

HM Revenue and Customs AML/CTF Thematic Review

Anti-money laundering
Compliance in the Money
Service Business Sector

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1 Summary

1.1 About this review

This review has been prepared by HM Revenue & Customs (HMRC) for the benefit of Money Service Businesses (MSBs) – especially those businesses engaged in money transmission through networks of agents. The review will, we expect, be of interest to MSB businesses using different operating models, or those non-MSB's that operate with an agency model.

The review is concerned with how those businesses are conducted from the point of view of compliance with UK anti-money laundering (AML) law and good practice.

During 2014/15 HMRC carried out an intensive program of supervisory activity focused on the agents of the largest money transmission networks. Nearly 1500 visits or other significant contact took place, and the bulk of this review is based on what was found in those visits.

This review sets out HMRC's findings in two sections reporting on good and bad practice. Another section sets out additional recommendations that will be relevant to businesses supervised by HMRC for AML purposes that use an agency / principal model.

1.2 Changes introduced by the Money Laundering Regulations 2017.

Section 3.4 of this Review deals with the impact of the changes introduced by The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017. For brevity we refer to those regulations as the Money Laundering Regulations 2017¹ or MLR2017.

These changes are important not least because there are new legal requirements on MSBs to ensure that their agents are fit and proper, which took effect on 26 June 2017.

1.3 Who should read the review?

The review is especially relevant to money transmission businesses supervised by HMRC for AML purposes. Other money service businesses (cheque-cashers and currency exchange offices) may also find it helpful to them in identifying and addressing money laundering (ML) vulnerabilities.

As noted above, the review may also be especially relevant to other businesses supervised by HMRC for AML purposes that use a principal / agent model.

¹ <http://www.legislation.gov.uk/ukxi/2017/692/contents/made>

1.4 The principal / agent model

There are various business models available to businesses with local, regional or national networks. The business might use a single corporate structure – a company, or network of related companies, which operate the outlets through which its services can be accessed.

Another model involves a corporate centre that enters into relationships with one or more agents. This paper is particularly concerned with this model.

This paper does not seek to provide advice on the law of agency, but the key features of agency can be summarised as where the agent is authorised to act on behalf of the principal. The arrangement between the agent and the principal will be set out in an agency agreement. An agent who acts within the scope of authority conferred by their principal binds the principal in the obligations the agent creates with third parties.

So, in practice, where an MSB customer deals with an agent who acts within his mandate the agent binds the principal to perform the service the customer has paid for.

The use of the agency model is widespread in the MSB sector. But it is not the only commercial model adopted in the industry. And that choice of models – how a business is structured or organised - is entirely for the parties concerned. HMRC does not recommend or endorse any structure or arrangement compared to others.

1.5 “Should” and “must”.

This review refers to both the legal requirements placed on businesses and makes recommendations which set out HMRC’s view of good practice that businesses should follow.

Where this review refers to legal requirements it says ‘businesses must comply with their legal obligations’. Where the review makes recommendations it says ‘businesses should follow these recommendations’.

2 HMRC as an AML Supervisor

HMRC is one of 25 UK Anti-Money Laundering supervisors. We currently supervise about 27,000 principal businesses across the following business sectors:

- Money Service Businesses (MSB)
- High Value Dealers (HVD)
- Trust and Company Services Providers (TCSP)
- Accountancy Service Providers (not supervised elsewhere, i.e. not affiliated to an accountancy body (ASP))
- Estate Agency Businesses (EAB)
- Bill Payment Services Providers (BPSP)
- Telecommunications, Digital and IT Payment Services Providers (TDIPSP)

The Money Laundering Regulations (MLRs) require businesses to have policies and procedures in place to help them recognise and report suspicious activity.

It is an offence to carry out relevant business without registering with HMRC and businesses may be penalised or face criminal prosecution if they fail to do so. All businesses in the regulated sector are required, if they know or suspect money laundering, to report those suspicions to the National Crime Agency (NCA).

HMRC's supervisory role involves testing and challenging that supervised businesses meet their obligations under the Regulations, providing them with guidance and education on how to meet these obligations, and responding appropriately to significant failures with sanctions, civil and criminal, as appropriate.

HMRC's wider responsibilities mean that it has a role in potentially investigating criminal offences either under the MLRs or in a wider context, such as under the Proceeds of Crime Act 2002 (POCA). HMRC may then refer cases for prosecution.

HMRC's work has led to successful prosecutions for breaches of the MLRs or POCA². Prosecution is usually a final step for HMRC; we can and have successfully used a range of sanctions, including de-registration which removes a business's ability to trade legally. MLR2017 created new enforcement powers which are now available to HMRC.

Our role as supervisor is to test and challenge businesses' understanding of the risks they face and their compliance with their obligations. This includes understanding when and how to report suspicious transactions, and in doing so protecting themselves, the UK, and the wider financial system from criminals trying to launder money.

HMRC's strategy for supervision is to understand the risks in our supervised sectors, and to tailor and target our compliance activity appropriately as a result. This includes providing clear guidance and advice to customers, so that they understand their obligations; challenging businesses before they register with HMRC, to ensure they are fit to be running businesses in the supervised sectors; and responding effectively where we identify that businesses are failing to put the right policies and protections in place.

HMRC takes a robust, intelligence led approach to the businesses it supervises. This includes visits and telephone interventions to test and challenge their approach to applying customer due diligence measures, and to test their compliance, including identifying beneficial owners as appropriate.

² These include JGE Plant (2013) convicted of regulatory offences, Kumarathas and Anandan (2014) for POCA offences, and Mian (2014) for regulatory offences, Sangha (2014), the first regulatory offences conviction resulting in a term of imprisonment, Moothathamby, and Sriskantharajah etc (2014) convicted of POCA offences, and Debagh (2016) convicted of regulatory offences.

