



HM TREASURY

**PROPOSED REVISION OF THE
MONEY LAUNDERING REGULATIONS 1993 AND 2001**

A Consultation Document

NOVEMBER 2002

**Proposed revision of the
Money Laundering Regulations 1993 & 2001 to:**

- A) Implement the requirements of the Second EC Money
Laundering Directive**
**B) Clarify and update the existing requirements on the regulated
sector**

A Consultation Document

Introduction

This paper is a consultative document on proposals under consideration by the Government to amend the Money Laundering Regulations 1993 and 2001, in order to:

- implement the requirements of the Second EC Money Laundering Directive by including new professions and activities within the regulated sector
- consolidate, clarify and update the existing provisions of the 1993 MLR, with some substantive changes where problems have become apparent.

The first section of the paper outlines the new requirements of the Directive, discusses the main issues arising from the expansion of the regulated sector and presents a risk assessment arguing the need to widen the coverage of the Regulations. Options for the expansion of the regulated sector are presented with an indication of the government's preferred measures, and with some open questions for the industries affected. A cost-benefit analysis follows, including a projection of compliance costs for the regulated sector arising from the proposals. The second section of the paper highlights the main elements in the revision of the existing Regulations.

Draft Regulations are included, and an address is provided for responses.

A) The Second European Money Laundering Directive

1. Issues and objectives

The European Parliament and the Council of the EU adopted the Second Money Laundering Directive (2001/97/EC) on 4 December 2001 and the text was published in the Official Journal on 28 December. The Directive amends the 1991 Money Laundering Directive to introduce changes in two main areas:-

- It widens the scope of predicate offences for which suspicious transaction reports (“STRs”) are mandatory from drug trafficking to all serious offences
- It brings within the regulated sector the following “legal or natural persons acting in the exercise of their professional activities”:
 - Auditors, external accountants and tax advisors
 - Real estate agents
 - Notaries and other legal professionals acting on behalf of their client in any financial or real estate transaction (including specific areas of assistance defined in the Directive)
 - Dealers in high-value goods, such as precious stones or metals, or works of art, auctioneers, whenever payment is made in cash, and in an amount of EUR 15 000 or more;
 - Casinos

Firms engaged in these areas of business will be required to maintain the same systems for staff training, customer identification, record keeping and reporting of suspicious transactions as are currently required of credit and financial institutions under the 1993 Money Laundering Regulations.

Member States are obliged to implement the Directive in national law by 15 June 2003 at the latest; in the UK, this will take place through a new set of money laundering regulations replacing the 1993 and 2001 Money Laundering Regulations. The UK system already meets the requirements of the Directive in some respects. Under the new Proceeds of Crime Act, all crimes are predicate offences for the purposes of money laundering, and since the 1993 Regulations catch relevant *activities*, UK professionals are already within the regulated sector when they engage in financial and investment activities.

The main change under the Directive will therefore be the extension of the regulations to a wider range of businesses and professional activities thought to be vulnerable to use by money launderers. This regime is designed to assist authorities to detect, disrupt and deter money laundering and the underlying criminal activity. By requiring higher standards of due diligence across the regulated sector, it will improve the intelligence available to law enforcement agencies, and result in a higher number of criminal convictions, and a rise in the

amount of criminal assets confiscated. The government also aims to ensure that the regulations represent a clear, enforceable, and proportionate response to the risks of money laundering in each of the specified sectors. They should take into account the possibility of competitive distortion where different professions offer comparable services, and aim to minimise the impact on small businesses and consumers. The regulations will be kept under review to ensure that they meet the government's objectives as effectively as possible.

2. Risk assessment

The risk posed by money laundering is twofold: its facilitation of underlying criminal activities, and the threat to economic and financial activity when high flows of laundered money distort normal market incentives. Most crimes are committed for financial gain, and the volume of criminal assets laundered through the UK each year is undeniably large. Recent estimates indicate that the value of illegal drugs transactions in the UK could be up to £8.5 billion per annum¹, with direct losses from fraud totalling some £10.3 billion per annum². The human cost of underlying criminality is far greater: drug trafficking in particular has a disproportionate effect on deprived communities and young people. Moreover, comparatively small flows of money can facilitate serious offences: efforts to disrupt the funding arrangements of terrorist organisations have led governments around the world to strengthen their anti-money laundering regimes.

