

<b>Title: Enhanced due diligence: designation of high-risk countries - Economic Crime and Corporate Transparency Bill</b>	<b>De minimis assessment</b>
	<b>Date: 20/06/2023</b>
<b>Lead department: HM Treasury</b>	<b>Type of legislation: Domestic</b>
	<b>Date measure comes into force:</b>
<b>Contact for enquiries:</b> stephanie.ukpelukpe@hmtreasury.gov.uk	<b>On such day as the Treasury may by regulations appoint</b>
<b>Cost of Preferred Option: &lt;£5m</b>	<b>Equivalent Annual Net Direct Cost to Business per year: &lt;£5m</b>

### **Summary**

The government’s current approach uses a statutory instrument to align the UK’s list of high-risk countries relating to money laundering to countries identified by the Financial Action Task Force (FATF), the international anti-money laundering standard setter. This measure proposes to replace the current system, by allowing Money Laundering Regulations to directly refer to FATF’s lists. This streamlines updates with regulations automatically reflecting the latest international findings. Statutory instruments will still be needed to include or exclude any countries from the Regulations, where doing so deviates from the FATF. There is no direct impact on business because this is about government and parliamentary process and the policy impact remains the same. Specifically, there is no impact at this time because this impact assessment only considers the change to primary legislation to empower Money Laundering Regulations to subsequently be altered. The Treasury will produce additional impact assessments for subsequent changes to regulations which could automatically align the UK to the FATF list.

### **What is the problem under consideration? Why is government intervention necessary?**

The Money Laundering Regulations (MLRs) set out obligations that businesses must undertake for Anti-money laundering, counter terrorism financing and counter proliferation financing purposes. This includes requirements for firms to carry out customer due diligence and enhanced due diligence (EDD) on customer and business relationships.

The Regulations require financial institutions and other firms regulated for Anti-money laundering to carry out EDD in respect of business relationships and certain transactions involving ‘high-risk third countries’. These are countries that have been identified as having strategic deficiencies in their Anti-money laundering regimes and that could pose a significant threat to the UK’s financial system.

The definition of a ‘High-Risk Third Country’ in the MLRs is set out in Regulation 33A which states that a ‘high-risk third country’ is a country which is specified in Schedule 3ZA of the MLRs. Schedule 3ZA is a list of countries that mirrors the lists of countries identified by the Financial Action Task Force (FATF)<sup>1</sup>, the global AML/CTF standard setter, as having strategic

<sup>1</sup> The FATF is the international standard setting and monitoring body for anti-money laundering (“AML”), counter terrorist financing (“CTF”) and counter proliferation financing (“CPF”). It has a detailed and extensive set of standards against which countries are monitored using a transparent and rigorous peer review mechanism. This includes requirements as a matter of policy for countries to have mechanisms by which financial institutions and

deficiencies in their Anti-money laundering regimes. The FATF meets periodically (3 times a year) to discuss global money laundering risk profiles and amends its public lists.

When the government introduced the UK's high risk third countries list, it committed to reflect updates to the FATF's own lists in the UK list. This is so that the UK's list remains up-to-date and reflective of global money laundering, terrorist finance and proliferation financing risks identified by the FATF, mitigating risks of threats from countries with strategic deficiencies in their regimes pose to the UK financial system.

The UK's list is periodically updated by way of a statutory instrument (SI), typically three times per year. Each SI is laid under the 'made affirmative' procedure, pursuant to sections 49 and 55(2) and (3) of the Sanctions and Anti-Money Laundering Act 2018 (SAMLA). Though the made affirmative procedure means the updated list comes into force as soon as it is laid, the current administrative and parliamentary process for updating Schedule 3ZA of the MLRs via secondary legislation can prolong updates to the UK's list, leaving a period of time when the UK's list is outdated, and there is a delay in the regulated sector needing to apply enhanced due diligence measures in relation to customers of transactions with nexus to high risk third countries. This has varied from several weeks and on occasion several months. This can leave the UK more exposed to money laundering, terrorist finance and proliferation financing risks. More rapid, routine updates to the UK's list will ensure that risks can be managed more effectively; the government can provide greater clarity to businesses on which jurisdictions are deemed to be high risk at the speed necessary, allowing businesses to protect themselves and their customers from money laundering and terrorist finance exposure.

Additionally, the current process requires that once an SI is laid and changes are implemented, it must be debated within 28 days of laying to remain in effect, thereby requiring priority for parliamentary time. Given the up to 3 updates to the list a year and accompanying debates, this process generates considerable pressure on the parliamentary timetable.

### **Why are the new provisions necessary?**

The Government remains committed to reflecting findings by the FATF when designating High-Risk Third Countries. This requires frequent, routine updates to the Money Laundering Regulations after FATF Plenary meetings, which take place at a minimum three times per year.

