

FULL REGULATORY IMPACT ASSESSMENT

MONEY LAUNDERING REGULATIONS 2003

Introduction

1. This is the full Regulatory Impact Assessment 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.

(A) The Second European Money Laundering Directive

Issues and objectives

2. The European Parliament and the Council of the EU adopted the Second Money Laundering Directive (2001/97/EC) on 4 December 2001.
3. Treasury has been consulting on the issues raised in implementing the ML Directive informally since it was adopted, including at the Money Laundering Advisory Committee¹ (MLAC) and an MLAC Working Group. The formal public consultation began 15th November 2002, ending three months later on 15th February 2003. 68 formal replies were received (see later in RIA).
4. The Directive amends the 1991 Money Laundering Directive to introduce changes in two main areas:
 - It widens the scope of predicate² 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”:
 - o Auditors, external accountants and tax advisors
 - o Real estate agents
 - o 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);

¹ MLAC is a public, private and consumer forum formed to discuss topical money laundering issues and pass the views of those they represent to Government.

² Predicate offences are those criminal offences which create the criminal benefit to be laundered.

- 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 €15,000 or more;
 - Casinos.
5. Firms engaged in these areas of business to be brought within the new Regulations 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. The “Failure to Report” offences under the Proceeds of Crime Act, with their obligation to report where there are reasonable grounds to know or suspect money laundering will now also apply.
6. Member States were required to implement the Directive in national law by 15 June 2003. Implementation was delayed in the UK in order to resolve a number of outstanding issues and to consult further with industry groups, especially those who had not responded to the initial consultation. The Directive will be implemented 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.
7. 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 particularly 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.

Risk assessment

8. 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 is undeniably large. Recent estimates indicate that the value

of illegal drugs transactions in the UK could be up to £8.5 billion per annum³, with direct losses from fraud totalling some £10.3 billion per annum⁴. 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.

9. The recent Proceeds of Crime Act 2002 (POCA) strengthened the law on money laundering. The Money Laundering Regulations 2003 will set out the system requirements required by those within the regulated sector to meet the duty to report set out within POCA. 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 reports from the Financial Action Task Force (FATF) 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.
10. A particular concern in this context is the low level of Suspicious Activity Reports (SARs, sometimes known as Suspicious Transaction Reports or 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. The UK Threat Assessment 2002, published by the National Criminal Intelligence Service (NCIS), makes mention that solicitors may provide expertise or lend credibility to financial transactions, and may be used in the setting up of trusts as a means to launder money, thus becoming obvious targets for criminals requiring help to launder money. Statistics from NCIS show that prior to the Proceeds of Crime Act 2002, only three SARs in a thousand come from accountants and tax advisors, while lawyers account for only a further 10-13 of every 1000 reports. The fourth report of the Select Committee on International Development (2001) underlined this concern and called for Government action to improve standards of due diligence in these sectors.
11. In response to our public consultation the accounting industry took issue with the above comparison citing that accountants had fewer clients and were able to investigate transactions more fully, often negating the necessity to make reports. One response also highlighted a *lack of certainty amongst accountants as to when they have a legal right to pass on any suspicions. While accountants operating in regulated areas have protection against any breach of their ethical obligation of confidentiality, protection is only available to accountants outside the scope of the 1993 Regulations in limited*

³ Economic Trends, ONS, July 1998

⁴ “The Economic Cost of Fraud”, National Economic Research Associates, July 2000

circumstances. This response demonstrated a lack of understanding of the legislation which was in force at that time. There was a protection from breaching client confidentiality where there was suspicion or knowledge of money laundering and the reporting person was involved with a primary offence of laundering, but in the case of non-drugs or terrorism, there was no duty to report outside of involvement in an offence. The new Regulations together with primary legislation and associated guidance will remove this perceived uncertainty and increase the efficiency of the reporting regime. The Regulations will also provide protection to an individual who is required by primary legislation to make a report under POCA, by requiring the employer, where conducting business in the regulated sector, to have in place systems to ensure that such a report is made.

Options for regulation (by sector)

Lawyers, external accountants, auditors and tax advisors

12. 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”.

13. 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 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. The Government must therefore make a judgement upon how to best implement these parts of the Directive. In this context, the consultation document identified three main options for implementation.

Option 1: Qualifications Approach

14. 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. 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.