Where we uncover shortcomings, we will use the range of sanctions available - ranging from warning letters or applying civil penalties to referring the most serious cases for possible criminal investigation and prosecution.

2.1 What else does HMRC do as an AML supervisor?

We provide education and support to help our customers understand and meet their legal obligations, including easily accessible educational tools such as webinars and e-learning. We also carry out compliance visits and other targeted interventions to test that registered businesses have adequate controls in place and are complying with the MLRs. And we work closely with HM Treasury and other supervisors and law enforcement agencies, sharing information and intelligence as appropriate.

2.2 “AML” and “CTF”

The Money Laundering Regulations 2017 and other UK anti-money laundering law generally deals with two threats:

- Money laundering (ML) – the concealment of the proceeds of crime, which is tackled through anti-money laundering (AML) activity; and
- Terrorist financing (TF) – funding terrorist activity, not necessarily involving criminal proceeds, which is addressed through countering terrorist financing (CTF) work.

These problems differ in their nature and scale, in that the sums required to mount terrorist activities can be much smaller than the sums encountered in money laundering of the proceeds of crime. Generally the requirements on businesses have common features (such as customer due diligence) but there are some important differences between the actions needed for effective AML and CTF.

For reasons of simplicity and brevity this paper generally uses the term AML to capture both AML and CTF issues. Where there are specific CTF issues these will be separately identified and discussed.

3 HMRC and the Money Service Business Sector

There continues to be considerable interest in the MSB sector – in particular the money transmission sector that allows fast, safe remittances around the world.

The MSB sector was carefully considered in the UK National Risk Assessment (NRA) that was published in October 2017³. There is a summary of the key findings of the 2017 NRA in section 4.1.

MSBs rely on global banks to provide the financial infrastructure that allows them to move funds around the world. In recent years, many global banks have paid greater attention to their obligations under AML rules and have taken a closer look at the MSB business model. Due to concerns that MSBs may be easily abused by criminals and terrorist financiers, some banks have withdrawn services from them as they do not wish to run the risk of regulatory action. This has led to concerns from the MSB sector that they may be unable to operate.

The FCA published a report on the drivers and impacts of de-risking, written by John Howell & Co. That report is available on the FCA website⁴.

Remittances are vitally important in many less developed economies, and diaspora communities. The government has therefore been involved in seeking to ensure that remittances can continue to flow to such jurisdictions, despite the difficulties experienced by businesses in obtaining or retaining mainstream banking services, for example by setting up a Remittances Action Group.

The UK is committed to the agenda of improving remittance providers' access to banking services. A working group of the Financial Stability Board (FSB), chaired by the UK, will report to the G20 Finance Ministers and Central Bank Governors in March 2018 with a stocktake of current initiatives to address remittance providers' access to banking services, and recommended actions where more can be done to address remaining barriers. Separately, the government has concluded that the Home Office and Treasury should press ahead with a national action plan to reform the UK's anti-money laundering regime to make it more effective, while reducing business burdens. The action plan is available on the gov.uk website⁵.

The FATF⁶ Mutual Evaluation Review of the UK in 2017/ 18 will look at the effectiveness of the UK regime as a whole, including the use of sanctions and the transparency of supervisors.

Addressing vulnerabilities in the UK's money service business industry is therefore critical for both anti-money laundering and counter terrorist financing purposes.

3.1 The MSB sector

At the end of August 2017 there were 1,854 MSB principal registrations with HMRC. MSB activities were carried on at 44,471 premises, typically through agents.

| DETAIL (all as at August 2017)⁷ | No. of registrations | No. of premises |
|---------------------------------------------------|-----------------------------|------------------------|
| MSB sector overall | 1,854 | 44,471 |
| Currency exchange | 1,178 | 20,941 |
| Money transmission | 990 | 28,790 |

³ <https://www.gov.uk/government/publications/national-risk-assessment-of-money-laundering-and-terrorist-financing-2017>

⁴ <http://www.fca.org.uk/static/documents/research/drivers-impacts-of-derisking.pdf>

⁵ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/468210/UK_NRA_October_2015_final_web.pdf

⁶ The Financial Action Task Force, the international standing setting body for money laundering, of which the UK is a member.

⁷ HMRC data.

| | | |
|----------------|-----|-------|
| Cheque cashers | 445 | 2,386 |
|----------------|-----|-------|

Note that the sector overall total is not the total of the subsectors (as some businesses carry out multiple activities).

See Annex 1 for selective historical data on the MSB and money transmission sectors. Interestingly, the historical data shows a broad stability – in fact a slight rise – of overall MSB business premises since April 2010 to 2016. This means that the number of premises from which MSB services (money transmission, cheque cashing and bureau de change services) were available was broadly stable. Over the same period there was a slight fall in the number of premises known to HMRC at which money transmission was available.

The number of principal businesses offering either MSB or money transmission services fell more steeply over the same period, although as the premises numbers show services continued to be widely available. This trend may reflect a consolidation in the market, and/or a change in status amongst businesses – businesses ceasing to operate as principals but continuing to trade as agents.

3.2 Size of UK remittance activity

The Migration Observatory (University of Oxford) has reported there is considerable uncertainty about the value of remittances to and from the UK. Since the end of foreign exchange controls in 1979, there is no official mechanism for recording remittances.

World Bank data suggest that the UK is a major receiver as well as sender of remittances. Its data suggest that in 2015 inflows of remittances to the UK were valued at US\$ 5,487 million⁸ and outflows (2014) were valued at US\$ 11,569 million.

The UK can be a significant source of funds to third countries – sending over \$3bn. to India and to Nigeria, and over \$1bn to each of France, Pakistan, Germany and Poland⁹.

The cost of remitting from the UK varies per destination country and transfer method. The major money transfer operators typically charge 6-11% of the total amount remitted.

