

| Sector                                 | Supervisor that monitors for compliance with AML and CTF measures  | Estimated number of firms not currently monitored for AML/CTF |
|--|--|---|
| Credit institutions                    | FSA  | 0   |
| Financial Institution                  | Some of the activities by the FSA but not all. MSBs are supervised for AML/CTF purposes by HMRC.<br><br><b>Other annex 1 financial institutions not authorised and regulated by the FSA or HMRC, e.g. consumer credit financial institutions, other lending and financial leasing firms.</b> | <b>21,000</b>   |
| Legal Professionals                    | Large majority by self regulatory organisations (notaries regulated by the Master of Faculties but not for AML purposes, up to 900 although majority may be covered by existing professional societies such as the law society)  | <b>0-900</b>  |
| Accountants, tax advisers and auditors | Auditors and accountants under designated professional organisations are monitored for compliance for AML/CTF measures.<br><br><b>Potentially 40, 000 unregulated accountants not monitored AML and CTF compliance</b>   | <b>40,000</b>   |
| Estate Agents                          | <b>Not monitored</b>   | <b>14,500</b>   |
| Trust or Company Service Providers     | <b>Not monitored</b>   | <b>5000-10,000</b>  |
| High Value Dealers                     | HMRC   | <b>0</b>  |
| Casinos                                | Gambling Commission  | <b>0</b>  |

The maximum number of firms that need monitoring is estimated at between 80,000 – 86,000

## Options

**1.107** The consultation document for implementing the Third Money Laundering Directive described three main options for monitoring the above firms.

**1.108** Option 1: no active monitoring. The Government has considered whether it could meet the requirements by giving powers to the law enforcement but with no active monitoring on their part. This is the do nothing option.

**1.109** Option 2: risk based and proportionate monitoring. Monitoring firms for their compliance with the Regulations.

**1.110** Option 3: a fuller monitoring regime comprising more visits, transaction monitoring, and relationship managers with firms.

## Discussion and risks

**1.111** Ensuring compliance, and taking action against those that are not compliant with the preventative measures of customer due diligence, internal procedures and record keeping and the reporting of suspicious transactions is crucial to the effectiveness of the anti- money laundering and counter- terrorist financing regime.

**1.112** The following options look at how best to meet both the Directive’s requirements and the policy objectives behind them, in the most proportionate and targeted way.

**1.113** The Government believes that option 2 is the best way to meet both the requirements Directive and the policy objectives that underlie the requirements.

## **Costs and benefits of option 1**

**1.114** The UK could refuse to implement the requirements on the basis that it is already a criminal offence not to comply with the Regulations.

**1.115** The direct cost would be minimal as there is no change to the current situation. The indirect cost would be that of failing to meet the objectives behind the monitoring requirements, namely ensuring compliance with the measures to prevent and detect money laundering and terrorist financing. Not implementing the current UK Money Laundering Regulations is already an offence and yet sectors such as estate agents have been highlighted by SOCA as sectors that are underreporting relative to their vulnerability to money laundering. Further, the Government believes that this option would not meet the text of and intention behind the Third Directive which states that there should be “effective monitoring with a view to ensuring compliance”, that bodies should have the “powers to compel the production of information that is relevant to monitoring compliance and perform checks”, and that the competent authorities should have “adequate resources to perform their functions”. This option would therefore risk infraction proceedings by the Commission. The current status has been marked down in our FATF mutual evaluation as only partially compliant with the recommendations.

## **Costs and benefits of option 2**

**1.116** To estimate the costs of option 2 the previous RIA modelled the monitoring regime on that of HMRC’s existing procedure for monitoring of high value dealers. It is likely however, that fees may start higher and reduce over time, once full cost recovery of supervisors has been achieved. Further, fees can be varied according to size of firm.

**1.117** Different supervisors will be able to charge fees to cover the cost of their supervision, including set up costs. In practice this may lead to differences in fees across different sectors. For the purpose of this final RIA, it is estimated that fees might average around £100 per premise, using an estimate of 2 premises per firm as an average, this leads to a total cost of option 2 to between £16 and 19million. Supervisors will publish their stated fees for this work.

**1.118** In addition to fees there will be administration costs to firms associated with the time taken to fill in registration forms, annual returns or preparing for a monitoring visit. Since May 2005 HM Treasury and the OGC have been taking part in the Administrative Burdens Reduction project carried out by PricewaterhouseCoopers and coordinated by the Better Regulation Executive. This research produced a unit administration cost of £91 for the preparation of an assurance visit under the Money Laundering Regulations 2003, while the Government has assumed that 4 hours per year will be the time taken for time taken to fill out registration or annual return forms. Combining these costs across all firms generates to a total estimate of between £8 and 10 million.