15. 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 recognized 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.
16. However, this approach has a substantial disadvantage. It would create a ready-made loophole for those who did not wish to comply with the Regulations. They would simply have to resign membership of the relevant institute, saving on compliance costs and costs of membership. Nor would it cover foreign professionals practising in the UK without membership of a UK self regulating organisation. It would be counter-productive to create a loophole which excluded accountants and lawyers who had been disqualified by their professional associations.
17. Failure to regulate such a large number of accountants and tax advisors, bookkeepers etc, purely because they do not belong to an institute, would be to ignore a significant potential source of intelligence to counter money laundering. The activities carried out by unqualified practitioners are essentially the same activities carried out by qualified ones (e.g. bookkeeping, investment and the advice, consultancy services). The only distinction is that non-qualified practitioners are not allowed to carry out certain statutory audit work. It cannot be said that the unqualified group faces a lower money laundering risk. Indeed there is an argument that the unqualified ones are more likely to be targeted by the unscrupulous.
18. Whilst competition issues are apparent with this option, they should not be overstated; the number of unscrupulous customers who would switch to non-affiliated advisors would be small, and actual competitive disadvantages from higher regulatory costs would be likely to be compensated by the higher status of affiliation and correspondingly higher fees charged.

Option 2: Activity Approach

19. 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.
20. This approach, which has been adopted in the Regulations, aims to ensure consistent treatment of people offering equivalent professional services in order not to create loopholes for criminal activity and to meet the concerns of

the institutes over competitive distortion. This option has the advantage of covering all those carrying out the targeted activities of accountancy, bookkeeping, tax advice, auditing etc. The unaffiliated professionals who would be additionally caught by this option (option 2 would also capture those within option 1) are at least as much, if not more at risk of assisting money launderers. This option would widen the coverage of this part of the Regulations from an estimated 22,000 accountancy firms who are members of the recognised institutes to 65,000 firms by including the estimated 43,000 non-affiliated firms. This option would do away with the loophole outlined at option 1 above and there would be the greater scope for intelligence to be provided to law enforcement to counter money laundering, and through it the underlying crime. A disadvantage would be the regulatory burden imposed on a greater number of firms having to comply with the Regulations' requirements. As shown later in this assessment, the cost estimated for unqualified practitioners is large taken in its entirety, but not so great when divided amongst the number of firms in this sector.

21. 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 have existing powers to investigate and prosecute breaches of the Regulations.

Option 3: activity approach plus supervisory authority

22. 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 benefit from ensuring compliance with the Regulations and thereby reducing the risk of money laundering taking place through small firms that failed to comply would justify such a cost.

Real Estate Agents

23. 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. Estate agents will, however, often be the first professional involved in the sale of property and may have access to more details about their clients than would the conveyancer or mortgage provider. We do not expect that the Regulations will result in significant extra costs for a typical business; most estate agents take careful steps to identify clients for their own business reasons and so the main additional costs of the Regulations would be found in the training provisions and appointing a Money Laundering Reporting Officer (MLRO).

24. We also expect that any impact on competition in this sector would be minimal.
25. Due to the assessment that this sector presents a lower risk than others in the context of money laundering, and 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

26. 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 or more.
27. 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.
28. In the initial RIA it was stated that record keeping requirements should be set with a €1,000 threshold. Following representations from the industry we have reconsidered the **€1,000 record keeping requirements** as set out above and are satisfied that the Directive would be properly implemented without such a requirement.
29. The casino industry will still be subject to the existing Code of Practice supervised by the Gaming Board whereby all transactions of £2,500 and any linked transactions of £10,000 per gaming day are recorded. The industry will also still be required to train staff and appoint an MLRO.
30. We expect the effects of the regulations on competition to be minimal; each option would apply to all casinos.

Option 1

31. Casinos would be required to identify any client who purchased chips with a value of €1,000 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.

32. 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 €1,000 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

33. Casinos would be required to identify all clients before they were granted access to gaming facilities. **This is the Government's preferred option.**
34. Given that €1,000 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 to the gaming area 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

35. 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 €15,000 or more".
36. 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

37. 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.

38. 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 loophole in this option 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 could simply transfer their activity to a new area that fell outside the regulated sector.

Option 2

39. Any dealer in goods who was willing in principle to accept cash above the value of €15,000 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 for and above the €15,000 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.

40. 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.