3.3 What the Money Laundering Regulations require

HMRC is the money laundering supervisor of non-bank MSBs. HMRC supervises MSB businesses to ensure they comply with the Regulations.

This means that MSBs must register with HMRC, and the beneficial owners, managers and Directors must pass a fit and proper test. (Before June 2017, which is when the work reported in the review was undertaken, only principals were subject to the fit and proper requirements.) Principal businesses are liable for the conduct of their agents, and must, for example, keep HMRC's records of their agents complete and up to date. Principals should also monitor their agents.

Once registered and able to trade the business must carry out customer due diligence (identity and other checks) where required – or carry out enhanced checks where the risk is elevated. There are also special rules where the customer is a Politically Exposed Person (PEP).

Businesses must keep records of the checks they carry out, such as the identity documents they see to check that their customers are who they claim to be (verification). They also need to carry out training, and have

⁸ <http://www.worldbank.org/en/topic/migrationremittancesdiasporaissues/brief/migration-remittances-data>

⁹ Using the 2015 World Bank Bilateral Remittance Matrix.

policies and procedures to manage their money laundering risks. They also need to have systems capable of monitoring their customers' behaviour.

They must report suspicious behaviour by their customers to the NCA.

In addition we expect businesses to take security seriously, so that, for example, access to their systems is properly managed and controlled, through the use of properly protected passwords and other procedures.

HMRC publishes detailed guidance for MSB businesses¹⁰ (as it does for other sectors). That guidance makes clear both the minimum legal requirements and where HMRC thinks good practice should go further.

There were significant changes in June 2017, and we summarise those in the next section.

3.4 Changes to the AML rules in June 2017 – fit and proper testing for agents

This review looks at a period during which businesses were subject to the Money Laundering Regulations 2007 (MLR2007) and the Wire Transfer Regulations (Regulation (EC) No 1781/2006).

New EU AML rules (a new Directive and new EU Wire Transfer Regulations) were adopted in 2015 and both came into effect in June 2017 in the UK. The Directive was implemented through the MLR2017 which took effect on 26 June 2017; the EU Regulations will have direct effect but will be enforced through MLR2017. The new regulations ensure the UK meets the latest FATF standards.

Businesses that continue to trade after those measures took effect must comply with the new requirements.

The key effect of MLR2017 in the context of the Review concerned the extension of the fit and proper requirements in MLR2007 to cover MSB agents.

The law (MLR2017 regulation 58) requires that HMRC must refuse to register an MSB that has agents (or officers, managers or beneficial owners of the agent) who are not fit and proper. A person is not fit and proper if they:

- have unspent convictions of a kind listed in Schedule 3 to MLR2017,
- have consistently failed to comply with the Money Laundering Regulations of 2001, 2003, 2007 or 2017, or
- are otherwise not fit and proper having regard to the risk of the business being used for money laundering or terrorist financing.

Additionally regulation 19 (4) (e) of MLR2017 requires an MSB with agents to have a written policies, controls and procedures to ensure that agents used by the business would satisfy the fit and proper test in regulation 58.

This means that principals are now subject to requirements with legal force to ensure that their agents (including the officers, managers or beneficial owners of the agent) are fit and proper as defined above.

HMRC has published revised guidance both for MSBs and on the application of the new fit and proper test¹¹.

HMRC requires MSBs to satisfy themselves that their agents are fit and proper. This means principals will need to identify the individuals who are in scope of the test at each agent and satisfy themselves that those individuals are fit and proper. MSBs must keep records of the enquiries they carry out and must be prepared to make their policies and procedures, and the evidence of the enquiries they carry out, available to HMRC. HMRC also expects

¹⁰ The June 2017 MSB guidance is available here; <https://www.gov.uk/government/publications/anti-money-laundering-guidance-for-money-service-businesses>

¹¹ Available at : <https://www.gov.uk/topic/business-tax/money-laundering-regulations/latest>

that as part of their controls MSBs will keep records of the responsible persons (officers, managers or beneficial owners) including basic identifying information (full names, home addresses and dates of birth).

3.5 Other changes in 2017

This review does not seek to set out in detail the changes made by MLR2017, but there were significant changes to many features of AML law which took effect from 26 June 2017, including:

- Changes to policies and procedures, risk assessment and training,
- Changes to the reliance rules,
- New rules on PEPs, including domestic PEPs
- New rules on enhanced and simplified due diligence (EDD and SDD)
- New rules on fit and proper testing, which now applies to managers and to MSB agents (see above),
- New requirements for internal controls, and
- New investigation and compliance powers for HMRC.

Other changes were implemented in the new Fund Transfer Regulations (Regulation (EU) 2015/847) which took effect at the same time.

3.6 The 2016 Budget Announcement on data collection

The government is introducing legislation to extend HMRC's existing data-gathering powers to MSBs. This measure will make it more difficult for non-compliant individuals and businesses to exploit cash services offered by MSBs to hide sources of income from HMRC and operate in the hidden economy.

At Budget 2016 the government announced a consultation on the extension of HMRC's data-gathering powers to MSBs. After considering responses to that public consultation, including those from the MSB sector, in December 2016 the Government published draft legislation to extend Schedule 23 to the Finance Act 2011 to MSBs. Following a consultation on the draft legislation, which concluded in February 2017, the Government include this measure in the Finance (No. 2) Act 2017.

Responses to the consultation demonstrated that the data MSBs already hold under their AML obligations should be sufficient to meet the Government's aim of tackling the hidden economy. The measure does not require MSBs to collect any new information. HMRC will only require data that MSBs already collect from their customers, and not on individual transactions, only aggregated data on customers' total transactions.

4 HMRC's Agent Network Compliance Activity in 2014/2015

4.1 Introduction

This agent network compliance activity was prompted by work, including international liaison, which highlighted the potential risks with agent networks.