**1.119** The Government, in consultation with the professional bodies has now estimated that there will be a small increase in administrative cost for firms who are supervised by the professional bodies. For some there will be no change in practice but in other there will be additional information supplied to their body. We have estimated that this will take 2 hours per year for around 50% of those belonging to a listed professional body. In total this cost is estimated at £2.5million a year.

**1.120** One can also consider that as monitoring would increase compliance with the Regulations, there would also be costs on firms that do not already have measures such as know your customer or record keeping measures in place. The previous RIA assumed that compliance would increase by 1-5%.

**1.121** The benefits of this option is that it meets the objectives behind the requirements of the FATF and Third Money Laundering Directive; increasing compliance with anti-money laundering measures and ensuring that firms are applying the preventative measures, and reporting suspicions. As supervisors will not only be able to monitor compliance but also take enforcement action (e.g. through issuing fines) against those that are seriously non compliant, this will also to ensure that we deter, detect and disrupt money laundering and terrorist financing.

### **Costs and benefits of option 3**

**1.122** The costs of this option are the cost of a fuller monitoring regime. There are no obvious models of this but features such as relationship managers and full transaction monitoring are examples. Assuming that a doubling of monitoring activity would double the costs to individual firms then, using the same assumptions as above that there are on average two premises per firm then a total cost would be around £32-39 million. In addition, administration costs would also be likely to double leading to an administration cost of £21-25 million.

**1.123** The benefits of this approach could be an increase in compliance. However, this increase in compliance would be achieved at disproportionate cost.

### **Small firms impact test**

**1.124** All sectors affected by the monitoring requirements have a large proportion of small firms. Given this, and the costs involved, specific working groups have been held and the Small Business Service has been consulted.

**1.125** The competent authorities that will take on the role of monitoring have direct power over the fees. The Government intends to work closely with the supervisors to ensure that the fees were proportionate and take into account the size or turnover of firms.

### **Competition Assessment**

**1.126** The market affected by this measure is very large and it is unlikely that one firm will have a share above 10%.

**1.127** In both options 2 and 3 it is unlikely that the costs would put off new firms from considering entering the market, although this may become a concern for small firms if the fees rise significantly.

## Consultation responses and conclusion

**1.128** A large majority of consultation responses supported option 2. The Government has therefore adopted Regulations for supervisors that enable them to undertake this function. These Regulations are in part 4 of the Money Laundering Regulations.

## FIT AND PROPER TEST FOR TRUST AND COMPANY SERVICE PROVIDERS AND MONEY SERVICE BUSINESSES

---

**1.129** The Third Money Laundering Directive requires the registration of casinos, money service businesses and trust and company service providers and the application of a fit and proper test as a precondition of registration. The Directive does not give any direction as to what that test should include but states that at a minimum the supervisor should be assured that the firm is not run for criminal purposes. The Gambling Commission already meets these requirements for casinos<sup>6</sup>. This section will therefore consider the costs and benefits for the different options for a fit and proper test for trust and company service providers and money service businesses. It updates the previous RIA.

## Sectors Affected

**1.130** Quantifying the number of trust and company service providers that are not already professional accountants or lawyers or authorised by the FSA is challenging as there is no existing register or academic estimates. For the purposes of this RIA the Government is using an estimate of 5000-10,000 firms. Consultation respondents have stated that this is broadly correct.

**1.131** HMRC have registered 3,200 money service business firms.

## Options

**1.132** There are three broad options to consider:

**1.133** Option 1: no fit and proper test for trust and company service providers and money service businesses. The Government could choose to not implement the requirement of the Third Money Laundering Directive on this point. This is the do nothing option.

**1.134** Option 2: a targeted fit and proper test, for the purposes of prevention of money laundering and terrorist financing

**1.135** Option 3: a fuller fit and proper test taking in prudential, capital adequacy and competency requirements.

## Discussion and risks

---

<sup>6</sup> Although the Gambling Commission does not cover Northern Ireland, Casinos are prevented by law in Northern Ireland which therefore means that there are no casinos that need to be subject to a fit and proper test.

**1.136** This measure will help to prevent trust and company service providers and money service businesses, knowingly or unknowingly being complicit with criminals who wish to exploit their services to launder money or finance terrorism.