41. While the cost of compliance may have a greater proportional impact on small businesses, the registration fee could be recouped in one cash transaction as opposed to payment of as little as a 1% commission when accepting a credit card for the same transaction. And, of course, it would be open to all firms to choose not to accept large cash payments rather than register.

Option 3

42. 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 (e.g. France and Italy). The use of cash would thus be limited to transactions below the threshold of €15,000.

43. 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.

44. However, it would go well beyond the requirements of the Directive to introduce a very 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.

45. 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.
- 46. Following consultation with the industry and Customs, the registration requirement to be registered as an HVD will be extended until 1st April 2004, although any dealer accepting cash of €15,000 will still need to carry out identity checks, appoint a nominated officer and keep records.**

Issues of Equity or Fairness

47. The Government's proposals do not raise any significant issues of equity and fairness. The Directive is narrowly focused 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.

Benefits

48. The 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.
49. The benefit of these regulations will be the reduction in money laundering activity which itself has a significant cost to the UK economy overall, to individual businesses, to individual victims of money laundering, and to society, in the social effects of criminal activity. A recent estimate suggested that annually around £25 billion of criminal money might be available for money laundering in the UK. As noted earlier, it has been suggested that the value of illegal drugs transactions in the UK as up to £8.5 billion per annum⁵, with direct losses from fraud totalling some £10.3 billion per annum⁶. 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. The ideal measure of success would be the quantifiable reduction

⁵ Economic Trends, ONS, July 1998

⁶ "The Economic Cost of Fraud", National Economic Research Associates, July 2000

on money laundering that is attributable to these anti-money laundering measures. However, it is difficult both to quantify the amount of money laundering activity given that by its very nature it is clandestine, and 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).

50. 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:

- suspicious activity reports (SARs) received from businesses newly included within the regulated sector, and in particular from lawyers and accountants;
- criminal convictions (for the predicate or money laundering offence) to which these reports contributed;
- the value of criminal assets confiscated and the cash forfeited to which these reports contributed;
- disruptions of criminal activity.

51. It is important to note that increases in the number of convictions and confiscation orders against launderers or prosecution for breaches of the Regulations 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 SARs will provide the best single measure of success, given that prevention and deterrence activity is hard to quantify, and thus SARs will indicate the regulated sector's awareness and activity in combating money laundering.

52. Statistics provided by the National Criminal Intelligence Service (NCIS) show that businesses in the relevant sectors made the following number of SARs in 2001-2:

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

53. These sectors account for a small proportion of the total of reports received (63,000 reports were received in 2002 and the figure is expected to rise this year to over 100,000). 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. This view is backed up by reports from NCIS of reports and requests for consent which have come in from lawyers and accountants since the introduction of Part 7 of the Proceeds of Crime Act 2002 (POCA). With the wider definition of money laundering applied by POCA from earlier legislation those who become aware that they may be involved in a money laundering offence can in certain circumstances access a defence to that offence by making a disclosure to NCIS. In some instances, those persons can also obtain consent to continue with this conduct whilst retaining the protection of a defence from a charge of money laundering. Currently (July 2003) lawyers are accounting for 70-80% of requests for consent to continue transactions.

54. In 1990, ie 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 1994, when the UK Money Laundering Regulations came fully into effect, this number had risen to 15,000. This experience indicates that the extension of the Regulations to non-financial professions and businesses is likely to result in a significant increase in the intelligence available to law enforcement.

Compliance costs for businesses, charities, and voluntary organisations

(i) Business sectors affected

55. The Regulations are not expected to have an impact on charities or voluntary organisations as they are formulated in a way which covers those carrying out the targeted activities by way of business. 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.

56. 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, bookkeepers, company and trust service providers would be affected.

57. 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. 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.

(ii) Compliance costs for a typical business

Accountancy and legal services

58. 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.

59. In the initial RIA we asserted that 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. The Law Society and Accounting bodies have taken issue with this point, stating that where many firms do in fact carry out authorised investment business, this function is limited to small areas of the firms only (even though guidelines suggest that these systems should be in place throughout the authorised firm) and that to extend systems and training to all areas of the firm brought under the Regulations would involve a higher cost than originally estimated. One accountancy body indicated that three quarters of its membership were not currently subject to the Money Laundering Regulations 1993. The Law Society stated that only 300 firms were authorised by the FSA but that many firms did carry out non-mainstream financial services and are subject to the current Regulations. It is for this reason that the estimates of costs to this sector have risen substantially, as set out below.