In addition, the 2017 NRA highlighted that:

- The risk of the MSB industry being exploited by money launderers and terrorists remained significant, while recognising that HMRC was having some success at mitigating this risk through its supervisory activity;
- Criminals are using currency exchange services to convert illicit cash into high denomination notes to facilitate cash smuggling;
- MSBs continue to be identified by law enforcement agencies as a key enabler in cases where criminal funds are transferred overseas;
- Competition among high street agents drives down levels of compliance.
- The overall money laundering risk was judged to be “high” (increased from “medium” in 2015). The terrorist financing risk remains “high”.

The 2014/15 agent network programme was the largest MLR exercise carried out by HMRC and involved 1450 interventions (visits and other significant work with businesses). It was informed by intelligence from UK law enforcement and a European AML supervisor at significant risk from agent non-compliance.

The exercise was comprehensive – the initial programme looked at about two dozen networks which between them comprise over 90% of the money transfer agents operating in the UK. The networks examined accounted overall for about 97% of the premises at which money transmission was available

HMRC worked with the network principals to identify the largest and smallest agents, and sampled from each

These were announced visits – there were no unannounced or surprise visits. Results were disappointing, though some areas of good practice were also found.

The key concerns were about on-boarding processes (how agents were recruited, including the nature and quality of the checks carried out by principals), monitoring by principals, and training of agents. Our findings are detailed in the next two sections.

As a result of the findings from this initial programme, HMRC have continued with similar programmes in other MSB agent networks.

4.2 Why are we identifying good and bad practice?

We hope businesses will take steps to avoid the poor practices we identify and learn from the good practice we highlight, though these positive examples are not the only possible approach

Consistent with the risk-based approach mandated by the international, European and UK requirements, **businesses need to consider the risks that the business is exposed to and respond accordingly**. This includes the risk that poor agents or poor control and monitoring of agents places the principal business themselves at risk of exploitation or regulatory/criminal breaches or failures.

Where businesses face the sorts of issues discussed here they need to think how best they can respond to manage the risk.

While we highlight specific risks here, businesses must consider their own particular circumstances, and respond to the risks they face. Businesses will be exposed to different risks, to different extents.

It will be evident that the analysis in this review focuses heavily on the risks presented by agents, and in particular the risks presented by agents who are either deliberately engaged in money laundering or facilitate it through poor or negligent compliance practices. This analysis reflects what we found in some of the businesses we looked at. It is not a generalised criticism of agents as a whole, or how they do business.

Businesses must keep their risk analysis and response under periodic review. The analysis and response should also be reviewed when there are substantial changes in scale or scope to the business concerned.

5 What we found – Good Practice

We are very pleased to be able to report on the good practice we found. Principals using these practices or similarly effective controls can be more confident about the continuing compliance of their agents.

Principals who are more effective are alert to risks that criminals will seek agency relationships, and can address that risk through a combination of:

- Appropriate policies, procedures and scrutiny when recruiting agents;
- Establishing the anticipated business levels the agent will achieve and monitoring against that;
- Transaction monitoring;
- Requiring agents to apply appropriate scrutiny to transactions;
- Clarity about their expectations;
- Appropriate oversight and monitoring, including audit and testing of the agent;
- Having and applying appropriate checks and sanctions, including suspicious activity reporting and the termination of agency status where there are significant failures by the agent; and
- Following clear procedures when an agency arrangement is terminated.

There is more about good on-boarding and monitoring in chapter 9, “Good principal / agency practice”.

Please read this section in conjunction with section 4.2, “Why are we identifying good and bad practice?”

| What we found | Why we think this represents good practice |
|-------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Principals carrying out physical inspections of agent locations prior to on-boarding. | This allows principals to determine the suitability of the site for providing a retail service, likely levels of customer footfall, geographical corridors that are likely to dominate. All of these factors will inform the principals risk assessment of the agent location, and enable better agent monitoring. |
| Principals controlling access to their systems outside of agents’ trading hours. | This allows principals to be reassured that their systems are only available during legitimate trading hours, and not being exploited or ‘hacked’ out of hours. |
| Principals keeping their records in electronic format. | This made all aspects of both agent and customer monitoring easier. It facilitated sound, informed, risking judgements by principals. |
| Principals carrying out ‘mystery shopping’ and/or unannounced visits to agents and their premises. | This enabled principals to ensure that the agents they had on-boarded were present, that no untrained staff were operating the agency, and that the transaction values recorded related to the cash on the premises. |
| Principals treating as higher risk agents or refusing to have agents who are involved in multiple other networks. | <p>Avoiding agents in multiple relationships allows principals to accurately analyse the credibility of agent / premises / footfall / customer base in relation to expected or actual values and volumes of money transmitted.</p> <p>With agents in multiple network operations, individual network operators cannot establish what value or volume of transactions goes through the agent, which lessens their ability to assess their own level of risk.</p> <p>Multiple relationships may be used for valid commercial reasons (for example where different networks serve different corridors), but in some cases members of multiple networks have used this to break up and hide the true volume and value of money (especially criminal money) passing through the agent to avoid attracting the attention of</p> |

| | |
|------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| | principals or to avoid triggering higher level controls in the principal's network. |
| Principals ensuring that agents operate in a commercially viable context. | Where agents operate in a context where commercial sustainability is difficult to achieve, they may be subject to pressure to ignore the legal requirements. For example, they may be tempted to overlook basic Customer Due Diligence requirements in order to attract illicit customers. |
| Principals entering into arrangements with "master agents" also scrutinised the sub-agents involved. | <p>In a principal – master agent – sub-agent chain a principal enters into an arrangement with one or more master agents; the master agent then has further agency relationships with other sub-agents.</p> <p>In the good practice we have seen principals consider not only the master agent with whom they directly contract but also the sub-agents. This is because the sub-agent is, from a risk perspective, in the same position as a direct or master agent, as the sub-agent will be putting business through the principal's system. And the principal is legally accountable for regulatory compliance by the master agent and the sub-agents.</p> |

6 What we found – Poor Practice

References to “the Regulations” mean the Money Laundering Regulations 2007 (in force at the time of the compliance activity) unless otherwise made clear.

