

# THE MONEY LAUNDERING REGULATIONS 2001

## FINAL REGULATORY IMPACT ASSESSMENT

### Introduction and summary

This assessment estimates the costs and benefits of the new Money Laundering Regulations 2001.

This regime will oblige Money Service Businesses (bureaux de change, cheque cashers and money transmission agents) to be registered with HM Customs and Excise and subject to a risk based inspection regime, thereby ensuring that they understand and are compliant with their existing obligations. Customs will be given new powers to enter Money Service Business premises, search them and, where they find evidence of a breach of the 1993 Regulations, prosecute under those Regulations. Customs already have the power to prosecute Money Laundering offences.

Society will be the main beneficiary of the new regime, as a result of the more effective combating of money laundering and the criminal activity that underlies it. It will assist Money Services Businesses in meeting their existing obligations and promote better business practices, thereby reducing fraud and enhancing the sector's reputation. It will also dissuade criminal operators from entering the market and remove the unfair competitive advantage enjoyed by those operators who choose to ignore the legal requirements of the Money Laundering Regulations (and their associated compliance costs).

### Background

The Cabinet Office Performance and Innovation Unit, in its June 2000 report "Recovering the Proceeds of Crime"<sup>1</sup>, recommended a light touch regime for regulating bureaux de change, money transmission agents and cheque cashers ("Money Services Businesses")<sup>2</sup>. Money Services Businesses are already subject to the Money Laundering Regulations 1993 (SI 1933).

The Money Laundering Regulations require Money Service Businesses to implement a system of anti-money laundering controls, including: appointing a Money Laundering Reporting Officer ("MLRO"); identifying customers where a single transaction exceeds Euro 15,000 or where there is an ongoing business

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<sup>1</sup> <http://www.cabinet-office.gov.uk/innovation/2000/crime/crimeindex.htm>.

<sup>2</sup> Recommendation 59.

relationship or where there is a suspicion that the transaction is linked to money laundering; keeping records; and having systems in place to facilitate the reporting of suspicious transactions (making Suspicious Transaction Reports or 'STRs').<sup>3</sup> Unlike most other financial businesses, however, Money Services Businesses are not supervised by a regulator such as the Financial Services Authority or a professional body.

The Treasury carried out a review of the impact of the Money Laundering Regulations, and the general state of UK anti-money laundering policy in 1996-1997. The financial services industry was consulted, as were the various law enforcement agencies and regulators. The main conclusions were that, while compliance with the Regulations needs to be improved in some key areas, the Regulations themselves were adequate for the sectors currently covered.

A further review will occur when the Government considers how to implement the proposed Second European Money Laundering Directive.

## **Risk Assessment**

Most crimes are committed for financial gain. This is particularly true for crimes such as drugs trafficking, fraud and tax evasion. Criminals seek to protect themselves and their illegitimate assets from the criminal justice system through the process of money laundering. Greater cross border mobility of people and capital is increasing the scope for international money laundering. The predicate offences that underlie money laundering affect everyone; drug trafficking in particular has a disproportionate effect on deprived communities and young people. Terrorists fund their actions by moving legally and illegally acquired funds through the financial system. Finally, money laundering poses a threat to the international financial system; money launderers undermine confidence in financial institutions, mis-allocate financial resources and are prone to capital flight, thereby skewing markets. They also corrupt people and institutions. The collapse of the Bank of Credit and Commerce International (BCCI) in 1991 after admitting laundering drug money and other crimes, and the consequential shock to the global banking system, demonstrates the substantial risk to financial markets. The events of September 11 this year reinforce the need for governments to strengthen their anti-money laundering regimes.