60. Estimates in the initial RIA were based upon figures supplied by the Law Society in February 2000. 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 (£1,000) and 2 hours training for each fee earner every 3 years (£300 per person). The cost of training includes not only fees but also the cost of the time of those attending.
- Reporting system: ongoing monthly costs of £1,000
- 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**

61. Taking on board Law Society comments that the figures needed updating from those provided three years ago, we propose to increase the previous figures by 10% per firm. There are many variables to take account of in the production of these figures, all of which give rise to uncertainty. Therefore the annual cost to a medium sized firm might be approximately **£17,600**.

Total sector costs (excluding firms that are already compliant)

Option 1: Qualifications Approach

62. The initial RIA assumed that 5,000-10,000 solicitors, and 10,000-20,000 accountants would additionally be brought within the scope of the Regulations. Accepting the comments from the Law Society and accountancy bodies, we have reassessed the additional personnel brought within the new Regulations as 70,000-80,000 solicitors, and 32,725-37,400 accountants (equivalent to 3,500-4,000 medium sized firms detailed above). Total sector costs would be in the range of **£60 million to £70 million**.

63. These figures are substantially larger than the initial RIA, which estimated such cost would be between £8 million and £16 million. It is not certain that these figures do realistically reflect the true cost to this sector owing to the use of assumptions without a wealth of evidence to back them up. No responses to our consultation suggested costs for the sector, so the above figures are based on estimates from the Law Society previously mentioned. That said, the Law Society for England and Wales suggest that 42% of solicitors are sole practitioners, and the ICAEW that 60% of accountants are sole-practitioners. Indeed, the ICAEW suggests that 80% of its membership (by number of firms) are small businesses, and from the Law Society indicate that a similar percentage of its membership represents small businesses. Where firms are run by sole-practitioners the costs associated with complying with the proposed Money Laundering Regulations would be much lower, indeed comparable with those unqualified practitioners discussed in option 2 below. The average size of a firm of solicitors is eight staff⁷, and the average for a firm of affiliated accountants is two⁸.

Option 2: Activity Approach

64. 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 small businesses, but additionally, much smaller than the average firm outlined above, the sector including a larger number of sole practitioners. Following results of the consultation we have assumed an average firm size of 2-3 practitioners (unlike the initial RIA which assumed 4 persons in such a firm). The initial RIA, which used estimates based upon the Law Society figures but with reduced system costs, estimated average costs to be just under £3,000 per firm, indicating a cost of **£130 million to cover the unaffiliated practitioners alone**. We believe in the light of information gathered during the consultation that these costs were over-estimated. For a sole practitioner there would be no duty to appoint an MLRO, and a small firm of this average size would not be expected to undergo the level of training expected of an MLRO in a large firm. The ICAEW are currently providing part day training courses for £50 available to ICAEW members and non-members

⁷ Law Society figures for 2002: 70,571 solicitors working in 9,231 private practice firms.

⁸ ICAEW figures 2003: 124,000 members, 34,049 in practice, 16,047 firms of which 10,534 are sole practitioners. 15,877 firms have less than 10 partners which would indicate a staff of under 50, thereby making them small businesses.

alike, and guidance is freely available from the CCAB and ICAEW websites. The costs for compliance with the Regulations for non-affiliated businesses therefore would be much lower than previously estimated and could be expected to be in the region of £500-£750 for a 2-3 person firm. This would make the expected cost to those unaffiliated practitioners only: **£21.5 million to £32.25 million.**

65. Adding in the cost of option 1 (where within option 2 we cover those members of the institutes as well as unaffiliated) **the total cost is £80 million to £100 million.**

Option 3: Activity Approach plus Supervisory Authority

66. Costs as for 2 above plus the cost of new regulatory authority. Therefore this would involve £80-100 million plus the cost of a new authority set up to supervise and register those practitioners which are not affiliated to the recognised institutes: i.e. an estimated population of 43,000 firms (and using the estimate of 2-3 person making 86,000-129,000). There are many variables concerned with the setting up of supervisory agency from scratch, and the level of supervision undertaken. Any estimate must be treated as being only an indication of costs. By way of a guide the Asset Recovery Unit in 2002 was estimated to cost £3 million to set up with annual running costs of £13 million. Thus as an indication of the potential cost for setting up a supervisory body for unaffiliated practitioners might be in the region of £16-20 million on top of the cost for option 2. Therefore, **the total cost for option 3 is estimated at £96 million to £120 million.**

Estate agents

67. 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.
68. 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 for the first year, and half that amount for subsequent years.