UK law enforcement officials report a growing trend of involvement in money laundering (both intentionally and unknowingly) of professionals and businesses not currently subject to the 1991 Directive. As money laundering controls have strengthened, so money launderers have sought more sophisticated ways to disguise the source of their funds. The Financial Action Task Force (FATF) reports on money laundering techniques, compiled by law enforcement agencies around the world, demonstrate that money launderers have progressed from the more traditional financial instruments to other methods of "cleaning" tainted funds.

A particular concern in this context is the low level of STRs made by those lawyers and accountants with a legal or professional obligation to maintain an anti-money laundering system, and corresponding uncertainty over their ability to meet even their existing obligations. Statistics from the National Criminal Intelligence Service (NCIS) show that at present, only 3 STRs in 1000 come from accountants and tax advisors, while lawyers account for only 10 to 13 of every 1000 reports. The fourth report of the Select Committee on International Development underlined this concern and called for government action to improve standards of due diligence in these sectors.

¹ Economic Trends, ONS, July 1998

² "The Economic Cost of Fraud", National Economic Research Associates, July 2000

3. Options (by sector)

Lawyers, external accountants, auditors and tax advisors

The Directive requires us to regulate “auditors, external accountants and tax advisors in the exercise of their professional activities”; and “independent legal professionals, when they participate in any financial or real estate transaction e.g. by assisting in the planning or execution of transactions for their client concerning the

- buying and selling of real property or business entities
- managing of client money, securities or other assets
- opening or management of bank, savings or securities accounts
- organisation of contributions necessary for the creation, operation or management of companies
- creation, operation or management of trusts, companies or similar structures”.

The main question for implementation arises from the wide range of activities in which UK professionals are engaged, ranging from the core activities of auditing and accounts’ preparation to areas such as financial investigation, insolvency work and general business advice. There is a considerable overlap between the activities of qualified accountants and lawyers, and these professionals frequently offer comparable services to those offered by management consultants, insolvency practitioners, company formation agents, and other unqualified practitioners. In this context, there appear to be three main options for implementation.

Option 1

The regulations would cover firms and sole practitioners that are members of the Institutes on the Consultative Committee of Accountancy Bodies, the Chartered Institute of Taxation, and other relevant professional organisations such as the Association of Business Recovery Professionals. They would also cover qualified UK lawyers when they assisted in the planning or execution of any real estate or financial transaction, and in providing company formation or trust services.

The main advantage of this approach would be that it catches a discrete group of qualified professionals, who are already required to meet certain standards of competence and integrity, and are under the supervision of a recognised professional body. There would be clear lines of communication to ensure that all those affected by the Regulations could access guidance on industry best practice, and a clear supervisory structure within the existing arrangements of the Self Regulating Organisations.

However, this approach would also carry substantial downsides. It would introduce further competitive distortions where professional firms offered services

equivalent to those of other, unregulated institutions. Nor would it cover foreign professionals practising in the UK, without membership of a UK self regulating organisation. Moreover, the risks of money laundering taking place are no less among unqualified practitioners. It would be counter-productive to create a loophole for unscrupulous clients to turn to unregulated institutions, who might in any case have fewer resources for compliance work, or to accountants and lawyers who had been disqualified by their professional association.

Option 2

The regulations would cover the activities of providing accountancy services; taxation advice; insolvency services; legal services in relation to any real estate or financial transaction; and company formation or trust services. Their application would be irrespective of professional qualifications. Anyone providing such services would be covered, including “technicians”, those who had been disqualified by a professional association, and foreign practitioners.

This approach, which has been **adopted in the draft Regulations**, aims to meet concerns over competitive distortion, and to ensure consistent treatment of people offering equivalent professional services in order not to create loopholes for criminal activity. There is a question as to whether the regulatory burden will have a disproportionate impact on smaller firms that are currently unregulated, and do not have well-developed compliance mechanisms. These firms may find it more difficult to absorb new regulatory costs: and some unqualified practitioners may not already have the same expertise and training as qualified professionals in detecting suspicious activity. However, it can be argued that the obligations will be proportionate to the risk that such firms would otherwise be targeted by money launderers, as it became more difficult for them to use the services of qualified practitioners.

Under this option, monitoring of compliance by qualified practitioners would take place within the current supervisory framework of Self Regulating Organisations – the chartered accountancy bodies, the Chartered Institute of Taxation, and other appropriate practitioners’ associations. There is no obligation at present on those offering accountancy services to register or obtain the approval of any licensing body, so there would be no formal supervision of unqualified practitioners. However, all firms would be able to access guidance notes on best practice; and law enforcement agencies would have extensive powers to investigate and prosecute breaches of the Regulations.