The context for these concerns is that businesses who wish to engage in money laundering may find it attractive to be taken on as an agent of a well-known money transmitter or other MSB. Apart from the specific access this might give them to the principals’ commercial systems and bank accounts, the concern is that the status of agent of a well-known principal creates an impression that the business has been vetted and approved.

Any failure to follow good practice creates ML risks.

There is more about good on-boarding and monitoring in chapter 8, “Good principal / agency practice”.

Please read this section in conjunction with section 4.2, “Why are we identifying good and bad practice?”

| What we found | Why we think this represents bad practice |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p>Issues where the focus is on the conduct of principals.</p> | |
| <p>Principals not carrying out “know your agent” due diligence when on-boarding agents.</p> <p>Principals not monitoring changes of agent ownership or management.</p> | <p>Where principals do not rigorously verify the identity of their agent and scrutinise the agent, the agent business and agent premises, they increase the risks of exposure to criminal infiltration of their agent populations or of unsuitable agents who then attract criminals to use those agencies. This may include agents who lack honesty or integrity or capability, those with relevant criminal convictions, persons lacking business experience, or those lacking adequate understanding of the importance of and understanding of AML and TF issues. Similar considerations arise where the ownership or management of an agent changes. Principals should ask themselves:</p> <ul style="list-style-type: none"> • How to test whether they are satisfied with an agent? • How to record the results of scrutiny? • What to do if an agent is unacceptable? • How to track changes to agent ownership? <p>As explained in section 3.4, new legal requirements took effect from 26 June 2017. Those now legally require MSBs to satisfy themselves that their agents are fit and proper.</p> |
| <p>Principals not ensuring adequate training of staff within the agent’s business.</p> | <p>Training failures potentially engaged MLR2007 Reg.21 – now MLR2017 Reg.24. A principal is responsible for ensuring that his agents are adequately trained within the terms of Regulation 21, and that training is kept up to date. Principals should ask themselves:</p> <ul style="list-style-type: none"> • Have they ensured training is adequate and appropriate, and sufficiently rigorous? • Is training adequately recorded – what training is given when and to who? • Who performs the training? • Can training records be produced and inspected on demand? • Is training tested to see whether it is effective in raising staff understanding and awareness? |

| What we found | Why we think this represents bad practice |
|------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Principals not ensuring that training is kept up to date. | <p>Training failures potentially engage regulatory failures under MLR2007 and MLR2017, as noted above.</p> <p>Training needs to be kept up to date, both in terms of the training materials, and to ensure staff keep abreast of changes and get periodic refresher training.</p> <p>Principals should ensure the training is kept up to date in the light of changes in the agent's operations or staff and in the light of significant legal or policy changes. Staff should receive periodic refresher training, which should be properly recorded and tested.</p> |
| Principals' systems not set up to carry out customer due diligence | <p>Where agents can manipulate or override principals' systems there is a major risk that the legal requirements (for example to carry out customer due diligence) will be ignored. This represents a serious potential failure.</p> <p>Principals should minimise opportunities to manipulate their system. The use of overrides or similar options to get past system restrictions should be recorded, reported and scrutinised by the principal.</p> |
| Principals systems unable to deal adequately with linked transactions. | <p>There is a risk of larger transactions being split into smaller transactions in order to avoid the scrutiny or due diligence required for larger sums.</p> <p>Principals' systems should minimise and as far as possible eliminate such risks. Principals' systems should highlight what appear to be linked transactions that have not been treated as such, and such transactions should be scrutinised by the principal.</p> <p>Principals' systems should be effective across the totality of their business, including across multiple agents (so the system should, for example, capture the situation where the same customer processes multiple transactions through several different agents).</p> |
| Principals' record keeping is not adequate. | <p>Such failures in record keeping potentially engage MLR2007 Reg.19 and MLR2017 Reg.40.</p> <p>Principals may have poor records of their recruitment or subsequent monitoring of agents. They may have poor records of the business being conducted by their agents, making it difficult, for example, to satisfy themselves that an agent is operating in line with parameters established when they were recruited.</p> |
| Principals not adequately monitoring the source of funds where appropriate. | <p>This is a serious failure that potentially engages MLR2007 Reg. 8 and MLR2017 27 and 28.</p> <p>The scrutiny of the source of funds is an important feature of the Regulations. Principals should have systems that identify the source of funds when required, and that prompt the agent to carry out and record the results of enquiries.</p> <p>Scrutiny of the source of funds can be appropriate in the course of the ongoing monitoring of a business relationship, and must be carried out when dealing with a politically exposed person.</p> |
| Principals not effectively monitoring agent's business and trading patterns. | <p>The principal should record the normal business pattern of the agent and monitor whether the business actually done is consistent with that. For example:</p> |