Casinos

69. 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

70. 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 was accepted in cash. It is likely that this will occur 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.
71. Costs would therefore be limited to training (£250 to train one Money Laundering Reporting Officer) and the fee for registration with Customs (estimated to be under £100), totalling £350 per annum. It may be that the retailer in one such cash transaction saves the cost of registration where payment under credit card would have incurred a percentage commission fee due to the credit card company. This saving has not been factored into our calculation.
72. 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

73. Typical small businesses affected by the proposal include firms of solicitors, accountants, tax advisors and real estate agents. As detailed above in the section on accountants and lawyers, the bulk of such firms, both affiliated and unaffiliated, are small businesses. 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.
74. The Small Business Service (SBS), Institute of Chartered Bookkeepers (ICBK), Association of Accounting Technicians (AAT), Chartered Institute of Taxation (CIOT), Association of Taxation Technicians (ATT) and Federation of Small Businesses (FSB) were in favour of including all accountancy practitioners whether members of a professional association or not. The SBS and FSB, although not going so far as recommending option 3, as some of the accountancy institutes did, together with the ICAEW, suggested a compromise for the supervisory function to be carried out by an existing authority, perhaps Customs. They did, however, express resistance to small businesses having to pay for such supervision. This has not been consulted on and we have no plans to amend the Regulations in this way.

75. The impact upon small business will be broadly proportionate to the amount of business carried out and the risks involved. A small firm will have fewer employees meaning less training and, in many cases, less complex systems for reporting. Although a Money Laundering Reporting Officer would still need to be appointed, this post would only need to be a part time post, carried on with other duties within the business.

Other costs

76. Guidance is already available to the financial sector through the Joint Money Laundering Steering Group (JMLSG) for a small fee. The JMLSG are considering whether to make the Guidance Notes freely available on the JMLSG website in 2004.

77. The estate agents bodies have already discussed guidance with Treasury and are also contacting the JMLSG. Estate agency guidance need not be as detailed as other higher risk/complex sectors, and will thereby be less costly to produce.

78. The gaming industry, legal profession and accounting/audit professions already have codes of practice or guidance but will incur further costs updating the guidance to comply with the Regulations. The cost of providing guidance to each sector will, when split between members of the bodies, be reasonably small. For example, if an association captured by the new Regulations developed guidance independently of other like associations, and that guidance cost, say, £40,000 to develop, this cost split over a membership of 20,000 would equate to £2 per person. If such an association worked together with a similar association the costs would then be shared. Customs already have guidance for Money Service Operators and are writing guidance for High Value dealers (HVDs). The cost to Customs is taken into account within the registration fees paid by MSBs and HVDs.

79. Other costs will be incurred by the Government in processing and following up on an increased number of Suspicious Activity Reports 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 SARs. Further, the way in which reports are handled by NCIS and law enforcement is changing. The Home Office recently commissioned KPMG to review the money laundering reporting system and the result was a package of recommendations about how the system should be improved. The Home Office has set up a Task Force to monitor and support follow up to the KPMG review, and it will oversee a re-engineering of the reporting system. Keeping down the additional costs of the anticipated growth in reporting as a result of these Regulations will be one of the factors underlying the reform programme. The additional costs to NCIS and law enforcement, therefore, of regulations per se are unlikely to be significant.

Competition Assessment

80. The Regulations will have an impact on a variety of sectors, including: lawyers, accountants, auditors and tax advisers, estate agents, casinos, high value dealers (HVDs), and providers of training (insofar as there will be demand for training on money laundering controls).
81. By selecting Option 2, the activity approach, for lawyers, accountants, auditors, bookkeepers, tax advisors, etc, we have sought to minimise any potential disproportionate effect arising from imposing different requirement on those operating in the same sector but who may not be affiliated to a particular regulatory body. Furthermore, it is important to note that these activities are segmented with the result that large firms may not be competing directly against small firms and firms within professional organisations may not be competing directly against those outside professional organisations. As such, they may not necessarily be operating within the same market although, if this is indeed the case, it is possible that a chain of substitution may link smaller firms to larger ones.
82. In addition, the compliance cost per firm is estimated to be relatively small, especially when compared with other training and professional costs these firms typically undertake. As such, it is not expected to distort competition to a significant degree.
83. We expect that the changes to the regulations will create additional opportunities for the provision of training on compliance, which will help strengthen competition in this area.