It is difficult to quantify accurately the risks posed by money laundering, as they relate to sophisticated global criminal activity. Nevertheless, the problem is undeniably large; the Office of National Statistics estimates that the value of illegal

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<sup>3</sup>There are also general statutory obligations relating to reporting suspicions of money laundering pursuant to the *Drug Trafficking Act 1994*, *Terrorism Act 2000*, and *Criminal Justice Act 1988*.

drugs transactions in the UK could be up to £8.5 billion per year.<sup>4</sup> The global figure is more alarming – in 1994 the IMF estimated the global magnitude of drugs proceeds laundered was somewhere between 2% and 5% of global GDP – or US\$500 billion – US\$1.2 trillion. Other criminal activities such as fraud and terrorism add to the size of the problem. One way to assess the scope for combating money laundering is to note that in 1998 in the USA there were 70 disclosures per US\$ million in circulation in the USA economy, whereas the equivalent figure for the UK was 17 disclosures.<sup>5</sup> Similarly, the latest figures indicate that in the USA, \$8,142 is confiscated per disclosure, whereas the UK figure is \$1,868.

As money laundering controls have become more robust, so money launderers have sought other ways to disguise the illicit source of their funds. The Financial Action Task Force on Money Laundering (“FATF”) reports on money laundering techniques, compiled by law enforcement agencies around the world, demonstrate that money launderers have progressed from the more traditional financial instruments to other methods of cleaning ‘tainted’ monies. A particular concern in the UK is the low level of STRs made by most Bureaux de Change, Money Transmission Agents and cheque cashers and corresponding uncertainty over the ability to enforce the existing obligations. In response, Customs has developed a structured educational programme for Bureaux de Change involving visits to operators during which they are reminded of their existing statutory obligations under the Money Laundering Regulations and invited to declare that they understand those obligations. Following the implementation of this programme, the number of disclosures by Bureaux de Change and Money Transmission Agents has increased from about 1100 in 1996 to about 3000 in 2000. Perhaps more importantly, the quality of information passed is much higher. The National Criminal Intelligence Service has also held meetings with senior managers of larger companies to assist them in understanding their obligations.

Nevertheless, in 1999 ninety percent of disclosures in this sector were made by just 7 companies, leaving the vast majority of Money Services Businesses without a single disclosure. Law enforcement officials have also found widespread evidence that money launderers and those who finance terrorist activities have identified weaknesses in Money Services Businesses, and that without a positive change in this area, these businesses will increasingly be used by international money launderers and terrorists. One reason for the vulnerability of Money Services Businesses is that money launderers can use their control of them as an explanation for the banking of large amounts of notes and coins. Of even greater concern is the increase in the number of independent Money Transmission Agents, frequently in the form of a single outlet. Some of these are ‘alternative remittance

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<sup>4</sup>Economic Trends, ONS, July 1998.

<sup>5</sup>Financial institutions are required in the United States, subject to certain exemptions, to report all cash transactions in excess of \$10,000.

agents' or *hawala* banks, which move funds across borders without using the mainstream financial sector. These increase the ease with which money launderers and terrorists can use the sector to transfer funds with minimal risk of detection.

## **Consultation Period**

From 15 October to 5 November, HM Treasury conducted a public consultation on the proposed regime. Copies of a Consultation Document were sent to representatives of the business sector, major business outlets, a number of small to medium sized enterprises, Government departments and trade bodies. The Document was also published on the Treasury's public website.

Three principal options were proposed:

### Option 1: Rely solely on the existing controls

Rely on the present controls, in which Money Service Businesses are subject to the 1993 Money Laundering Regulations and statutory obligations, but there is no regulatory oversight.

### Option 2: Self-regulation

Require Money Services Businesses to implement a system of self-regulation, such as an industry code of conduct. Money Services Businesses would be expected to become members of a recognised business association, and subject to a detailed set of guidelines in support of the Money Laundering Regulations.

### Option 3: Regulatory regime

All Money Service Businesses would be required to register with Customs and include with their registration details of their business, details of any agents or franchisees and an annual fee. Customs would then send each registered Money Service Business a registration number, production of which would become a mandatory part of ordering currency from wholesalers and other Money Service Businesses. Customs would also conduct educational and supervisory visits and be given powers to enter and inspect premises to assess their compliance with the 1993 Money Laundering Regulations.

