

Money Laundering Regulations 2007: Summary of responses to consultation on draft Regulations

July 2007



HM TREASURY



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INTRODUCTION

1.1 In July 2006 the Government published a consultation on its proposals for implementing the Third Money Laundering Directive. In January 2007 the Government published a further consultation document, which included draft Money Laundering Regulations¹. The purpose of the consultation on the draft Regulations was to seek further views on the drafting of the Regulations. The consultation concluded on 2nd April 2007.

What this document does

1.2 This document, which is available from HM Treasury's website, summarises the responses to the January 2007 consultation, and the resultant Government conclusions.

- Chapter 2 provides an overall summary of responses and next steps.
- Chapter 3 explores the specific points made during the consultation in more detail.
- Chapter 4 lists the respondents to the consultation.

1.3 The Government is also publishing today a short user guide to the new Regulations, which includes advice on where to get more information.

Who should read this response?

1.4 This response will be especially relevant to businesses that will be affected by the Money Laundering Regulations 2007, representative bodies active on their behalf, supervisors listed in the Regulations, and law enforcement.

1.5 The Government is grateful to everyone who responded to the consultation in writing or who participated in any of the meetings held.

Home Office consultation

1.6 Aside from Money Laundering Regulations, the Third Money Laundering Directive also has implications for existing UK counter terrorism and criminal legislation, specifically the Terrorism Act 2000 (TACT 2000) and to a lesser extent the Proceeds of Crime Act 2002 (POCA 2002). Some of the responses received to the July 2006 consultation on implementing the Third Directive identified the need to ensure that these Acts met the requirements of the Directive. The Home Office will therefore consult on draft Regulations which propose to update TACT 2000 and POCA 2002. The Home Office consultation will be launched this summer.

¹ The HM Treasury January 2007 consultation document is available at http://www.hm-treasury.gov.uk/documents/financial_services/money/fin_crime_policy.cfm

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OVERVIEW OF RESPONSES AND NEXT STEPS

OVERVIEW OF RESPONSES

Analysis of responses 2.1 The Government received over 100 responses to the consultation of the draft Regulations. The majority were from trade or professional bodies or from firms active in the markets concerned. There were also responses from individuals responding in a private capacity.

2.2 There was broad support for the draft Regulations. The majority of respondents believed that the Regulations were easy to follow, that firms were clear about their requirements under them and that they adequately reflected the Government's policy intention. A number of specific points of policy were raised and helpful comments were received on the drafting. These are addressed in Chapter 3

Changes to the Regulations 2.3 To address specific issues raised in response to the consultation, the Government has made a number of drafting changes to the Regulations and added some new Regulations. The summary table at the end of this chapter shows the structure of the new Regulations when compared to the draft Regulations.

2.4 The table and Chapter 3 summarises the changes the Government has made, but firms subject to the Regulations should also undertake their own steps to familiarise themselves fully with the final Regulations.

NEXT STEPS

Implementing the Regulations 2.5 The final Regulations are being published alongside this response. Subject to Parliamentary approval the Regulations will come into force on the 15th December 2007. This is not a common commencement date, but has been chosen as the implementation date because it allows firms the maximum possible time for implementation while meeting the legal requirement to implement the Directive on time.

Transitional arrangements 2.6 Regulation 50 provides transitional provisions for the registration of existing trust and company service providers, money service businesses and high value dealers.

- Trust and company service providers who are in business on 15th December 2007, must apply for registration by the 1st April 2008;
- Money Service Businesses who are in business on the 15th December 2007, must apply for registration by 1st February 2008
- High Value Dealers who are in business on the 15th December 2007 must apply for registration by the first anniversary of their current registration that falls on or after the 1st January 2008.

Supervisory arrangements 2.7 All of the sectors within the scope of the Money Laundering Regulations will be supervised for compliance with the Regulations. The supervisory authorities are listed in Regulation 23. In 2006 the Chancellor announced the creation of a supervisory forum for listed supervisors. This forum's aim is to share understanding and best practice on risk based supervisory practices. The forum first met in April 2007 and meets quarterly.

Post-implementation review **2.8** The Government will conduct a post-implementation review of the Regulations two years after the Regulations come into effect.