**1.137** The previous consultation document considered there to be two main types of test—one based on negative criteria (option 2), the other based on a positive, holistic assessment (option 3).

**1.138** The UK could opt for a test based on basic negative criteria. Under the negative criteria approach, the test would be failed if the applicant met certain criteria. The alternative is some form of positive, holistic assessment. This would involve the design of a test capable of establishing a more comprehensive account of an individual's propriety.

## **Costs and benefits of option 1**

**1.139** The direct costs of option 1 would be minimal. It would equal the cost of monitoring without a fit and proper test highlighted in the section above.

**1.140** The indirect costs would be the costs of not meeting the objectives for a fit and proper test for trust and company service providers and money service businesses. The Government could also be subject to infraction proceedings and marked down in future evaluations on our domestic anti -money laundering and counter -terrorist financing regime, with resulting reputation effects to both firms and the regime.

**1.141** The benefits would be limited additional costs to the sector.

## **Costs and benefits of option 2**

**1.142** The costs of this measure will fall largely to the named supervisory body, the sector and consumers.

**1.143** The supervisor will have to operate what will essentially be a licensing scheme for the sector. As discussed in the previous consultation document, the integrity of the scheme will need to be supported by a mechanism to remove the licenses of those found to be “unfit or improper” according to the criteria; and measures to “police the perimeter” to ensure that unlicensed traders are not operating.

**1.144** There will be a number of implementation costs for the supervisor which would need to be reflected in fees charged to the sectors. It is likely that the fit and proper test could be conducted in full when it is introduced and supplemented by a signed annual declaration from traders that their circumstances had not changed since the original application. For many businesses that have one person in charge or a small group of owners / directors who remain in post for a long period the cost will be minimal. For businesses with more frequent changes of responsible personnel there will be an ongoing cost in maintaining their fit and proper status. Regular random sampling to ensure the validity of declarations could support this system. Such a scheme would mean that the costs of the fit and proper test would largely be borne upfront for the majority of businesses, with much smaller recurring costs thereafter.

**1.145** Estimates for option could be up to £5million. This would include the cost of creating the capacity and infrastructure to deliver the fit and proper tests. Administrative decisions on how these costs will be met will be made by the supervising body but as the majority of these start up costs will be translated into fees initial expectations are for them to be recovered gradually over time. Work is under way to estimate the cost of the test

based on the likely number of businesses and the number of individuals within each business that will be liable to the test.

**1.146** The Government has also looked at administrative costs of filling in information on fitness and propriety. It has estimated that this takes firms an additional 4 hours per year. This would result in an total administrative cost of £0.5- 1million.

**1.147** The benefits of a negative criteria approach would be offering important new safeguards to exclude clearly inappropriate persons (such as those with convictions for money laundering) from positions in money service businesses and trust and company service providers where they might abuse their role as gatekeepers to the financial system. Option 2 will also provide a number of collateral benefits including:

- Reduced risk of money laundering and terrorist financing through the sector;
- Reputational benefits—relating to Money Laundering Regulations compliance—for those who gain permission to operate;
- Improved competition in the sector, through the removal of those gaining a competitive advantage through criminal activity;
- Reduced risk to consumers from criminal abuse.

**1.148** A risk of this negative criteria is that does not include the option for a more holistic assessment, or indeed other intelligence relating to money laundering or terrorist financing not specifically captured by the list of tests, such as where a person had been convicted of an equivalent criminal offence abroad.

## Costs and benefits of option 3

**1.149** The previous RIA looked at general FSA supervision of financial services and the Jersey Financial Services Authority supervision of trust and company service providers as a full model of authorisation (option 3). It estimated that costs could be up to £4000 per firm if a fuller fit and proper and supervision regime looked at prudential indicators of competency indicators. This is likely to be the very maximum estimate. Administrative costs under option 3 would also be significantly higher. An estimate of administrative costs is double that of option 2, leading to a total of £1-2million.

**1.150** A more ‘holistic’ fit and proper test (option 3) would provide stronger reassurances that money service businesses and trust and company service providers licences were denied to those who lacked sufficient honesty, integrity, reputation, competence and capability to undertake their MLR obligations. It would have greater scope for more rounded judgements to be made by the regulator and for stronger reassurances to be given about those individuals occupying positions of influence in firms.

## Small firms impact test

**1.151** It is likely that there will be small firms who act as trust and company service providers. Given the impact of this measure and the potential costs to firms the Government has held a specific working group on the fit and proper test for trust and company service provider, and has consulted with the Small Business Service.