Option 3

A third possibility is to build on option 2, strengthening enforcement of the Regulations by requiring either all firms providing the services listed under option 2, or all those who were not already members of a recognised self-regulating

organisation, to register with a new supervisory authority. The supervisor would have powers to monitor and enforce compliance with the Regulations.

The creation of a new supervisory authority would be a major step, and it is arguable whether the risk of extensive money laundering taking place through small firms in its absence would be significant enough to justify such a move. We are also aware that this is one aspect of a much wider question over standards and supervision of unqualified practitioners, and it may be premature to introduce changes in the established supervisory framework in respect of money laundering only, in advance of more general reforms. It appears preferable to test the effectiveness of existing arrangements, and keep this option under consideration in the longer term.

The draft Regulations adopt the second option. However, the arguments for the options outlined above are finely balanced. We would welcome comments on the following points in particular:-

Q. Do the risks of money laundering, and the possibility of competitive distortion, justify the inclusion in the regulated sector of accountancy firms that are not members of a professional association?

Q. Are there other professional bodies or industry associations which should be included in the list of supervisory authorities?

Real Estate Agents

The Directive's requirement that estate agents be included within the regulated sector reflects a body of evidence from law enforcement that many criminals invest their money in real property. However, in the UK, the money laundering risks in this sector are mitigated by two factors. Firstly, the client is usually the vendor rather than the purchaser of property. Secondly, the estate agent does not generally handle the client's assets: the actual transactions will be subject to scrutiny by other intermediaries such as lawyers, banks and mortgage lenders. Moreover, most estate agents take careful steps to identify clients for their own business reasons, and we do not anticipate that the Regulations will result in significant extra costs for a typical business. We also expect that any impact on competition in this sector would be minimal.

This sector therefore presents a lower risk than others in the context of money laundering, and the government is not proposing that there should be a new system to supervise compliance with the Regulations. It would, however, look to industry associations to raise awareness of money laundering risks across the sector, and develop guidance notes in consultation with HM Treasury.

Casinos

The Directive requires us to include casinos within the regulated sector and to supplement the normal identification requirements with an obligation to conduct checks wherever a customer buys or sells chips with a value of 1000 euros or more.

UK casinos already maintain anti-money laundering procedures broadly in line with the requirements of the Directive, under a voluntary Code of Practice issued by the British Gaming Board. The main change required to comply with the Directive will be to strengthen the identification procedures for guests, who can currently be signed in by a member without the information being verified. It will also be necessary to align record keeping requirements with the 1000 euro threshold in the Directive.

We expect the effects of this requirement on competition to be minimal given the relatively low additional costs of compliance.

Option 1

Casinos would be required to identify any client who purchased chips with a value of 1000 euros or more. This could be done either in the course of gaming, when it became apparent that the threshold had been reached, or as a standard procedure for all clients who wished to use gaming facilities.

This option follows the text of the Directive closely, and would allow casinos maximum discretion in meeting their obligations. Casinos that had the ability to monitor clients' gaming closely would be able to ask for identification documents only from those clients who exceeded the 1000 euro threshold. This would mean that casinos would not have to turn away clients without ID documents outright, provided that their gaming remained at a low level. However, the advice of the Gaming Board is that few casinos would have the capacity to monitor clients' activities in such detail. In order to be sure that they were compliant with the Regulations, most casinos would still need to conduct identification checks on entry to the premises.

Option 2

Casinos would be required to identify all clients before they were granted access to gaming facilities.

This is the government's preferred option. Given that 1000 euro is a relatively low threshold for the industry, and that guests are already required to register in some form on entry to a casino, identification of everyone on entrance will probably be the easiest route to compliance. One concern expressed by the

industry had been that clients who did not intend to game, and thus did not pose any risk, might be deterred by the need to produce identification documents. Under this option, identification would be required before access to gaming facilities was granted, but casinos would still be able to make a distinction between clients who intended to game, and those who only used the other facilities.

Dealers in high value goods

The Directive requires us to bring within the scope of the regulations

“dealers in high value goods, such as precious stones or metals, or works of art, auctioneers, whenever payment is made in cash, and in an amount of 15000 euros or more”.