The Treasury received 45 responses, including comments from the British Cheque Cashers Association, the British Banking Association, the Campaign for Community Banking Services, the Law Society, the Financial Services Authority, the London Investment Banking Association, a number of police forces, the Association of Chief Police Officers of Scotland, the Post Office, the seven biggest

UK bureaux de change companies and a number of smaller Money Service Business operators.

The respondents universally accepted the need for a regulatory regime for Money Service Businesses, recognised the resultant benefits for the sector and supported the proposed third option. A small number of respondents argued that the regime should be made more robust but only one respondent criticised the proposals to the point of requesting reconsideration.

## **Details of the Regulations**

- a) All Money Services Businesses will be required to be registered with Customs within 6 months of the regulations coming into effect. Agents will not be required to register purely on the basis of carrying on the business of an agent, but will be required to register if they carry on any independent Money Service Business. The registration details and fee for those agents who have not independently registered will have to be provided by the principal. Franchisees will have to register and pay fees in respect of their business, since they act as principal in respect of the rights assigned them by a franchisor.
- b) Applicants will be required to provide sufficient information concerning business activity so as to allow Customs to maintain an effective register. Specifically, applicants will be required to supply:
  - (i) the applicant's name and (if different) the name of the business;
  - (ii) the applicant's VAT registration number or, if he is not registered for VAT, any other reference number issued to him by the Commissioners;
  - (iii) the nature of the business;
  - (iv) the address of each of the premises at which the applicant carries on (or proposes to carry on) business;
  - (v) any agency or franchise agreement relating to the business, and the names and addresses of all relevant principals, agents, franchisors or franchisees;
  - (vi) the name of the relevant money laundering reporting officer (if any); and

(vi) whether any person concerned (or proposed to be concerned) in the management or control of the business has been convicted of a money laundering offence or of money laundering within the meaning of regulation 2(3) of the 1993 Regulations.

- c) An annual fee of around £100 will be required for each registered place of business. This reflects the administrative costs of registration, risk assessment, educational material and visits and inspections. The amount of the fee will be reviewed in future years to ensure cost recovery for the regulatory regime.
- d) Registration will be renewable annually.
- e) The Registration Number will become part of the identification requirements under the Money Laundering Regulations.
- f) Educational and supervisory visits will operate on a targeted basis on the assessment of Customs; businesses will also be able to request educational visits from Customs.
- g) Customs will have the authority to inspect Money Services Businesses. This will include powers to enter premises and to inspect documents and records and, where criminal offences are suspected, to seize or copy evidence. These sorts of inspection powers are typically granted to regulatory bodies (e.g. Financial Services Authority, Foods Standards Agency). Customs already uses such powers in relation to other matters within its jurisdiction.
- h) Existing criminal penalties pursuant to the Money Laundering Regulations will continue to apply and Customs will become a prosecuting authority for breaches of these Regulations. An additional system of civil penalties will be introduced to enforce the requirements set out above. The VAT and Duties Tribunal will deal with any appeals.

### **Issues of Equity and Fairness**

There are no significant adverse effects on equity and fairness. The regulatory regime is narrowly focused on Money Services Businesses and is intended in part to remedy existing unfair competition by Money Services Businesses that are not currently in compliance with their obligations under the Money Laundering Regulations. The setting of the fee on a per premises basis has been consciously designed to allow for equity between small and larger businesses. The impact on customers will be minimal, although they will have to provide evidence of identity

where required to under the 1993 Money Laundering Regulations. This is not a new requirement but we expect compliance to increase significantly.

At present, the Financial Services Authority regulates Money Service Business activities in Banks. Some concern was expressed during the consultation that there should not be an unfair imbalance between the two regimes. Customs and the FSA are in dialogue on this issue and are preparing a Memorandum of Understanding to address these concerns. However, a Money Service Business which is regulated by the FSA should be covered by an inspection regime of at least equal intensity as a Business which is regulated by Customs (differences in risk assessment between individual businesses notwithstanding).