In order to ensure that the regulations are updated more swiftly to reflect high-risk jurisdiction listed by the FATF, legislative change is necessary to ensure the latest findings are reflected in a more streamlined way. For this, SAMLA will be amended to confer powers to the Money Laundering Regulations to define high-risk countries as those identified by the FATF, unless otherwise specified. This will ensure regulations are responsive to evolving money laundering, terrorist finance and proliferation financing risks. The new provision will thereby reduce pressure on parliamentary time for routine updates in line with FATF findings, removing the need for up to 6 parliamentary debates each year.

This provision retains the need to bring forward statutory instruments via affirmative procedure to designate additional countries as high risk or exclude any countries. This ensures that

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designated non-financial businesses and professions apply enhanced due diligence to transactions and business relationships where higher risks are identified. Countries with significant shortcomings in their AML/CTF controls are regularly identified by the FATF in its public statements on 'High-Risk Jurisdictions subject to a Call for Action'; and 'Jurisdictions under Increased Monitoring'.

Parliament retains the ability to scrutinise instances in the event that the power was to be used to deviate at any point from FATF decisions.

This measure will amend SAMLA; consequential amendments to the MLRs will be required to implement the new process for designating high risk countries enabled by this measure. The Treasury will produce impact assessments for any changes made to MLRs in due course.

## **2. What are the policy objectives and the intended effects?**

Effective and responsive AML/CTF regulations are a key part of making the UK a hostile environment for illicit finance, protecting the UK's reputation as a safe place to conduct business, and maintaining confidence in and integrity of the financial system.

The Government's policy is for the UK's High-Risk Third Country list to mirror those countries identified by the FATF for their shortcomings in their AML/CTF systems and there are no intentions for this policy to change. The objective of this amendment is to streamline the process by which the latest FATF findings are reflected in UK regulation, while retaining parliamentary scrutiny in the event that Government were to bring forward any designations of high risk countries that would deviate from FATF findings. Allowing the latest international findings to be automatically reflected in UK regulation ensures that risks can be managed more effectively. The government can thus provide greater clarity to businesses on which jurisdictions are deemed to be high risk at the speed necessary, allowing businesses to protect themselves and their customers from money laundering and terrorist financing exposures.

These changes are also intended to reduce pressures on parliamentary time and the amount of time taken to consider routine updates mirroring FATF, by reducing the need for up to six parliamentary debates per annum.

## **3. What policy options have been considered, including any alternatives to regulation? Please justify preferred option**

**Option 1, Do nothing.** Under this option, the Government would not amend the process by which the list of High-Risk Third Countries in the MLRs is amended and maintain the current administrative and parliamentary processes for updating the list. This can create delays, of several weeks up to months, in how quickly the list can be updated and leave a period of time when the UK's list is outdated and non-reflective of global money laundering / terrorist finance risk identified by the FATF, leaving the UK financial system at risk of threats from countries with strategic deficiencies in their AML/CTF regimes.

**Option 2 (preferred option).** Legislate to amend the SAMLA and, in due course, the MLRs to streamline the process by which routine updates to the definition of high-risk third countries are made, where it mirrors FATF findings. This will allow regulations to reflect the latest international findings more rapidly and ensure that risks can be managed more effectively, while retaining parliamentary scrutiny for any updates that deviate from FATF findings.

## **4. Please justify why the net impacts (i.e., net costs or benefits) to business will be less than £5 million a year.**

### **How many businesses will this impact per year?**

Based on data collected from AML supervisors in the latest Treasury annual return, covering the period between 6 April 2020 and 5 April 2022, we estimate that around 101,000 entities are

within scope of the MLRs and will thus be in scope of the mandatory EDD and enhanced ongoing monitoring requirements relating to high-risk third countries.

### **What will businesses have to do differently?**

These legislative amendments will not require businesses to do anything differently. Policy with respect to High-Risk Third Countries itself is not changing, and these changes do not create any new obligations for businesses.

Impacts to businesses arise when the countries designated as high risk change, as they are obligated to consider EDD measures in relation to a changing set of customers and populations. We previously conducted impact assessments each time those changes were implemented.<sup>2</sup> Further impact assessments will be conducted when consequential amendments are made to implement the change to the definition of high risk countries in the regulations, triggering automatic inclusion of FATF listed countries in MLRs.

### **What is the direct cost/benefit per business per year?**

These measures do not create any additional financial requirements for the regulated sector. As this measure does not result in new obligations for businesses and or the processes businesses must follow to apply EDD, there will be no significant direct cost/benefit impacts. This measure changes government procedures for designating high risk countries; it does not change the countries in scope or policy intentions for how the list should be implemented. The main costs we anticipate would be incurred by business due to familiarisation. This is a relatively small legislative measure, and we predict that these costs will not be higher than £5m.

To expand further, for this measure, firms will need to familiarise themselves with new text and read 163 words that will be added to legislation. Familiarisation costs are usually calculated by multiplying the word count with the reading speed, wages and number of affected parties.