This provision is intended to address the risk of criminal assets being transferred through the purchase of physical goods, rather than through monetary or financial channels. The Directive has identified certain high-risk areas, with the implication that these should be covered as a minimum. However, the precise definition of “dealers in high value goods” is at the discretion of Member States.

Option 1

The Regulations would cover dealers in certain “luxury goods”, including the areas of business specified in the Directive. These businesses would be required to appoint a money laundering reporting officer and provide training for staff. They would be required to identify customers, report suspicious transactions, and retain records only where a transaction or linked transactions involved cash payment above the value of 15 000 euros.

The assumption underlying this option would be that certain goods are especially attractive to criminals, as being of high and stable value, and easily converted or sold on at a later date. The regulations would accordingly target those goods that had been identified as “high-risk”. A major disadvantage, though, is that any such list would necessarily be an arbitrary one. If regulations were tightened in areas perceived as high-risk (currently including dealers in precious metals, fine art or luxury cars), money launderers would simply transfer their activity to a new area which fell outside the regulated sector. It could also have a negative impact on competition if some high-value goods were covered but not others similar in nature.

Option 2

Any dealer in goods who was willing in principle to accept cash above the value of 15 000 euros would be required to register with HM Customs and Excise as a “high value dealer”. The dealer would then be required to appoint an MLRO and

train staff. He would be required to maintain identification, record keeping and reporting procedures only in respect of cash payments above the 15 000 euro threshold. It would be an offence to accept such a payment prior to registration with Customs, who would have powers to monitor and enforce compliance with the Regulations.

This approach, the government's **preferred option**, recognises that there are money laundering risks inherent in any large transfer of cash, irrespective of the type of goods purchased. However, it allows dealers to make a business decision as to whether the benefits of accepting occasional large cash payments justify the costs of registration and due diligence procedures. It avoids the need for dealers engaged in very few high value transactions to maintain costly compliance procedures, provided that unregistered businesses accept the limitation on accepting large volumes of cash. They would be free to accept payment by cheque or in electronic form.

While the cost of compliance may have a greater impact on small businesses due to the registration fee (other costs would be largely proportionate to firm size), such costs would be relatively small, and it would be open to all firms to choose not to accept large cash payments rather than register.

Option 3

A more radical approach would be to prohibit the use of cash in transactions above a certain value, following a model already established in other Member States (eg France and Italy). The use of cash would thus be limited to transactions below the threshold of 15 000 euros.

The main advantage of this overarching requirement would lie in its clarity. It would apply to everyone in the UK, so would not lead to arbitrary application, competitive distortions, or indeed any regulatory burden, other than the obligation to refuse large payments made in cash.

However, it would go beyond the requirements of the Directive to introduce a significant change in the definition of legal tender. In particular, it makes no concession to the fact that certain groups are accustomed to making large payments in cash for perfectly legitimate purposes – for example, in the agricultural sector, or in certain ethnic communities. Nor is it at all clear that it would be effective in preventing money laundering: it would be difficult to detect breaches of the restriction, and easy for launderers to “smurf” below the threshold, with no fear of a report being made to NCIS. On balance, it appears preferable to allow both businesses and consumers the option of using cash for any value of transaction, provided that appropriate procedures are maintained.

Q. Do you agree that it is preferable for businesses to have a choice as to whether they accept cash payments in high value transactions?

4. Issues of Equity or Fairness

The government's proposals do not raise any significant issues of equity and fairness. The Directive is narrowly focussed on businesses and professionals and the Regulations, covering equally all firms engaged in particular activities, are intended in part to reduce existing unfair competition. Customers affected are unlikely to be members of a vulnerable group, and the only direct impact on them will be a requirement to identify themselves in certain circumstances.

5. Benefits

The primary aim of these measures is to deter criminals from using UK businesses as conduits to launder their proceeds; and so to change the economics of crime by increasing both the costs and the risks of laundering. Criminals will be forced to use new, more circuitous routes to hide the origins of assets; reducing the profits available from crime, and the amounts available to invest in ongoing criminal activities. However, it is difficult to quantify the deterrent effect of anti-money laundering procedures on criminal activity, as they cannot be viewed in isolation from other law enforcement measures or indeed other changes in society. The main intermediate, quantifiable benefits of the proposed options would be an improvement in the intelligence available to law enforcement and prosecutors, with a resultant increase in:-

- 1) suspicious transaction reports received from businesses newly included within the regulated sector, and in particular from lawyers and accountants
- 2) criminal convictions resulting from these reports
- 3) the value of criminal assets confiscated

It is important to note that increases in the number of convictions and confiscation orders will not be the strongest indicator of proposals' success. The government's objectives will also be promoted by disrupting and deterring criminal activity, neither of which will lead to convictions or confiscations. As with other law enforcement measures, it is certainly not necessary that anti-money laundering regulations be self-funding. Ultimately, the increase in the number and quality of STRs will provide the best single measure of success.