**1.152** Almost all money service businesses can be categorised as small businesses. Concerned about this impact, we have from the outset been engaged in discussions with the Small Business Service, and with HMRC—responsible for supervising MSBs—to gain a deeper understanding of the implications of these options on the sector. The Government has held a series of meetings with representative bodies and pre consultation events to get preliminary feedback on our options. Such informal consultations have led us to a recommendation of option 2 to use a more limited negative set of criteria over option 3, a more holistic approach.

**1.153** As with the monitoring requirements, it is in the power of the competent authority named as supervisor to structure fees to take account of different size firms.

## Competition assessment

**1.154** Trust and Company Service Providers are a small but diverse sector. In the sub sector of company formation agents it is known that 10 firms have over 50% of the share for company formations.

**1.155** The UK MSB market is fairly concentrated, with the biggest firm controlling 51% of premises, and the top three firms controlling 66% of all premises. The rest of the market is largely made up of small firms—often sole premises. It follows from this that where regulatory burdens come with additional costs for firms in the sector, the large firms will be better positioned to absorb these costs than their smaller competitors.

**1.156** The competition effects of option 3 would be significant. The costs of full prudential authorisation and supervision would prevent firms entering the market and could remove smaller firms.

**1.157** We believe, however, that the impact of option 2 on the competitiveness of this sector will be minimal for the following reasons:

- The small firms impact test revealed that small firms are largely welcoming of the proposals—no firms expressed the concern that the proposals might put them out of business—indicating that the proposals are unlikely to affect the market structure;
- The proposals themselves are designed to level the playing field for firms, working to improve competition in the sector.

## Consultation responses and conclusions

**1.158** The draft Regulations document proposed a set of negative criteria (option 2). While some of the responses favoured this approach others preferred a more holistic test. One criterion felt necessary was the ability of the supervisor to take account of other specific intelligence related to but not included in the listed tests, such as if there was information that a person had committed a relevant offence overseas.

**1.159** The Government continues to favour a more limited test but is persuaded of the need to ensure some specific additional intelligence can be taken into account in determining fitness and propriety. It therefore proposes that the test should also include a ‘catch all’ to include other intelligence related to the listed tests, such as information on equivalent criminal offences convicted abroad. However, this catch all is limited to information that would show the person is “otherwise not fit or proper...with regard to the risk of money laundering or terrorist financing”. Regulation 28 includes the test for those persons that will be supervised by HMRC.



### Enhanced Customer Due Diligence for Politically Exposed Persons (PEPs)

**1.160** As previously mentioned, the RIA for the Third Directive considered the total costs for implementing the Directive as a whole. It summarised that the main costs (other than those outlined above) were for the more specific customer due diligence measures, in particular enhanced due diligence for PEPs.

**1.161** It was estimated that this would effect potentially up to 50% of all sectors, except credit and financial institutions who, informal consultations have shown already largely implement this through implementing the Joint Money Laundering Steering Group guidance.

**1.162** Given that many firms are implementing a risk based approach it is possible that they will not have any additional costs as they will already be treating foreign clients or clients with politically exposed occupation as higher risk. Therefore the cost was given as a range with a minimum of £1-2m across all firms for familiarisation only.

**1.163** The previous RIA estimated that if enhanced due diligence could take up to 20minutes per week extra leading to total extra costs of £19million.

**1.164** Using the updated sector information and labour market costs we can estimate the total cost as around £20.5-23.5million.

### Consultation responses and conclusion

**1.165** The consultation responses confirmed that there would be labour and software costs and ongoing costs of running searches. To take account of this, this final RIA continues to include an additional £2m capital cost.

### Other costs as mentioned in the RIA published on the Third Directive

**1.166** All other changes to the Directive were estimated as minimal costs, leading to a total of £1-2m for familiarisation costs.

**1.167** A few consultation responses to the previous RIA noted that there may be some costs in identifying and verifying beneficial ownership. While the Government does not agree that they would be significant, it will take account of these responses by adding £2m to the familiarisation costs. The Government did not receive any other responses that significantly alter our perception. The Government continues to welcome, however, your views on the assumptions in this RIA and will update any costs in its 2 year implementation review.