The Financial Conduct Authority (FCA) regulates nearly 50,000 firms (2022). The firms regulated by the FCA will be used as a proxy due to lack of alternative accurate number of businesses in the wider regulated sectors.

If we take the median wage figure for financial institution managers and directors Standard Occupational Classification (SOC) code 1131 of £ 31.93 per hour,<sup>3</sup> FCA data which suggests that there are 17,403 employees in financial crime roles in the regulated sector,<sup>4</sup> and the average reading time is 238 words per minute (wpm) /14280 words per hour,<sup>5</sup> familiarisation cost calculations will be:

Average time for one person to read 163 words:  $163 \text{ divided by } 14,280 = 0.01141457 \text{ hr}$

Cost for one employee to read 163 words:  $0.01141457 \text{ multiplied by } £31.93 = £0.36446709$

Cost for 17,403 to read 163 words:  $£0.36446709 \times 17,403 = \mathbf{£6,343}$

<sup>2</sup> [https://www.legislation.gov.uk/ukxi/2022/393/pdfs/ukxi0d\\_20220393\\_en.pdf](https://www.legislation.gov.uk/ukxi/2022/393/pdfs/ukxi0d_20220393_en.pdf)

<sup>3</sup> [Earnings and hours worked, occupation by four-digit SOC: ASHE Table 14 - Office for National Statistics. Table 14.5a. https://www.ons.gov.uk/file?uri=/employmentandlabourmarket/peopleinwork/earningsandworkinghours/datasets/occupation4digit2010ashtable14/2022provisional/ashtable142022provisional.zip](https://www.ons.gov.uk/file?uri=/employmentandlabourmarket/peopleinwork/earningsandworkinghours/datasets/occupation4digit2010ashtable14/2022provisional/ashtable142022provisional.zip)

<sup>4</sup> [Financial Crime: analysis of firms' 2017-2020 REP-CRIM data. https://www.fca.org.uk/data/financial-crime-analysis-firms-2017-2020#f-chapter-id-key-observations-staff-in-financial-crime-roles](https://www.fca.org.uk/data/financial-crime-analysis-firms-2017-2020#f-chapter-id-key-observations-staff-in-financial-crime-roles)

<sup>5</sup> <https://www.sciencedirect.com/science/article/abs/pii/S0749596X19300786#:~:text=Abstract,and%20260%20wpm%20for%20fiction.>

The total minimum predicted cost to industry, as an approximate value, will be £6,343.

The Financial Conduct Authority (FCA) regulates nearly 50,000 firms (2022). The firms regulated by the FCA will be used as a proxy due to lack of alternative accurate employment statistics on businesses in the wider regulated sectors.

If the cost is predicted to be £6,343 for FCA regulated entities (50,000), and we estimate there to be 101,000 total entities (102% increase), we can predict an upper estimate for the familiarisation cost to be:

£6,343 multiplied by 2.02 = **£12,813**.

The predicted maximum cost will therefore be **£12,813**, as an approximate value.

We note that the real-world impact is likely to be higher. However, the calculations above provide a reasonable indication that the overall costs will be less than £5m.

**5. Please confirm whether your measure could be subject to call-in by BRE (Better Regulation Executive) under the following criteria. If yes, please provide a justification of why a full impact assessment is not appropriate:**

**a) Significant distributional impacts (such as significant transfers between different businesses or sectors)**

No. The measures do not oblige any businesses to change any of their processes or procedures and therefore does not have any significant distributional impact.

**b) Disproportionate burdens on small businesses**

No. There is no disproportionate burden enforced within these measures to small businesses as a whole, because as mentioned, these measures extend to businesses on a risk rather than size basis. Furthermore, the measures do not oblige any business, regardless of size to change its current process or procedures.

**c) Significant gross effects despite small net impacts**

No. As per the above there should be limited to none, gross and net effects.

**d) Significant wider social, environmental, financial or economic impacts**

No. These measures do not oblige any businesses to change any of their processes or procedures and most businesses will likely have appropriate processes in place already therefore there should be insignificant impact on the above.

**e) Significant novel or contentious elements**

No. The policies being proposed are within public interest and wider policy aims, the proposed is likely to be more contentious should the measures not be implemented.

Sign-off for de minimis assessment: SCS

***I have read the de minimis assessment and I am satisfied that it represents a fair and proportionate assessment of the impact of the measure.***

**SCS of Sanctions and Illicit Finance**

Signed: **Giles Thomson**

Date: 21/06/23

**SCS of Better Regulation Unit**

Signed: **Linda Timson**

Date: 21/06/23

Sign-off for de minimis assessment: Minister

***I have read the de minimis assessment and I am satisfied that it represents a fair and proportionate assessment of the impact of the measure.***

**Treasury Lords Minister**

Signed: **Baroness Penn**

Date: 23/06/23