Statistics provided by the National Criminal Intelligence Service show that businesses in the relevant sectors made the following number of STRs in 2001-2.

Sector	2001	2002
Solicitors	316 STRs from 173 firms	281 STRs from 159 firms
Accountants	74 STRs from 38 firms	83 disclosures from 40 firms
Casinos	305 STRs from 16 casinos	393 STRs from 12 casinos
Estate agents	2 STRs from 2 firms	3 STRs from 3 firms
High value goods	100 STRs from 6 firms	82 reports from 9 firms

These sectors account for a small proportion of the total of reports received (approximately 35,000 STRs were received in 2001 and the figure is expected to rise this year). Given the volume of financial flows handled by these businesses, especially in the law and accountancy sectors, it is likely that many cases of money laundering are not being reported; whether because firms do not maintain anti-money laundering procedures that would alert them to suspicious circumstances, or because they do not consider that they have a duty to pass on such suspicions. Before the 1991 Money Laundering Directive was adopted, establishing the current requirements on the financial sector, the number of disclosures to NCIS stood at 2,000 in 1990. In 1994, when the UK Money Laundering Regulations came fully into effect, this number had risen to 15 000 disclosures. This experience indicates that the extension of the Regulations to non-financial professions and businesses is likely to result in a significant improvement in the intelligence available to law enforcement.

6 Compliance costs for businesses, charities, and voluntary organisations

6(i) Business sectors affected

The Regulations are not expected to have an impact on charities or voluntary organisations. They do not imply any multiplication of regulatory costs stemming from the Proceeds of Crime Act or any hidden costs for the existing regulated sector.

The Regulations will have an effect on all casinos and real estate agencies operating in the UK. As regards legal and accountancy services, the Regulations would affect **either** (under option 1) qualified professionals, including lawyers, accountants, tax advisors and insolvency practitioners, **or** (under options 2 and 3) all firms providing legal or accountancy services, including unqualified practitioners, company formation agents and trust service providers would be affected.

The options relating to dealers in high value goods are more complex. Under option 1, auctioneers and dealers in precious metals, jewellery, arts and antiques, cars, and other luxury goods would be affected. Under option 2, dealers in any type of goods would be required to make a choice as to whether they accept cash payment above a threshold of 15 000 euros. Those who accept such payments would be covered by the regulations, but this is likely to be a relatively small number. Under option 3, the only cost would be the potential loss of business due to the obligation to refuse high value payments in cash; but this would represent a major limitation on the use of cash as legal tender.

6(ii) Compliance costs for a typical business

Accountancy and legal services

Approximately 65,000 firms operate in the UK in providing auditing, book-keeping, tax consultancy and other accountancy services. Approximately 22,000 of these are members of the CCAB bodies. Over 100,000 qualified solicitors are members of the Law Societies of England and Wales, Scotland and Northern Ireland. Many law and accountancy firms, including most of the major players, are registered to carry on investment business, and are thus already subject to the Money Laundering Regulations. Many other businesses already have extensive systems in place pursuant to a code of conduct, and could therefore comply with the regulations with minimal additional cost.

Estimates from the Law Society indicate that a medium sized firm (10 partners and 20 associates) whose system was not yet substantially in compliance with the Regulations would incur the following costs:-

Training: 1 day per year for the Money Laundering Reporting Officer (£1000) and 2 hours training session for each fee earner every 3 years (£300 per person)

Reporting system: ongoing monthly costs of £1000

Storage costs: minimal. Solicitors typically keep client files for a minimum of 6 years and other affected sectors keep client records for tax or business reasons.

Total annual costs: £16 000

Total sector costs (excluding firms that are already compliant)

Option 1: Assuming that an additional 5,000-10,000 legal professionals and 10,000-20,000 accountants (equivalent to 500-1,000 medium-sized firms) would become subject to the Regulations, total sector costs would be in the range of £8 million to £16 million.