## **Benefits**

**SUMMARY: The regulatory regime will ensure that the Money Laundering Regulations are being properly implemented and will deter criminals from using or controlling Money Services Businesses for money laundering. It will further ensure that Money Service Businesses have systems in place to detect money launderers who do use them, and that these businesses report their suspicions. This in turn will assist the authorities to detect, deter and disrupt terrorist financing and money laundering and thereby reduce the underlying criminal activity and enhance international financial stability.**

The mechanisms linking anti-money laundering measures and the effects on crime and financial stability are difficult to quantify. For example, it may not be clear in any particular case whether detection and prosecution of crime, disruption of criminal activities or deterrence reduce criminal activity. Some changes in criminal activity may be completely unrelated to government controls; for example, a reduction in the amount of drugs trafficking could be due to changes in drug user demographics. Nevertheless, there are several potential benefits of the regime that will promote the government's objectives:

- a) Reduced criminality in UK;
- b) An additional weapon in the fight against the financing of terrorism;
- c) Increase in number and quality of Suspicious Transaction Reports;
- c) Reduction in opportunities for money laundering and increase in associated costs for criminal operations;
- d) Increase in criminal prosecutions; and
- e) Increase in the value of criminal assets forfeited or confiscated.

It would be wrong to assume that the only indicator of the success of the proposals is increased criminal prosecutions or value of criminal assets confiscated. The government's objectives would also be promoted by disrupting or deterring criminal activity, neither of which would necessarily lead to convictions or confiscations.

The registration system, associated education programmes and risk assessment will increase the number, quality and speed of STRs. This is the most effective way to achieve the government's overall objectives. STRs assist law enforcement authorities in initiating and conducting investigations, which lead to prosecutions and confiscations. These in turn would reduce the benefits of, and incentives and opportunities for, criminality. Reductions in criminality would also be achieved by implementing barriers (by raising the awareness of legitimate Money Services Businesses), which increase the costs incurred in laundering the proceeds of crime.

The Treasury anticipates that significantly more STRs will be made as knowledge of and compliance with the Regulations increases. When similar requirements were introduced in the Netherlands in 1996, there were 5,636 disclosures from Bureaux; by 1998 this had increased to 11,193. The implementation of better staff training and reporting systems, and the educational visits, will reduce the number of spurious STRs and increase the quality of those that are made. Investigating authorities will also be able to build a more comprehensive picture of criminal networks and activity by implementing a modern information system. This will assist them to efficiently target resources at the most vulnerable points of criminal networks rather than dealing with organised crime on a case by case basis.

Deterring or preventing criminals from corrupting individuals and institutions, and using illicit funds to cause market instability or distortions, will also enhance the integrity of the international financial system. The regime will also implement an important recommendation of the international Financial Action Task Force.

Finally, the regulatory regime will improve the internal management of registered businesses (e.g. by enforcing the requirements of the Money Laundering Regulations relating to training for staff and record keeping) and strengthen the reputation of industries that have suffered from a lack of public confidence in the past.

### **Business Sectors affected**

The regime will cover anybody who is concerned with the business of changing currency from any currency to another, transmitting or transferring money (including electronically) or cashing third-party cheques. The regulations will apply to Bureaux de Change, Money Transmitters and Cheque Cashers.

As defined under the UK Standard Industrial Classification (SIC 1992) structure, categories that may be affected, in whole or in part, include Financial Intermediation (Group J).

Those businesses which are currently regulated by the Financial Services Authority (FSA) and which carry out money service activities would continue to be regulated by the FSA. The Treasury noted in its consultation document that it was minded to exclude these businesses from the regime and asked for comments. The overwhelming majority of respondents, including the FSA, supported this proposal.