Comparison of final Regulations and the draft Regulations

2.9 This table is explanatory only, and does not form part of the final Regulations

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RESPONSES TO THE CONSULTATION

3.1 In this chapter the responses to the consultation are considered in greater detail. This chapter is accordingly divided into subsections, dealing with each of the major issues, or sets of issues, raised in the consultation.

3.2 In order to ensure this response document is kept within reasonable bounds this response does not necessarily address points made by only a single respondent or where the Government has not significantly altered its approach.

3.3 The Government's response to the points made generally falls into one of these categories.

- In several instances there was explicit support for the approach adopted. We are grateful for that endorsement of the Government's approach, and are making no changes in those instances.
- A variety of points of clarification were made, where we consider that no change to the Regulations is required, but that it would be appropriate to address the issue in guidance.
- There were some comments with which we disagree, for example because we consider that the draft Regulations are already sufficiently clear or otherwise adequate.
- There are a number of instances where the Government has accepted that the Regulation should be amended. The revised Regulations incorporate such amendments.

REGULATIONS 2 AND 3: DEFINITIONS AND SCOPE

Business relationship

3.4 There was broad support for the definition of business relationship. Some firms requested the term 'client' be used as well as 'customer' to reflect the relationship of many professional advisers. It was noted that the phrase "element of duration" potentially expands the number of business relationships. Many respondents requested that they judge whether the relationship is a business relationship not "when contact is first made" but when contact is established. Concern was also raised that the scope of business relationships was very wide, especially when considered alongside the approach of defining the scope of the Regulations by reference to entities rather than activities.

3.5 The Government's view is that the term "customer" has been widely accepted and therefore should remain the term used in the Regulations (except in Regulation 11(2), where "client" has been used). Guidance for professional advisers can make it clear that 'customer' includes 'client'. The Government agrees that a firm should judge whether they are in a business relationship when contact is established rather than when "contact is first made".

Conclusions 3.6 The Government has amended the definition of business relationship to “which is expected...when contact is established to have an element of duration” (see Regulation 2). The Government has redrafted the scope provisions to make it clear that that the Regulations apply to the institutions concerned only when they carry out the activities listed.

Financial Institutions

3.7 Respondents asked about the treatment of certain insurance contracts, insurance intermediaries, and the scope of investment firms as defined in the Markets in Financial Instruments Directive (MiFID), and whether this includes those excluded in Article 2 of that Directive. The Government’s treatment of operating leases was welcomed.

3.8 The Government can confirm that persons who act as general insurance intermediaries are excluded from the Regulations.

Conclusions 3.9 The Regulations clarify that firms excluded by Article 2 of MiFID also fall outside the scope of these Regulations and that a consumer credit financial institution is limited to persons who require a category A licence to carry on a consumer credit business and excludes persons covered by a group licence (see Regulation 3(3)(c) and 22). The Government and supervisors are continuing to work together to provide further guidance on the scope of Annex I financial institutions.

Accountants, tax advisers, auditors and insolvency practitioners

3.10 Some respondents said that the Regulations should not include separate references to ‘accountant’ and ‘external accountant’, and that it should be made clear that the Regulations apply to firms or sole practitioners and not individuals within firms. Some respondents argued that tax advisers should be excluded.

3.11 The Government agrees there should be a single definition of accountant and that the Regulations should apply to firms rather than individual employees within the firms. Neither the FATF nor the Directive exempt tax advisers, and therefore they must be within the scope of the UK’s Money Laundering Regulations.

3.12 The treatment of insolvency practitioners gave rise to a number of comments, as these persons are currently included within the scope of the Money Laundering Regulations 2003. Some respondents argued that the risks of these persons being used to launder money appear to be low, as individuals and firms only enter the insolvency process in circumstances of financial stress. Law enforcement has shown, however, that a number of money laundering typologies exist that the insolvency practitioner should be aware of. The Government believes it is appropriate to retain the coverage of this sector but will work with relevant supervisors and law enforcement to provide more targeted guidance.

Conclusions 3.13 The Government has only used the term ‘external accountant’ to refer to accountants (as defined in Regulation 3(7)) except in Regulation 11(3), which may include individual accountants who do not fall within the definition in Regulation 3(7)). The Regulations continue to include tax advisers as defined in Regulation 3(8).