Options 2 and 3: In addition to the firms covered by option 1, approximately 43,000 firms of unqualified practitioners would be covered by the Regulations. However, many of these would be much smaller than the average firm outlined above, and the sector includes a large number of sole practitioners. Assuming an average firm size of 4 practitioners, and using the Law Society estimates above, we estimate average costs to be just under £3000 per firm. This would imply total sector costs in the range of £130 million to £150 million.

Estate agents

Minimal costs as few estate agents handle client monies or are involved in clients' financial affairs. Most, on the other hand, already take steps to identify clients, and keep records of their details, so there would be no significant additional storage costs. The regulatory impact is therefore likely to be limited to

training requirements and setting up systems for reporting suspicious transactions.

One-off costs of 1 day training for a Money Laundering Reporting Officer in a notional firm employing 5 people, and establishing a reporting system: £500
Ongoing costs of refresher training and reporting activities: £500 per year

Assuming 10,000-15,000 businesses, total sector costs would be in the range of £10 million - £15 million per year.

Casinos

Minimal compliance costs as casinos are already broadly compliant with the requirements of the Regulations, under the code of conduct agreed with the Gaming Board. More stringent identification checks for customers and guests may incur some limited costs in lost business, but the main training and reporting costs are already incurred as part of the criteria for holding a gaming licence.

Dealers in high value goods

Minimal compliance costs whichever option is adopted. Under option 3, there would be no regulatory costs. Under options 1 and 2, the identification, record keeping and reporting requirements would only apply to one-off transactions where payment above the value of 15,000 euros was accepted in cash. It is likely that this will occur very infrequently. Moreover, training requirements would be less costly than for other sectors, as the nature of transactions and the corresponding risks of money laundering would not be complex. Costs would therefore be limited to training (£250 to train one Money Laundering Reporting Officer) and the fee for registration with HM Customs (estimated at £100), totalling £350 per annum.

There is no indication as yet of the number of firms that would choose to register with Customs as "high value dealers" under the second option. It is not therefore possible to provide a comparison of total sector costs.

Consultation with small business

Typical small businesses affected by the proposal include firms of solicitors and accountants, and real estate firms. Representatives of these sectors, while expressing concerns over the costs of implementation, have been broadly supportive of its intention. Industry associations have stressed in particular that they wish unqualified practitioners to be subject to the same requirements as qualified professionals, so that unregulated competitors do not gain an unfair competitive advantage.

Other costs

Other costs will be incurred by the government in processing and following up on an increased number of UK and EU STRs resulting from the new requirements. However, the National Criminal Intelligence Service has already received additional resources in the context of related measures in the new Proceeds of Crime Act, increasing its capacity to process STRs.

Results of consultation

The Treasury published a partial Regulatory Impact Assessment assessing the impact of measures in the draft Directive, and responses from UK businesses were factored into the negotiations on the final text. In March 2002, the Money Laundering Advisory Committee (which includes representatives of government departments, law enforcement agencies, regulators, consumers and industry associations) discussed initial options for the Directive's implementation and confirmed its broad support for the approach suggested. The Treasury has also established a working group on implementation of the Directive, including a wider range of interested parties. The main recommendation of that group, at an initial meeting in July, was that concerns over competition should be taken fully into account in any consultation on the revised Regulations.

Summary and recommendation

In relation to law and accountancy services, the second option offers the widest coverage of businesses at risk from money launderers, and will thus maximise the benefits to law enforcement. This option also presents a level regulatory playing field across the sector, minimising the impact of the measures on individual businesses. The third option, establishing a new supervisory mechanism for the sector, would incur significant costs, and it is not clear at present that the benefits in terms of crime reduction would be significantly greater than under the second option. While this option should be kept under review, the government's initial preference is to supervise compliance through existing structures of self-regulation, with additional checks by law enforcement agencies where appropriate.

The options for identification procedures in casinos are neutral as regards both regulatory costs and benefits to law enforcement: however, the second option is recommended, as being easier to implement reliably. As regards high value goods dealers, the government recommends the second option: this will target the risks associated with high volumes of cash, while allowing each business to choose whether it wishes to take on those risks and accept a proportionate regulatory burden.