| What we found | Why we think this represents bad practice |
|-----------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| | <p>Are large out of normal trading hours transactions identified and scrutinised?</p> <p>Does the principal seek credible explanations for significant departures from the expected 'norm', carry out investigations or enquiries if needed, and keep appropriate records?</p> |
| <p>Agents who also register as principals under the MLRs but then claim never to trade as a principal</p> | <p>This can demonstrate bad practice – in some cases, agents have registered at the request of a network principal who think this covers their own obligations to verify and scrutinise the agent. Their own lack of scrutiny however leaves them legally exposed for any weaknesses in the actions of the agent using their network.</p> <p>The new requirements on MSBs to satisfy themselves that their agents are fit and proper are set out in section 3.4.</p> <p>In other cases the agent's "principal" registration has, alongside membership of multiple networks been used to camouflage the true value and volume of money passing through the agent.</p> <p>In some cases this risk area involved businesses registering in the UK under the MLRs (and with the FCA under Payment Service legislation) but having all or almost all of their operations, and agents operating in other EU countries. There is some concern that in certain cases, this approach has been taken to make regulatory supervision more difficult for authorities in the member states in which the MSB actually provides services, whilst presenting a picture of negligible trading to UK supervisors.</p> |
| <p>Issues where the focus is on the conduct of agents.</p> | |
| <p>Agents have poor record keeping.</p> | <p>This is potentially a significant regulatory failure by the principal – see MLR2007 Reg.19 and MLR2017 Reg. 40. Poor record keeping can take several forms, including poor records of identity or other checks, and poor associated commercial records.</p> <p>This undermines the agent's AML activities and systems and controls which, in turn, undermines the principal's own AML activities systems and controls. It makes it unlikely that the principal can meet their Regulatory obligations, check that the agent is following the principal's polies and procedures or provide the evidence required to show they are meeting their legal obligations.</p> |
| <p>Agents have a poor knowledge of the systems they operate.</p> | <p>Agents should have a good working knowledge of the system or systems under which they operate. This means they will be able to operate the system correctly and in accordance with the specification laid down by their principal.</p> <p>A poor knowledge of their principal's systems risks undermining their integrity.</p> |
| <p>Agents have difficulty communicating clearly in English.</p> | <p>Knowledge of the languages spoken by customers is clearly helpful to a business, and a knowledge of English is not a legal requirement for employment in an MSB. Nevertheless, a reasonable working knowledge</p> |

| What we found | Why we think this represents bad practice |
|-----------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| | of English is likely to be necessary to understand a business' AML policies and procedures, to understand HMRC's AML guidance, and to complete useful SARs ¹² . |
| Agents exhibit poor IT security, for example by widespread password sharing. | <p>A lack of control or adequate restrictions on access to network systems negates any risk assessment policies or procedures the principal may have, and leaves the network open to exploitation by criminals either directly through employees of the agent or by criminals themselves having usernames and passwords to access the systems and enter transactions. It also increases the risk that untrained/unauthorised staff will process transactions without understanding the ML and TF risk and without carrying out even basis customer risk and due diligence checks.</p> <p>In some cases access codes in agent premises were on printed sheets taped up by the counter, and all employees/temporary staff used the printed codes to enter transactions.</p> |
| Agents exhibit poor understanding of suspicious activity reporting. | Suspicious activity reporting is a central component of the UK's AML regime and of effective behaviour by a supervised business. It is vital that agents, including their staff, understand when and how to make a SAR, and are aware of the risk of sanctions for failure to make a SAR under section 330 of POCA. |
| Agents fail to adequately monitor or address cases where splitting of transactions is taking place. | <p>As previously discussed it is vital that split transactions which, when taken together trigger customer due diligence, are sufficiently well monitored and trigger attention when they occur.</p> <p>In addition to adequate systems being operated by principals, agents need to understand the significance of splitting transactions, whether to avoid network control checks or to camouflage criminal monies, and the increased risk for the agent and principal of Regulatory or other legal sanctions for bypassing necessary controls, and when and how to make a SAR.</p> <p>There is also a risk that a lack of understanding will lead to repeated suspicious transactions going through the agent, increasing the exposure of agent and principal to criminal sanctions under POCA or the Terrorism Act.</p> |
| Agents' records are so poor that transactions are missing. | As well as being potential Regulatory offences, these poor practices suggest significant disregard for compliance, and suggest that missing records may conceal irregular transactions. This leaves the principal at risk, as they cannot see or check whether the transactions are real, or involve ML or TF. In some criminal ML cases, "missing transactions" or missing paperwork on transactions have been indicative of large volumes of criminal monies going through an agent but the manufacture of fake transactions/paperwork has not kept pace. |
| The business operates from a residential address or premises used for non-commercial activities. | Principals should carry out basic due diligence on an agent's operations, for example to verify that the claimed business premises actually exist and are tied to the agent, as well as testing the credibility of the premises and location such as the use of unusual non-commercial (nonretail) premises. Trading from un-branded premises, such as a private home, where the money transmission business is not advertised or acknowledged is inherently questionable. |
| Principals are not aware of higher risks where a high number of agents operate in a | Principals should be aware of where their agents are active, and the context in which they operate, so that they are aware of when agents operate in very close proximity to other MSB principals or agents. There |

¹² Suspicious Activity Reports – made to the National Crime Agency.

| What we found | Why we think this represents bad practice |
|------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p>small geographic area (high agent density)</p> | <p>may be commercial factors – such as significant concentrations of customers – that underpin a concentration of businesses in a limited area. But situations that appear to lack commercial logic or justification are suspicious.</p> <p>Where there is little to suggest a high concentration of money transmission customers in a location, but there are a significant number of transmission network agents in close proximity, there is a higher risk of ML or TF funds being involved rather than genuine customer transactions. Either because (like agents in multiple network relationships) it is easier for criminals to split money across multiple agents and networks to camouflage the true scale of the money being moved, or with complicit agents, to manufacture higher volumes of fake transactions to camouflage criminal money volumes.</p> <p>There is also a risk that with such high density there is more competition amongst agents, and increased temptation to reduce ML and TF checks to prevent loss of custom to other agents. AML checks then decrease across the group.</p> <p>During our compliance activity the premises involved did not always appear to have been chosen with commercial factors (such as access to the intended customer base) in mind. Despite the apparent lack of customer footfall, businesses appeared able to achieve substantial throughputs.</p> |
| <p>Agents enter into relationships with multiple principals.</p> | <p>There may be a degree of genuine commercial logic for an agent to represent more than one principal, for example where principals specialise in particular geographic markets. But avoiding agents in multiple relationships allows principals to accurately analyse the credibility of agent/premises/footfall/customer base in relation to expected or actual values and volumes of money transmitted. With agents in multiple network operations, individual network operators cannot establish what value or volume of transactions goes through the agent and so lessens their ability to assess their own level of risk. Multiple relationships may be used for valid commercial reasons (for example where different networks serve different corridors), but in some cases members of multiple networks have used this to break up and hide the true volume and value of money (especially criminal money) passing through the agent to avoid attracting the attention of principals or to avoid triggering higher level controls in the principal’s network.</p> <p>Principals should consider whether to require agents to disclose all the agency relationships they have entered into, and whether to require material changes in their relationships to be notified.</p> |

7 What businesses should do.

This section summarises the steps principals and agents should take to minimise their exposure to ML risks.