REGULATION 6: MEANING OF BENEFICIAL OWNER

3.14 A significant number of representations, in particular from legal professionals and trust practitioners, were made regarding the application of the definition of beneficial owner to trusts. Representations requested further clarity and certainty on three core areas of the definition of beneficial ownership, namely who controls the trust, who is the beneficial owner of a trust, and the treatment of entitlement to income. The Government has also considered further the treatment of discretionary trusts.

3.15 The Government agrees that control should be limited to legal control, rather than influence, but believes that all those who have indirect or direct legal control should be identified. The Government also believes that the 25% test for control over the property of trusts should be removed as in the vast majority of situations the controller will have control over all the trust property. Regarding beneficiaries, the Government agrees that the definition should be limited to those with vested interests, but believes it should include defeasible as well as indefeasible interests. This provides certainty but reflects the economic reality of the situation. The Government also agrees that vested interests should be limited to interests in capital only.

3.16 The Government is persuaded that to require identification of beneficiaries of discretionary trusts at the moment of payout or when a beneficiary is added would place a disproportionate burden on some parts of the regulated sector. It therefore does not propose to add to the obligations in this way, but will, through guidance, require firms to monitor closely the transactions by a trust, work closely with law enforcement, and otherwise inform themselves of typologies featuring discretionary trusts.

3.17 The Government wrote to interested parties on 18th June 2007 proposing changes to the definition along the lines outlined above. These were favourably received although some respondents noted that the language used was technical and would need to be expanded on in guidance. A couple of respondents noted some unintended consequences of the changes, which the Government agreed were unintended and therefore has sort to remedy in the final Regulations.

Conclusions 3.18 Regulation 6 provides an extended definition of beneficial owner, when applicable to bodies corporate, partnerships, trusts and other legal entities and legal arrangements that manage and distribute funds. The Government believes that this definition provides clarity and certainty of purpose. It will continue to work with all relevant sectors and supervisors to ensure that firms are clear about their obligations in different situations.

REGULATION 8: ONGOING MONITORING

3.19 A number of respondents were concerned that the addition of ongoing monitoring measures within the customer due diligence measures placed impossible obligations on firms. They argued that it is impossible to carry out ongoing monitoring while establishing a business relationship, or while carrying out an occasional transaction.

3.20 The Government agrees with the representations made and has therefore separated these obligations. It still believes, however, that ongoing monitoring should be seen as a core part of a firm's customer due diligence systems rather than a separate consideration, and would want this to be reflected in any guidance.

Conclusions 3.21 The Regulations separate ongoing monitoring (Regulation 8) from the Customer Due Diligence measures (Regulations 7) of identification, verification and information on the nature and purpose of transactions. This makes clear that whilst identification and verification measures must be applied before the establishment of a business relationship or occasional transaction, the Government is not also expecting ongoing monitoring to be done at that time.

REGULATION 10: CASINOS

3.22 One respondent requested that customer checks should be allowed to be carried out on entry to the gaming area. The Government also received representations that identification on entry to internet casinos should mean identification when the first stake is made.

3.23 The Government has examined the proposal for a third option for customer checks, but believes, in line with international best practice, casinos should be encouraged to apply identification checks at a threshold and be able to link the customer due diligence information with higher value transactions. It believes that this should be the policy for all casinos except those who cannot provide such systems, or those who wish to operate a membership system.

3.24 The Government disagrees that “identification on entry” to internet casinos should mean when the first stake is made and believes that identification “on entry” should take place as part of registration with the internet casino. As this is when identification measures take place for other purposes, it should not present practical problems. The Government had previously proposed referring to a business or gaming day as the time period for the 2000 Euro threshold to cover. As there is not existing legal definition of gaming day the Government has, instead, inserted 24 hour time period during which the threshold test applies.

Conclusions 3.25 Regulation 10 provides for identification on entry to the premises of a casino, or when gambling over a threshold of 2000 Euros (if the Commission is satisfied that the Casino can operate such a system). The Regulation provides the same identification options for gaming machines on the premises and for internet casinos.