Enforcement, sanctions, monitoring and review

It is an offence under the 1993 Money Laundering Regulations for a firm who performs relevant financial business not to maintain proper money laundering procedures. The maximum penalty is two years imprisonment and/or a fine. Under the 2001 Regulations, Customs may impose a penalty of up to £5,000 where a money service business fails to register, pay the relevant fee, or provide supplementary information/access to information where requested.

These sanctions will be retained in the revised Regulations. High value dealers will be subject to the same penalties as money service businesses for failure to register with Customs. The final version of the Regulations may introduce a civil penalty regime in respect of breaches for which, under the 1993 Regulations, there is currently only criminal liability. This is discussed in more detail in the following section.

The effectiveness of the Regulations will be kept under review: in particular we will consider whether more formal supervisory arrangements would be appropriate for firms subject to the Regulations, but not yet monitored by any supervisory body or self-regulating organisation.

B) CHANGES IN THE 1993 REGULATIONS

The government intends to take this opportunity to consolidate and redraft the text of the 1993 Regulations, in the interests of clarity, and to ensure that all references are consistent with recent legislation. More substantively, the revised Regulations revisit a number of points where problems in the existing provisions had become apparent. However, it is not expected that these changes will have a significant regulatory impact on businesses already subject to the requirements of the 1993 Regulations. This section of the consultation document therefore highlights and explains the main changes arising from the revision of existing provisions: technical comments are also welcomed on any further points arising from the draft Regulations.

Consistency with the Proceeds of Crime Act

Section 330 of the Proceeds of Crime Act 2002 (POCA) provides that it is an offence for someone working in the regulated sector not to make a report when he has knowledge, suspicion, or reasonable grounds to suspect that money laundering is taking place. A court considering this offence is required to take into account steps taken to comply with relevant guidance issued by a supervisory authority or other appropriate body and approved by the Treasury. The 1993 Regulations provide that a court *may* take into account compliance with such guidance, when considering charges that a person conducting relevant financial business has failed to maintain the systems required under the Regulations. We propose to align this provision with the wording of the POCA, creating an obligation on the court. Guidance notes could be submitted to a Treasury Minister for approval, and if this was granted, they would have the same status in relation to both primary and secondary legislation.

Deletion of regulation 8, the “postal concession”

Regulation 8 of the 1993 Regulations defines a limited set of circumstances, in which payment from an account held in a customer's name at a bank or other credit institution **may be capable** of constituting the evidence of identity required under regulation 7. The principle is that a client and his money must undergo due diligence procedures on entering the financial system, but that “double due diligence” is unnecessary. The concession is thus limited to accounts where payment may be made only to the account holder; it is further confined to circumstances where it is reasonable to pay via post/phone/electronic means; and where there is no suspicion of money laundering. The complexity of the regulation appears to have led to misinterpretation. The following are some of the difficulties which have become apparent:

- **The “concession” carries risks of money laundering if used indiscriminately**

The term “relevant account” ensures that the postal concession can only be used to open a limited account (allowing payments only back to the account holder). With Regulation 8 as it stands, identification has to occur at least once in the system: this provides a deterrent to the “placement” of criminal funds, although multiple hurdles, with identification at each bank, would be more reliable. However, there is no such limit to the number of accounts that could be opened in reliance on the concession. Since only the payment that opens the account must be debited from an account at a credit institution, a criminal could use the concession to open a network of accounts through which to deposit and move around money. The bank relies on the identification procedures of another, and is unable to verify any KYC information it does have against documentary evidence. Without an accurate client profile, the bank would find it difficult to detect such “layering” activity.

- **It has a tenuous basis in the Directive**

The Directive provides a similar concession in respect *specifically* of insurance policies, a far more limited category. If regulation 8 were drafted as an absolute exemption from the identification requirement, it would be difficult to argue that it was compliant with the Directive. However, regulation 8 uses the words “...*shall be capable of constituting the required evidence of identity*”. This is not an exemption from Regulation 7 per se. It means that a payment debited from a credit institution may assist in the cumulative process of identification. As such, payment debited from a credit institution may function as the “*supporting evidence*” that is referred to in Article 3(1) of the Directive.

- **It adds nothing to the terms of regulation 7**

Regulation 8 does not provide a blanket exemption or in any way dilute the terms of regulation 7, under which it is at the discretion of the financial institution or employee to decide what constitutes “satisfactory evidence” of a client’s identity. It does not guarantee that such evidence of identity will always be sufficient in the specified circumstances – responsibility remains with the individual institution to judge what constitutes satisfactory evidence. The fact that payment is debited from an account in the account holder’s name at a credit institution *might* satisfy the institution concerned, but if not they should continue with identification procedures in accordance with Regulation 7.