7.1 Understand the law - and HMRC's guidance.

Agents and principals should have an adequate working knowledge of the Money Laundering Regulations and Wire Transfer Regulations in force.

Agents and principals should be alert to the changes in both these measures, which took effect on 26 June 2017. Agents and principals should also comply with other changes in guidance promulgated by HMRC.

Principals and agents should be clear about their respective roles and responsibilities, which should be contained in a written contract.

Principals should be alert to significant changes in their agents' businesses, and any significant expansion of their own business, for example through growing volumes of business or the recruitment of more agents. Where a business undergoes significant growth are there adequate compliance resources, in terms of people and systems, policies and procedures?

Principals carry accountability for MLR compliance by their agents.

7.2 Follow the HMRC guidance

Agents and principals should have an adequate working knowledge of the guidance for MSBs produced by HMRC. They should apply the guidance to their particular business, mindful of the risks to which it is exposed.

7.3 Apply a risk-based approach

Both principals and agents need to operate using the risk-based approach. This is clearly a statutory requirement for both parties in terms of managing their AML risks. A principal should also apply a risk-based approach when it manages its relationship with its agents.

Principals need to have a genuine and robust assessment of customer and agent risks in relation to ML and TF, and then apply controls to meet or mitigate those risks. Principals need to ensure agents and employees of agents also understand those risks and why the policies and procedures required of agents by the principal are necessary.

7.4 Use consultants intelligently.

Many businesses find outside help is useful in bringing an additional perspective and challenge to their AML compliance, though they cannot sub-contract their legal liability to comply with the regulations.

Similarly a policy provided by a consultant, or a generic policy sourced from the internet, can give the appearance of compliance. But serious compliance means that a business actually understands and thinks seriously and critically about its risk exposure and its response to those risks.

8 Good principal / agency practice

HMRC assumes that agents and principals will comply with the wider law on agency, and act in accordance with their agreements between each other. Principals with agents must also comply with the new requirements in MLR2017, which are explained in section 3.4.

HMRC has taken a range of steps to strengthen its support for MSB principals. In 2017, for example, HMRC published updated guidance for MSBs. That guidance sets out the legal requirements on businesses (things businesses must do) and recommends good practice (things businesses should do).

This supplementary guidance builds on that material. In particular, Chapter 9 of the 2017 MSB guidance dealt with principal-agent relationships and set out requirements or expectations on;

- Appointing and managing an agent
- Steps to take before and after appointing an agent
- Dealing with foreign currencies.

This guidance sets out in greater detail what HMRC encourages principals to do at key stages in their relationship with an agent. Each principal should apply this guidance in respect of each agent. This means that where an agent has relationships with two or more principals each principal should separately carry out these requirements, and not rely on another principal to have conducted necessary checks.

While this guidance focuses on the role of the principal we encourage agents to address these issues, and principals to take measures to respond to them, positively and cooperatively.

A principal is liable for and accountable under the Regulations for agent failures to meet MLR obligations on their behalf.

The following material constitutes a series of recommendations from HMRC to MSB principals. These are not legal requirements, but principals should be able to show how they apply these controls or similar relevant controls in order to meet their Regulatory obligations. However HMRC will expect principals to have arrangements in place to deliver appropriate good practice in terms of appointing and managing agents and to reduce and eliminate poor practice.

Businesses may deliver the required outcomes by adapting this material to their particular business circumstances, or deliver comparable outcomes by other means.

From 26 June 2017 it became a legal requirement that an MSB must satisfy itself that its agents would pass the statutory fit and proper test.

8.1 Agent “on boarding” – selecting and appointing an agent.

A principal must, from 26 June 2017:

- Undertake checks to satisfy itself that an agent would pass the statutory fit and proper test, having regard to:
 - o The honesty, integrity and reputation of the beneficial owner and managers of the agent;
 - o The competence and capability of the owners and managers, and
 - o Their financial soundness.
 - o Keep such assessments up to date by periodically checking the assessments remain valid;and
- o Undertake new checks where the owners, officers or managers of an agent change.

A principal should:

- Determine how many relationships the agent has with other principals. A principal should recognise that the levels of legitimate money transmission are finite in a geographical location, and that by being in multiple principal relationships there is a risk that the commercial sustainability of the business is undermined as throughput and profit are diluted;
- Visit agent premises from which the business is to be conducted, establishing their suitability for the provision of a retail financial service, verifying that it is owned or able to be used by the agent, and checking that there is adequate footfall to support anticipated levels of trade;
- Generally satisfy itself that the proposed business appears commercially sound and sustainable having regard, for example, to the nature of any other businesses to be conducted from the premises; and
- Obtain a photographic record of the owner and manager of the agent, relevant staff and the business premises. (This is to enable the principal's training and supervisory activities, mystery shopping etc., so that people undertaking such activities know exactly where the service should be supplied and by whom.)

8.2 Agent Monitoring

From 26 June 2017 principals are required to have policies, controls and procedures to assess whether its agents would pass the statutory fit and proper test.