### Headline Costs

**1.168** The above sections have gone into detail on the costs and savings where the information is available. In summary the headline figures are the following

## Policy Costs

| Policy   | Option 1 costs and savings                                      | Option 2 costs and savings   | Option 3 costs and savings  |
|--|---|--|---|
| <b>Financial activity on an occasional and limited basis</b>       | No change to current system                                     | Take advantage of the derogations. Up to £600,000 savings            | No third option   |
| <b>Identification policy for casinos</b>                           | £2m   | £2.5m savings  | £1.5m savings   |
| <b>Simplified due diligence</b>                                    | Do not take advantage of the derogations<br><br>Minimal costs   | Take advantage of the derogations.<br><br>Approx £2.5million savings | Take advantage of some of the derogations<br><br>Between £0-2.5million in savings |
| <b>Reliance</b>  | Minimal costs   | Up to £13-15million in savings                                       | Less than £13-15million in savings  |
| <b>Record Keeping</b>  | Minimal costs   | Up to £11-12million in savings                                       | No third option   |
| <b>Monitoring requirements</b>                                     | Minimal costs   | £16-19million  | £32-38million   |
| <b>Fit and proper test for trust and company service providers</b> | Minimal costs   | £5million  | Up to £20million  |
| <b>Enhanced due diligence</b>                                      | No options over implementation. Cost estimated between £2-23.5m |  |   |
| <b>Compliance/familiarisation costs</b>                            | Estimated at 2-4m   |  |   |

## **Administration costs**

| Policy                      | Option 1 costs and savings | Option 2 costs and savings | Option 3 costs and savings |
|-----------------------------|----------------------------|----------------------------|----------------------------|
| Monitoring requirements     | Minimal costs              | £10-12m costs              | £20-24m                    |
| Fit and proper requirements | Minimal costs              | £0.5 - 1m                  | £1-2mm                     |

**1.169** The Government’s preferred options total £25-52million in policy costs and £10.5-13million in administration costs for implementing the Directive. If other options were followed this cost could rise to £87million in policy costs and £26 million in administration costs. The total potential savings in implementing the Directive are estimated at up to £31million per year over time.

## Enforcement and Sanctions

**1.170** The measures discussed above will be implemented by a new set of Regulations.

**1.171** The monitoring of such measures is explicitly discussed in the sections above.

**1.172** The sanctions would be whatever sanction the supervisors choose for general non-compliance (for example administrative penalties) in addition any non-compliance with the Regulations is a criminal offence and money laundering and terrorist financing are themselves criminal offences.

## SIMPLIFICATION MEASURES

**1.173** As outlined above, implementing the Government preferred options will cost around £25-52million (rising up to over £87million if other options are followed) with up to between £10.5-13million in administration costs arising from new monitoring requirements. The Directive itself also includes a number of simplification measures such as the simplified due diligence and reliance provisions.

**1.174** Following consultation with stakeholders the Government has also proposed to simplify record keeping requirements to make bring in line with the requirements of the Directive. This RIA estimates these combined savings as up to £31million in total.

**1.175** The Government has been considering what further simplification measures can be achieved in anti -money laundering and counter -terrorist financing policy. As well as taking advantage of legal simplifications, the Government and its agencies has worked with industry to ensure that implementation is also in line with the better regulation agenda. Such partnership has produced fruitful results such as the publication of the JMLSG guidance, which promotes a more risk-based approach to implementation and the revision of the FSA money laundering handbook, which removes much of the previous prescription. Further the Money Laundering Advisory Committee is considering how to simplify implementation of identification requirements across all sectors, building on the work the FSA.

**1.176** Benefits from the simplification measures are difficult to cost as they are only just being implemented. Across all of the sectors, however, we estimate that the benefits add up to approximately £10 million over 5 years.

**1.177** Furthermore the Third Directive, for the first time promotes in legislation a risk based approach to both the customer due diligence measures and the monitoring requirements. This over time should produce cost efficiencies in terms of firms and supervisors targeting their resources at areas of higher risk and away from areas of lower risk.

**1.178** There were no responses to the request for further simplification measures in the draft Regulations consultation document. The Government, however, will continue to work with industry to identify further simplification measures.

## **POST IMPLEMENTATION REVIEW**

---

**1.179** The Government has committed to a post implementation review of the Regulations to establish whether the implemented Regulations are having the intended effect and whether they are implementing policy objectives efficiently. It will consider whether any further simplifications can be made, in particular with regard the monitoring regime, to minimise the policy and administrative compliance burdens. It will also consider whether the penalties regime is appropriate and proportionate in the context of the recommendations of the Macrory Review of Regulatory Penalties, accepted in full by the Government in November 2006. This review will be completed by December 2009.