REGULATION 12: EXEMPTION FOR TRUSTEES OF DEBT ISSUES

3.26 Following representations the Government has made minor changes to the exemption for trustees of debt issues, ensuring that not just the trustee, but those that advise the trustee are exempted from the requirement to identify beneficial owners. The Government believes that this exemption combined with the reliance and simplified due diligence provisions significantly meet the concerns expressed with regard to identifying beneficial owners of the bonds and similar instruments.

REGULATION 13: SIMPLIFIED DUE DILIGENCE

3.27 A number of respondents were concerned that simplified due diligence would not extend to occupational pensions under the Welfare and Pensions Act 1999 and the Pensions Act 1995 as these allowed assignment to third parties in prescribed circumstances.

3.28 The Government has clarified with other Member States that pensions which allow assignment under the Welfare and Pensions Act and the Pensions Act can benefit from simplified due diligence.

Conclusions 3.29 Regulation 13(7)(c) clarifies that occupational pensions set up under the above Acts can benefit from simplified due diligence.

REGULATION 14 AND 15: ENHANCED CUSTOMER DUE DILIGENCE AND BRANCHES AND SUBSIDIARIES

3.30 A number of respondents were concerned that the definition of politically exposed persons captured UK politically exposed persons who are resident abroad, which was not the intention of the international obligations. They also felt that the information needed in deciding whether someone is a known close associate could be more clearly expressed.

3.31 The Government agrees with the representations made.

Conclusions 3.32 The Government has clarified that for the purposes of these Regulations a foreign politically exposed persons is someone who is appointed to a politically exposed position in another country, or by a European or International body, no matter where they are resident (Regulation 14 (5)), and further clarified the information needed to decide whether someone is a known close associate of a politically exposed person (Regulation 14 (6)). The Regulations also move the obligations for risk management systems to identify politically exposed persons to Regulation 20 in the policies and procedures section.

3.33 The Regulations also further define subsidiary undertakings in line with the Companies Act 2006 (see Regulation 15.3).

REGULATION 17: RELIANCE ON A THIRD PARTY

3.34 Generally the Government's approach to the reliance that can be placed on third parties was welcomed. Representations were made that the Government had not fully implemented the derogations in article 15 of the Directive because the Regulations do not state that relevant persons may rely on persons in the regulated sector in other countries even if the documents or data required under the money laundering laws of that country are different to the documents or data required under the UK's money laundering laws. Some respondees raised the difficulty they will have of ensuring that a person in another country on whom they may wish to rely is subject to mandatory professional registration in that country and adequately supervised, and believed that to limit the persons on whom reliance can be placed within the EEA to persons who satisfy these two conditions is unnecessarily going beyond the Directive.

3.35 The Government does not believe that the Regulations need to include the phrase "even if the documents or data used on which these requirements have been based are different to those required in the Member State to which the customer is being referred". These words in Article 15 were included in the Directive at the specific request of the UK and the Government is supportive of their purpose. However, unlike the laws of some other Member States, the UK's Regulations do not "require" or specify particular forms of customer identification documents or data to be obtained. Indeed it would be incorrect and confusing to refer in Regulation 17 to documents or data being "required" in the UK when no such obligation has, in fact, been imposed in Regulation 7. The Government believes that both the Directive and the FATF Recommendations require firms to satisfy themselves that persons on whom they rely in other countries are subject to mandatory professional registration and adequately supervised. The

Government has provided that relevant persons may only have “reasonable grounds to believe” that persons on whom they rely are registered and supervised

Conclusions 3.36 The Government has amended Regulation 17 to allow firms to have “reasonable grounds to believe” that the person meets the conditions set out in the rest of the Regulation. It has not adopted the wording of Article 15 for the reasons set out above, but would be happy to approve any industry guidance that confirmed this fact. The Government has also made it explicit that obligations cannot be imposed on third parties without their consent.

REGULATIONS 19-21: RECORD KEEPING, POLICIES AND PROCEDURES, AND TRAINING

3.37 The option of keeping either references to or copies of the evidence of customer identity was again welcomed by the majority of respondents. A number of respondents commented that the time period for keeping records of transactions within a business relationship should be 5 years from the end of the transaction not 5 years from the end of the relationship.

3.38 The Government agrees with the representations made on the time period for keeping records of transactions that take place within a business relationship.

Conclusions 3.39 Regulation 19 (3)(b) has been amended to reflect the above. The Regulations also include in Regulation 19, rather than the reliance Regulation, the record-keeping obligations on third parties.