A principal should:

- Adopt and apply a written policy to risk assess potential agents;
- Document the assessment of each agent risk;
- Have such equipment, software, reporting, and appropriately trained staff as are needed to effectively monitor their agents, and make sufficient time available to those staff, having regard to the risks involved;
- Establish expected levels of transactions for each agent;
- Establish the main geographical corridors served and understand the likely variations in business levels due to religious festivals, holidays, and other seasonal factors;
- React promptly to any significant fluctuation in expected activity, and obtain and record reasonable explanations for them;
- Allocate sufficient resources to agent monitoring, and keep those resources under review when, for example, there is significant growth in their agency network (the number of agents, locations served, business volumes, etc); and
- Ensure there is sufficient protection against conflicts of interest such as agent monitoring staff being independent of local/regional agent sales/recruitment teams

8.3 Agent Training

A principal must comply with the full legal requirements in the MLRs in relation to training.

A principal should:

- Train agents and all their staff who access the principal's systems, assessing agents and staff to ensure that training messages have been understood and applied to an appropriate standard;
- Ensure that all agents are familiar with their obligations under the MLRs and other anti-money laundering legislation such as POCA, and that they understand how and when reports must be made to the NCA. This assurance is to be obtained by the provision of training and the assessment of staff to ensure that they have reached an appropriate standard;
- Ensure that nobody has unsupervised access to a principal's system unless they have received training and reached an appropriate standard;
- Periodically update and refresh the training; and
- Record training and ensure training materials are available at agent premises for reference.

An 'appropriate standard' of training does not mean a standard of legal or technical expertise is obtained. It does mean that staff should have (or be taking part in training to acquire) sufficient practical familiarity with the risks and threats of money laundering, and UK money laundering law and practice, so as to be able to identify and deal properly with attempted money laundering.

8.4 System and IT security

A principal should:

- Operate a system to ensure that exclusive passwords are issued to and used by each agent and relevant staff on an individual basis.
- Ensure that access to network systems is only allowed during opening hours agreed with the principal.
- This means, for example, that:
 - good IT security policies and procedures are adopted and followed;
 - passwords are regularly changed;
 - passwords are not written down where they may be seen or accessed by other users;
 - passwords cannot be shared amongst staff;
 - users lock access to their machines in the event of significant absences, and systems time-out users after periods of inactivity;
 - passwords should be controlled to ensure that they are not easily guessed, or duplicated;
 - multiple logins are not possible for a single person; and
 - IP addresses used to access their system are monitored to identify and prevent remote access and cloning of agent accounts.

8.5 Policy and procedures

A principal must comply with the full legal requirements in the MLRs in relation to policies and procedures.

A principal should:

- Make a copy of their current AML policies and procedures, including all policies covering issues discussed in this guidance, make these available to HMRC and notify HMRC of any amendments made; and
- Understand what policies and procedures are applied by their agents. If the principal provides policies and procedures and requires an agent to use them, the principal must also provide them to HMRC.

8.6 Documenting the relationship

A principal must comply with the full legal requirements in the MLRs in relation to record keeping.

A principal should:

- Keep sufficient written records, copies of contracts, correspondence, etc., to document his relationship with each current and past agent;
- Adopt an appropriate document retention policy in respect of the relationship with each agent; and
- Have sufficient records to demonstrate compliance with this guidance.

8.7 Keeping information up to date and notifying HMRC of changes etc.

A principal must comply with the full legal requirements in the MLRs.

A principal should:

- Ensure that the information, records, assessments, etc. held in respect of each agent are kept up to date;
- Ensure that the information provided to HMRC under this guidance is kept up to date;
- Ensure arrangements are in place with each agent to allow the principal to comply with their legal obligations to notify HMRC of material changes or significant inaccuracies in a timely way. This means that agents must notify their principal of such matters in a timely way.

8.8 Audit and compliance

A principal should:

- Consider whether it is appropriate to carry out a selective audit of an agent's compliance with the requirements placed upon them. The selection of agents is to be primarily risk based – that is to say at least half of the agents should be selected by the application of criteria designed to address the highest risk agents;
- Consider whether it is appropriate to carry out an independent internal audit within the business of the principal to assess the extent of his compliance and that of his agents with this guidance. HMRC encourages businesses to have internal independent review of the risk assessment of ML and TF;
- Make copies of such audit or review reports available to HMRC; and
- Take appropriate steps to address non-compliance with their requirements by their agents, having regard to the extent, seriousness and impact of that non-compliance. Promptly report such steps and the circumstances that gave rise to them to HMRC.

8.9 Ending a relationship

A principal must comply with the legal obligations to make a Suspicious Activity Report (SAR) where a relationship with an agent is ended because of suspicions that the agent is involved in money laundering or other criminality.

When a business relationship with an agent ends the principal should:

- Immediately report that change, with a brief explanation, to HMRC;
- Secure and remove records of business conducted via the agent; and
- Promptly remove any unused stationery, exterior or interior signage, etc. that bears the name or logo of the principal or otherwise suggests the agent has a relationship with the principal.

9 ANNEX 1 Size of the MSB and MT sectors.

9.1 Table 1

This table shows numbers of principal MSB and money transmission (MT) registrations and numbers of premises at which MSB and MT services are available from principals or agents. Breakdown of data not available prior to 2013.

| | Apr-10 | Apr-11 | Apr-12 | Apr-13 | Apr-14 | Apr-15 | Apr-16 | Apr-17 |
|--------------|--------|--------|--------|--------|--------|--------|--------|--------|
| MSB Reg | 3585 | 3628 | 3658 | 3365 | 2686 | 2295 | 2112 | 1946 |
| MT Reg | | | | 2344 | 1457 | 1185 | 1096 | 1036 |
| MSB Premises | 42738 | 44351 | 46922 | 48516 | 47176 | 45442 | 45376 | 44962 |
| MT Premises | | | | 31660 | 29012 | 27893 | 28298 | 29121 |
| | | | | | | | | |