Legal professional privilege

84. The accountancy profession raised the issue of extension of legal privilege to the accountancy sector. Accountants will now be required to make suspicious activity reports (SARs) to NCIS, while in some circumstances solicitors may be covered by legal professional privilege and not have to report. Therefore, the accountants argue, without an extension of legal professional privilege to them, business will be lost to solicitors. In practice, however, we doubt whether the problems will arise to any great extent.
85. This was discussed in Parliament during the passage of the Proceeds of Crime Act, and Ministerial assurances were given during the parliamentary debate on the Bill that where an individual is actively seeking to set their tax affairs straight, the procedure by which the Revenue deals with cases of suspected serious tax evasion, which has become commonly known as the "Hansard procedure" will remain unaffected by these new provisions.
86. The Department for Constitutional Affairs recently published the conclusions from its consultation "In the Public Interest"⁹ and examining the option of

⁹ (<http://www.lcd.gov.uk/consult/general/oftreptconc.htm#part2>)

extending legal privilege expressed the following observation: “There are serious concerns as to the effects of increasing the rights of non-disclosure. The Government has concerns about extension because it would greatly extend the number of individuals who could avoid the reporting obligation in respect of suspicious transactions by citing LPP. There could be a risk to the ability of the Inland Revenue and Customs & Excise to challenge tax avoidance schemes (leading to increased loss from tax avoidance). More generally, the withholding of potentially relevant evidence from the court should not, in the interests of justice, go further than absolutely necessary.”

87. DCA concluded that the scope of Legal Professional Privilege should not be changed, and the Regulations are consistent with this approach. In particular, it is not the Government’s intention to narrow the scope of Legal Professional Privilege. To make this clear, the Regulations define “professional legal adviser” as including anyone in whose hands information or other matter may come in privileged circumstances. This provides legal certainty, and removes any possibility that the Regulations might be interpreted as removing privilege from material in the hands of lawyers’ support staff, by imposing a duty of disclosure on them in relation to privileged material.

Enforcement, sanctions, monitoring and review

88. The Regulations bring new sectors within their scope. The Gaming Board for Great Britain will enforce compliance for casinos. Compliance for members of the legal and accounting professions will be supervised by the FSA and by the following professional associations: The Law Societies for England & Wales, Scotland and Northern Ireland; The Institute of Chartered Accountants in England & Wales, Scotland and Ireland; and the Association of Chartered Certified Accountants. Customs will undertake compliance for High Value dealers. Bookkeepers, unqualified accountants taxation advisors and real estate agents will have no supervising body.
89. It is an offence under the 1993 Money Laundering Regulations for a firm that performs relevant financial business not to maintain proper money laundering procedures. The maximum penalty is two years imprisonment and/or a fine.
90. 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.
91. 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 contains 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.

92. The effectiveness of the Regulations will be kept under review: in particular we will examine the operation of the Regulations in regard to unaffiliated practitioners in the absence of more formal supervisory arrangements.

Results of consultation

93. The Treasury published a partial Regulatory Impact Assessment assessing the impact of measures in the draft Directive, and responses 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 also established a working group on implementation of the Directive, including a wider range of interested parties. The main recommendation of that group, in July 2002, was that concerns over competition should be taken fully into account in any consultation on the revised Regulations.
94. The public consultation document was released on 14th November 2002, with a deadline for comments of 14th February 2003. There were 68 responses from various interested parties including supervisory authorities such as the FSA, Law Societies for England and Wales, Scotland and Northern Ireland, The Gaming Board, Institute of Chartered Accountants of England & Wales, and Association of Chartered Certified Accountants. Others replying included NCIS, the General Council of the Bar, Royal Institute of Chartered Surveyors, Chartered Institute of Taxation, Council for Licensed Conveyancers, Customs, British Bankers' Association, Finance and Leasing Association, Institute of Directors, Retail Motor Industry Federation along with individual firms of accountants and solicitors.
95. **Overwhelmingly, the legal, accountancy, audit, and tax advice sectors expressed strong preferences for the functional approaches of Options 2 or 3**, citing the dangers of competitive distortion for one part of the industry to be regulated and another not. The dangers of illegal activity being displaced to unregulated firms or practitioners also weighed heavily. Some respondents saying that option 3 would be too burdensome suggested a compromise option somewhere between 2 and 3 of registration to, and supervision by, an existing agency such as Customs. Many were satisfied that supervision would be carried out under option 2 by the professional institutes, or for those unaffiliated, by law enforcement in the normal exercise of their existing powers. As previously stated, the institutes were also representing a large proportion of small business members, although we had a relative lack of response from the small businesses themselves, even with the assistance of the Small Business Service.
96. For **Real Estate Agents**, the Royal Institute of Chartered Surveyors **accepted the need for this sector to be regulated under the Directive but welcomed the proposal not to introduce a supervisory regime** due to the apparent low risk and disproportionate cost that supervision would incur.