Regulations 22-35: Registration and supervision

General

3.40 The Government received a number of comments both on drafting and stylistic issues and on more substantial points, in particular addressing the obligations on supervisory authorities and on their powers to inspect premises.

Interpretation

3.41 The Government has created a new Regulation 22, to contain common definitions that apply to the whole of Part 4 of the Regulations. The Government has added references to the Department of Enterprise, Trade and Investment (DETI) in Northern Ireland here and at other appropriate places in the Regulations

Supervisory authorities

3.42 A number of comments were received about the role of HMRC and their supervision of accountants. The Government remains of the view set out in the consultation document on the draft Regulations. In response to representations made by certain listed professional bodies, the Government has clarified that their responsibilities apply to “relevant persons who are regulated by them” rather than “regulated members”.

Registration

3.43 Respondents welcomed the registration powers. Regulations 25 and 26 are unchanged. The power to maintain registers, now in Regulations 32, has been simplified.

The fit and proper test

3.44 The need for a 'fit and proper person' test was recognised. This is now dealt with in Regulation 28. The Government has re-examined the drafting of the definition of a person who is not fit and proper that will be applied by the Commissioners to money service businesses, or trust or company service providers. The Government was concerned that the proposed reference to an 'offence involving fraud' might have been unclear, causing difficulties for both HMRC and applicants. The Government has decided to substitute for that approach references to more specific offences. The Government has also removed the test of being subject to a recovery order from the list of tests; this is because a recovery order is made on a property rather than a person. Additionally, the Government has made the treatment of spent offences more explicit in Regulation 28 (3) (i.e. that spent offences are to be disregarded).

3.45 There was broad support for the 'catch all' provision but firms requested clear information from HMRC on how this was to be used

3.46 Comments were received on the need for review and appeal mechanisms, especially in view of the so-called 'catch-all' test. Those mechanisms are provided in Regulations 43 and 44.

Costs

3.47 Regulation 35 has been amended to make clear that it refers to the FSA, OFT and HMRC. The Gambling Commission already has separate charging powers. The supervisors, referred to in Schedule 3 to the Regulations (principally professional bodies), have their own independent fee-raising powers.

REGULATIONS 36 – 47: ENFORCEMENT

3.48 Generally respondents welcomed many of the enforcement provisions, as clear, appropriate and reasonable.

3.49 In reviewing the many comments submitted on Part 5 the Government has continued to seek to establish a regime that is proportionate and effective. In response to requests from DETI the enforcement powers have been extended to them when supervising credit unions. This ensures that they have adequate powers under the Regulations (as opposed to general legislation) to continue their role in supervising credit unions in Northern Ireland for compliance with money laundering measures.

Entry powers

3.50 Some respondents argued that the power to enter and inspect premises without a warrant or notice was too draconian. Their concerns have been carefully considered. The Government has concluded that the power to inspect premises that an officer has reasonable grounds to believe are used for a relevant person's business without a warrant or notice remains necessary and proportionate. This power allows supervisors to inspect the premises of businesses they believe are under the Regulations but which

refuse to register. Although a written notice of inspection could be issued for most visits, such advance warning can give those who are determined to avoid compliance the opportunity to close down and set up somewhere else before the visit takes place.

3.51 Other respondents were concerned that the enforcement powers gave the FSA, OFT or HMRC powers over sectors that they are not specified as supervising. The Government agrees this was not the intention and has clarified the Regulations to make this clear.

Appeals

3.52 In response to requests from some supervisors, the Government has amended the appeals procedures to reflect procedures that supervisors (and firms currently regulated by them) are familiar with. The Government believe that this still provides all firms with adequate recourse to appeals.

Other amendments

3.53 The Government has also made the following minor amendments to the enforcement section:

- Created a new Regulation 36 to contain common definitions that apply to the whole of Part 5 of the Regulations; and
- Added a new Regulation 46.(5), to require that the OFT is also notified of the outcome of proceedings previously notified to it.