Charities and voluntary organisations will not be directly regulated and will therefore only be affected in the same manner as any other customer of the regulated businesses. If a charity or voluntary organisation carries out money service business, it must be regulated by either Customs or the FSA but will not be charged a fee.

### **Compliance Costs for a Typical Business**

The customer identification, record keeping, training and reporting requirements of the Money Laundering Regulations already apply to Bureaux de Change, Money Transmission Agents and Cheque Cashers. The additional costs of the regulatory regime are expected to be relatively small for these firms.

Total additional costs per Money Service Business outlet per year would be in the region of £250. Registration is expected to cost around £100; in addition, the costs to each outlet of maintaining administration systems and hosting the outreach and educational visits are estimated at an average of £150.

### **Total Compliance Costs**

There are no accurate figures for the number of Money Services Business outlets in the UK, but initial information gathered from law enforcers and business operators indicates the following number of outlets.

Bureaux de Change:	12,000 – 17,500
Money Transmission Agents:	7,000 – 8,000
Cheque Cashers:	1,700 – 2,000
Total Outlets	20,700 – 27,500

Projected estimated total sector costs per year for registration fee, administration and hosting outreach:

20,700 – 27,500 outlets x around £250 per outlet = £5,175,000 - £6,875,000

The overall cost of implementation will necessarily depend on the number of businesses covered. The Treasury has received a number of useful observations from the sector on this point and has incorporated their comments into our final estimate.

### **Impact on Small Business**

Typical businesses affected by the proposed regulation include large chains and franchisors, as well as a number of smaller independent competitors. The leveling of the fee on a per outlet basis should remove any potential competitive advantage secured by larger businesses paying lower rates. Legitimate small businesses will see a removal of their current disadvantageous position in relation to dishonest businesses that choose not to pay the costs of compliance with the 1993 Money Laundering Regulations.

There will, for some small businesses, be an initial compliance cost to fulfilling their obligations under the 1993 Money Laundering Regulations. The education services offered by Customs and the six-month grace period on registering will help to offset this burden. **However, it should be stressed that this is already a preexisting obligation to operating in this part of the financial sector.**

The Treasury received comments from the Small Business Service of the Department of Trade and Industry and met with the SBS to try to address their concerns. The SBS noted that registration fees cause a burden for small businesses and has requested that the Treasury should reconsider the fee when the regulations come to be reviewed. They further noted that they are encouraged by the efforts of the Treasury to keep initial and recurring costs to a minimum.

The government has already consulted with several businesses and business associations regarding improvements to the implementation of the Money Laundering Regulations and they have been broadly supportive of improved enforcement measures. The Home Office has also consulted on the Performance and Innovation Unit report.

### **Other Costs**

The additional costs to the government will be minimal. The regulatory regime would be self-funding. Customs already conducts an outreach programme with Bureaux de Change on a voluntary basis; the regime will provide authority to make the acceptance of these sorts of visits and inspections mandatory. The registration system and structured education and assurance programme will be funded on a

full cost recovery user fee system. Other costs will be incurred by the Government in processing and following up on an increased number of STRs.

The Lord Chancellor's Department expects the additional work for the VAT and Duties Tribunal involved in hearing appeals to be minimal and comfortably absorbed in their current budgets. Should this prove incorrect, they will contact the Treasury.

### **Enforcement, Sanctions, Monitoring and Review**

It is an offence under the Money Laundering Regulations where a firm to which they apply fails to apply proper anti-money laundering procedures. The maximum penalty is two years imprisonment and/or a fine. Amendments to the Regulations to implement the regulatory regime will maintain the existing enforcement and sanctions provisions, as well as providing powers of entry, inspection and prosecution so that Customs can properly enforce the Regulations. An additional system of civil penalties will be introduced to enforce the provisions of the regulatory regime.

The effectiveness of the regulatory regime would be reviewed within two years of its introduction, and the compliance burden would be taken fully into account in any revision of it.