Several responses suggested that the assessment of estate agents as low money laundering risk was incorrect, asserting the need for this sector to be captured by the Regulations.

97. **The Casino industry**, through the Gaming Board for Great Britain, the British Casino Association and Association of Casino Operators, **supported the recommended option 2, being the identification of all entrants to the gaming area of casinos**, whether the entrants chose to game or not. This avoided costly and inconvenient procedures for ascertaining whether the customer had reached the Directive identification limit of €1,000. The casinos strongly objected to the proposal that they record all transaction of €1,000, stating this to be a huge burden, which would not advance any useful purpose in the cause of money laundering prevention or detection. They also suggested that such a measure had no basis in the Directive.
98. For **High Value Dealers the bulk of respondees welcomed option 2, to choose whether to accept cash payments of €15,000 or over and registering with Customs**. The Federation of Small Businesses suggested that the cost of registering should be waived and met from Government funds; however, it accepted that option 2 would give small businesses most freedom. Only one respondent supported option 3: the prohibiting of all cash transactions over €15,000.

Summary and recommendation

99. In relation to **legal and accountancy services**, the second option offers the widest coverage of businesses at risk from money launderers, and will thus maximize the benefits to law enforcement. Option 2 would remove the loophole where businesses wishing to avoid being subject to regulation need only resign membership from an institute, or where in the case of a client, may simply choose an accountant or tax advisor, etc, who was not a member of such an institute. 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 effectiveness of the Regulations should be kept under review, our preference is to supervise compliance through existing structures of self-regulation, with additional checks by law enforcement agencies where appropriate.

Option	Total cost per annum
1. Professional approach	£60 - 70 million
2. Functional approach	£80 – 100 million
3. Functional + Supervisor	£96 – 120 million

100. It is not possible to estimate the total benefit to each of these options in monetary terms. The benefit will come from preventing, detecting, prosecuting and displacing crime. The additional intelligence supplied under the Regulations to law enforcement will also assist in the process of restraint and confiscation of criminal assets. The benefit would be felt as social benefit

in less crime, and fear of crime, seeing justice being done as assets are removed from criminal hands and used for society's benefit. At the same time as reducing crime through the anti-money laundering regime we are protecting the integrity of the UK financial sector as a fair and safe place to do business. It would only be possible to say that option 1 is likely to elicit the least reports of the three options as it has the narrowest coverage of professionals. Option 2 and 3 would have the same coverage of professionals, but option 3 would ensure compliance with the Regulations, where option 2 may not do to the same extent.

101. With regard to estate agents, they will be regulated but no supervisory agency designated or set up, leaving enforcement to law enforcement. Training and systems costs: **£10 - 15 million first year, £5 - 7.5 million thereafter.**
102. Although the options for identification procedures in **casinos** are neutral as regards both regulatory costs and benefits to law enforcement, the second option commends itself, being easier to implement reliably and having unanimous support from those respondents to the consultation expressing a preference. The second option, whilst requiring strengthening of identification procedures, would not involve a large additional cost above that having already been incurred in the application for a gaming licence and would be easier for smaller casinos to implement where they may not have the surveillance capabilities required to identify when a player reached the €1,000 gaming limit under option 1.
103. As regards **high value goods dealers**, the second option is preferable: 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. Several respondent associations expressed the wish to allow members the choice to accept cash above €15,000, but suggested they would advise members not, in practice, to allow cash payments unless absolutely necessary. Costs to firms would be the registration fee with Customs (estimated as under £100) for which they would also receive a training pack. As shown above the **cost per firm would be £350 per annum inclusive of registration fee** but there is **no indication of how many applicants the Regulations would attract.**

B) CHANGES IN THE 1993 REGULATIONS

The Regulations consolidate and redraft the text of the 1993 Regulations, in the interests of clarity, and 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 final RIA therefore highlights and explains the main changes arising from the revision of existing provisions.