REGULATIONS 42 AND 45 CIVIL AND CRIMINAL OFFENCES

3.54 Some respondents were concerned that criminal offences were attached to “vague” requirements. As a matter of policy the Government believes that the obligations should remain high level and risk based, and that, in line with the MacCrory review of penalties, a range of penalties should be attached to the obligations. While the Regulations require firms to make judgements on a risk sensitive basis for the first time, many firms already apply this approach. As the risk based approach is generally agreed to be the most effective and targeted approach, both in the UK and internationally, it is right that the Regulations allow for strong penalties to be an option for the most serious cases such as those that consistently refuse to comply with the Regulations.

REGULATIONS 50: TRANSITIONAL PROVISIONS

3.55 The Government has substantially expanded Regulation to clarify the treatment of existing high value dealers, money service businesses and trust or company service providers, and to make other changes.

SCHEDULES 1 TO 6

Schedules 1 and 2

3.56 Schedules 1 and 2 are substantially unchanged. The Government has made it clear that the exclusion from the scope of the Regulations for financial activity on an occasional and limited basis does not apply to money transmission or remittance activities. This is in line with the implementing measures Directive.

Schedules 3 and 4

3.57 Schedule 3 has been amended by splitting the list into 2 parts, (only members of bodies in Part 1 may be relied on to apply CDD) and by making some additions to the professional bodies that can take on supervision. Schedule 4 is substantially unchanged.

Schedules 5 and 6

3.58 Schedule 5 now contains and expands the provisions relating to modifications in relation to appeals. Schedule 6 contains other revised minor and consequential amendments that were previously dealt with as part of the original Schedule 5.

4

LIST OF RESPONDENTS

4.1 The following persons responded to the January 2007 consultation.

Abbey

Akizo Nobel UK Ltd.

Alliance and Leicester

Association of Accounting Technicians (AAT)

Association of British Insurers (ABI)

Association of Business Recovery Professionals (R3)

Association of Chartered Certified Accountants (ACCA)

Association of Pension Lawyers

Aviva PLC

Axa Sunlife

Barclays Bank

Berwin Leighton Paisner

Betfair

British Bankers Association (BBA)

British Casino Association (BCA)

British Vehicle Rental and Leasing Association (BVRLA)

British Venture Capital Association (BVCA)

Business Tax Centre Limited

Casino Operators Association (COA)

Central England Trading Standards Authorities (CenTSA)

Chartered Institute of Management Accountants (CIMA)

Chartered Institute of Public Finance and Accountancy (CIPFA)

CIFAS

City of London Law Society (CLLS)

Clifford Chance

CMS Cameron McKenna LLP

Compliance Solutions Ltd.

Co-operative Bank

DLA Piper UK LLP

Electronic Money Association (EMA)

Finance and Leasing Association (FLA)
Financial Services Authority (FSA)
Financial Services Consumer Panel
Friends Provident
Futures and Options Association (FOA)

Gambling Commission
Geoff Hill Esq.

Hallinans
HBOS plc

ILS Group Ltd
Institute of Chartered Accountants in England & Wales (ICAEW)
Institute of Chartered Accountants in Ireland
Institute of Chartered Accountants of Scotland
Institute of Credit Management (ICM)
Institute of Financial Accountants
Investment Management Association (IMA)

Kerzner International UK Gaming Division
KPMG LLP

Legal and General (L&G)
Linklaters
Local Authorities Coordinators of Regulatory Services (LACORS)
London Investment Banking Association (LIBA)

Macfarlanes
Maclay Murray & Spens LLP
Mayer, Brown, Rowe & Maw LLP
MBNA Europe
Michael Hayes Esq.

Nationwide Building Society
Navigant Consulting (Europe) Ltd.

Office of Fair Trading (OFT)

Professional Contractors Group (PCG)

Reckitt Benckiser Pension Fund
Recruitment and Employment Confederation
Remote Gambling Association (RGA)
Revenue and Customs Prosecutions Office
Robert Dias Esq.
Royal Institute of Chartered Surveyors (RICS)

Scottish Crime and Drug Enforcement Agency (SCDEA)
Slaughter and May
Society of Scrivener Notaries
Solicitors Regulatory Authority

Thames Valley Police
The Association of International Accountants
The Council for Licensed Conveyancers (CLC)
The Faculty Office of the Archbishop of Canterbury
The Law Society
The Law Society of Scotland
The Society of Trust and Estate Practitioners (STEP)
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