In the light of these arguments, we intend to delete regulation 8 in the revised Regulations. The idea underlying the current concession, that a payment debited from a credit institution is useful for identification purposes, remains valid and may still apply in certain circumstances. However, we feel that removing the apparent concession will clarify the responsibility on firms and individuals in the regulated sector to decide what form of identification is appropriate to the risks of their own business.

Exemption from identification procedures for business introduced by a regulated person

The 1993 Regulations provide an exemption from identification procedures where there are reasonable grounds for believing that the applicant for business is a relevant financial business or is otherwise governed by the Money Laundering Directive. An exemption is not available at present to non-EEA institutions, including those based in countries with equally high regulatory standards. This constitutes an unnecessary competitive distortion. The draft Regulations therefore extend the exemption to credit or financial institutions which are regulated by an overseas regulatory authority and based in a non-EEA country whose law contains comparable provisions to those contained in the Money Laundering Directive.

Treasury power to prohibit business relations with a Non Cooperative Country

The draft regulations include a new provision allowing the Treasury to prohibit any person subject to the Regulations from conducting relevant business with a person based in a country to which the Financial Action Task Force has decided to apply countermeasures. This power is intended for use only in the last resort, where a country has not taken action in response to being listed as non-cooperative in taking measures against money laundering, and has not responded to approaches by the FATF to help the country come into compliance.

In such circumstances, the FATF applies a first stage of countermeasures: the country is subjected to additional scrutiny on its financial and, possibly, non-financial transactions and is given further time to comply with international standards. Only if the country refused to take steps to become compliant would the FATF move to the final stage of countermeasures, involving the restriction or, possibly, total prohibition on financial transactions with individuals and institutions based in that country.

To date the FATF has listed a number of countries as non-cooperative. Almost all countries have responded by entering into dialogue with the FATF on ways to become compliant and several have as a result of those efforts been taken off the list. In only one case (Nauru) has the FATF found it necessary to apply the first set of countermeasures and impose some requirements for additional scrutiny. In the UK these measures have been applied through guidance. So far, no countries have been subject to the final stage of countermeasures and the expectation is that this would only happen where the country was a clear money laundering risk and was doing nothing to comply with international standards. In such cases, which we would expect to be extremely rare, to protect the integrity of the UK financial system it may be necessary to place serious limits or even prohibitions on any transactions with that country.

Civil Penalties

The government is also considering the possibility of introducing civil penalties for breaches of any of the Regulations by institutions supervised by HM Customs and Excise. The intention would be to provide a more flexible and proportionate enforcement regime, consistent with the aim of "light touch" regulation in the sectors for which HMCE are responsible. As civil penalties are simpler to apply than criminal sanctions, a civil regime would also provide a more effective deterrent to firms with weaknesses in their anti-money laundering procedures. It would also improve consistency in enforcement across the regulated sector, introducing a parallel to the FSA's powers to enforce their Rules. However, there may also be some increased costs to industry. This proposal is not yet reflected within the draft regulations, but may be included when the Regulations are finalised.

Inclusion of originator information on money transfers

The draft regulations do not at present include measures on which the government consulted earlier this year, relating to the inclusion of originator information in money transfers. However, we are currently considering industry responses to that consultation, and subject to the outcome of discussions in the FATF, those measures may be finalised and included in a consolidated text when the Regulations are laid.

Exemption from registration requirements

The Post Office provides a wide range of services, including bureau de change and money transmission services. These activities fall within the definition of a money service business under the Money Laundering Regulations 2001, and many Post Offices are therefore required to register with HM Customs and Excise. However, a particular concern is that the activity of cashing benefits giro cheques would at present trigger the registration requirement and the accompanying fee. As these instruments carry minimal risks of money laundering, and there is a strong public interest in all Post Office branches continuing to offer this service, we are considering exempting cashing of benefits giro cheques from the registration requirement. Post Office branches offering other relevant services would still be required to register with HMCE.

Timing

The intention is to lay new Regulations following a three month consultation period. It is anticipated that the new Regulations will come into force on 1st June 2003.

Comments

Please send comments by 14 February 2003 to:

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This document is also available on the HM Treasury website at www.hm-treasury.gov.uk