Consistency with the Proceeds of Crime Act

105. 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 know or 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 were granted, they would have an enhanced status in relation to both primary and secondary legislation.
106. We will also be issuing orders under paragraph 5, Schedule 9 of the Proceeds of Crime Act 2002 aligning that schedule of business in the regulated sector with the Regulations, and also under Schedule 3A of the Terrorism Act 2000 (as amended by the Anti-Terrorism, Crime and Security Act 2001).

Deletion of regulation 8, the “postal concession”

107. 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

108. 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

109. 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

110. 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.
111. 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 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.**
112. The abolition of Reg. 8 was welcomed in five responses to our consultation, three of which also agreed that the principle belonged, as suggested in the consultation paper, in guidance. Seven responses were in favour of retaining Reg. 8, although this appeared, in several instances, to be motivated by a fear that the concession would be phased out of guidance at a later date. We have no plans to object to the Regulation 8 principle continuing in guidance to the financial sector.
113. There will no regulatory impact for those using the concession correctly in removing the Regulation 8 Postal concession. The Joint Money Laundering Steering Group is adding this principle to its Guidance Notes. The only impact would come where the concession is currently being abused. We have no data upon which to base an estimate on the extent of misuse.

Exemption from identification procedures for business introduced by a regulated person

114. 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 new 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.
115. We have no data upon which to assess how much this extension would save the financial sector in regulatory costs.

Treasury power to prohibit business relations with a Non Cooperative Country

116. The new Regulations include a 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 (FATF) 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.
117. 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 three cases (Nauru, Ukraine and more recently Burma) has the FATF found it necessary to apply the first set of countermeasures and impose some requirements for additional scrutiny. Ukraine quickly passed strengthened anti-money laundering laws and counter measures were lifted by the FATF. 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.

118. There were no strong objections to this power, except on the question of access to legal services and human rights. The Treasury would not use regulation 28 in a way which was incompatible with a person's rights under the European Convention on Human Rights. We are advised by our lawyers that a Minister could give the S.I. equivalent of a section 19 statement to the effect that regulation 28 and, indeed, the Regulations as a whole are compatible with Convention rights.

Civil Penalties

119. The new Regulations also include provision for civil penalties for breaches of any of the Regulations by institutions supervised by Customs and Excise. The intention is 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. There may also be some increased costs to industry for potential breaches but this would only be for businesses which were not compliant with the Regulations.

Originator information on money transfers

120. In the initial consultation and RIA it was noted that measures might be included in the Regulations to include provision for the inclusion of originator information on money transfers in line with FATF Special Recommendation 7. Following agreement in February 2003 by the FATF on an interpretative note, the Government will consider the matter further and will not include such measures in these Regulations.

Exemption from registration requirements

121. We originally explained our thoughts on exempting the Post Office from the provisions of the Money Laundering Regulations insofar as it was caught when cashing giro benefit cheques. There were few responses commenting on this part of the consultation, and they were generally in favour of the concession.
122. However, we have discontinued this approach following discussions with the Post Office. The Post Office wishes to be able to provide a range of banking and other services from all branches, which would be caught by the Regulations. This combined with the phasing out of giro benefit cheques in

favour of basic bank transfers, problems with drafting has caused us to reject this proposal.

Timing

123. **The intention is to lay new Regulations in November.** The new Regulations will come into force on 1st March 2004, except Regulation 10, HVD's, Regulation 2(3)(h) and Regulation 2(3)(i). Regulation 10 is the requirement for a High Value Dealer to be registered with the Commissioners. This not a direct part of the Directive and following Customs request, the date for this Regulation is 1st April 2004. Regulation 2(3)(h) comes into force on 31st October 2004 and refers to the date when mortgage intermediaries will become regulated by the FSA, exempting this activity from the Regulations. Regulation 2(3)(i) comes into force on 14th January 2005 and refers to the date when General Insurance Intermediaries become regulated by the FSA and exempts them from the Regulations. Regulation 25 (1) will require an "authorised person" (under the Financial Services and Markets Act 2000) who also carries out a business of operating a bureaux de change to inform the FSA of his intention to do so by 1st April 2004.

Declaration

I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.

Signed

Ruth Kelly

Date

26/11/03

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