

Transposition of the Fifth Anti-Money Laundering Directive

HM Treasury

RPC rating: fit for purpose

The impact assessment (IA) is now fit for purpose as a result of the department's response to the RPC's initial review. As first submitted, the IA was not fit for purpose.

Description of Proposal

The department identifies a significant threat of money laundering in the UK due to the size of the UK's financial and professional services sector and the openness of the British economy. The department explains that money laundering in the UK includes the illicit proceeds of a range of serious crimes including large scale drug dealing and human trafficking. The department therefore suggests that tackling financial activity and making use of financial intelligence would be a valuable tool for law enforcement's defence against terrorism.

The Government's objective is to make the UK's financial system difficult to exploit for illicit finance purposes while minimising the burden on legitimate businesses. The aim is to deter crime and terrorism by making it more difficult for criminals to benefit from the proceeds of their crime and easier to detect and investigate criminal or terrorist abuse of the financial system. The amendments in the Fifth EU Money Laundering Directive (referred to herein as 5MLD or the EU Directive) need to be transposed into domestic legislation by January 2020 to meet the UK's legal obligations to the EU.

The IA covers implementing the minimum requirements needed to comply with the EU Directive, and extending certain aspects of 5MLD through implementing measures that go beyond EU minimum requirements and implementing other changes not included in the EU Directive.

The department considers three options, outlined below:

- Option 0 of do-nothing - the department acknowledges that this would breach the UK's legal obligation to transpose the EU Directive and would not meet Financial Action Task Force (FATF) standards;
- Option 1 of transposing the EU Directive as required and making technical amendments (the "4MLD technical amendments") to clarify certain requirements under the UK Money Laundering Regulations (MLRs) which were implemented pursuant to the 4th EU Money Laundering Directive (4MLD) – as outlined in the IA, this would meet the UK's legal obligation to transpose. Option 1 will bring in new businesses into the scope of the MLRs and will further regulate existing businesses, within the EU Directive and EU regulations; and

- Option 2 of transposing the EU Directive as required, making the 4MLD technical amendments and going beyond the minimum EU requirements to amend the MLRs in a number of areas. As outlined in the IA, in addition to meeting its legal obligation of transposing the EU Directive, this option would ensure that the UK meets its legal recommendations from the 2018 FATF mutual evaluation report (MER) on the UK. Option 2 will bring in new businesses into scope and will further regulate existing businesses to fill in gaps identified in the MER and other gaps identified in the supervision regime.

Option 2 is the department's preferred option. The department intends to make amendments relating to eight measures, some of which only transpose the EU Directive and the rest of which will go beyond the EU minimum requirements.

Impacts of Proposal

1. New Obligated Entities

Under this measure, the department discusses amendments to expand the categories of obliged entities (i.e. entities required to comply with the MLRs), including tax advisers, letting agents, art market participants and firms providing exchange services for cryptoassets, cryptoasset ATMs, peer-to-peer exchange facilities and initial coin offerings (collectively, “cryptoasset businesses”).

- a) Expanding definition of a tax adviser - 5MLD expands the scope of obliged entities. This change is intended as a technical amendment to prevent avoidance of regulations by relevant persons that should already be regulated. The department does not anticipate any costs to business. The department intends to only transpose the EU Directive for this type of obliged entity.
- b) Letting agents - The department intends to bring estate agents, including letting agents into scope for transactions for which the monthly rent amounts to EUR 10,000 or more. As outlined in the IA, the department estimates 150 letting agents will be in scope. The department estimates one-off transition costs to be between £260,000 and £411,450 and estimates ongoing annual staff training costs to be between £2.5 million and £3.4 million. The department intends to only transpose the EU Directive for this type of obliged entity.
- c) Art market participants - The department intends to bring art market participants into scope for transactions exceeding EUR 10,000, regardless of whether transactions are carried out in cash. As outlined in the IA, the department estimates 2000 art market participants will be in scope. The

department estimates one-off familiarisation costs to be between £3.2 million and £5.2 million and ongoing annual staff training costs to be between £1.9 million and £2.9 million. The department intends to only transpose the EU Directive for this type of obliged entity.

- d) Cryptoassets - The department intends to go beyond the EU minimum requirements for this type of obliged entity. The department explains its intention to bring cryptoasset businesses into the scope of regulations. The department intends to extend the scope of cryptoasset businesses covered by the regulations to crypto-to-crypto exchange services providers, cryptoasset ATMs, peer-to-peer exchange facilities and initial coin offerings which are not covered by the EU Directive and EU regulations. The department estimates that there will be transition costs to cryptoasset businesses from training staff and hiring compliance specialists.

As outlined in the IA, for businesses carrying on activities for which the EU Directive will only be transposed, 15 cryptoasset businesses will be in scope. The department estimates transition costs to be between £1.6 million and £6.6 million and annual compliance costs to be £2.9 million.

As outlined in the IA, for businesses carrying on the activities for which the department intends to go beyond the EU minimum requirements, between 65 and 85 additional cryptoasset businesses will be in scope. The department estimates transition costs to be between £7.1 million and £37.2 million and annual compliance costs to be between £12.7 million and £16.6 million.

2. Electronic Money

The department intends to only transpose the EU Directive for this measure. The department plans to reduce the threshold for which Customer Due Diligence (CDD) measures will be applied to e-money products. The department estimates additional costs to businesses may arise from extending the number of customers on which e-money businesses are required to conduct checks. This cost has not been monetised.

3. CDD

The department intends to only transpose the EU Directive for the below amendments.

- a. Electronic information – The IA sets out the circumstances under which secure, remote or electronic identification processes may be considered when undertaking CDD. The department does not anticipate any costs to business.

- b. Identifying senior managing official – 5MLD extends CDD requirements for obliged entities to verify the identity of a senior managing official when the customer is a body corporate and the beneficial owner cannot be identified. This cost has not been monetised.

4. Beneficial Ownership Requirements

The department intends to only transpose the EU Directive for this measure. As mentioned in the IA, 5MLD requires that whenever an obliged entity enters a new business relationship with a company and verifies its identity, the obliged entity must collect either: a proof of registration on this register or an excerpt of the register. The cost of customer due diligence to obliged entities has not been monetised.

5. Enhanced Due Diligence (EDD)

The department intends to go beyond the EU minimum requirements for this measure. As mentioned in the IA, 5MLD expands the scope of persons whom obliged entities must conduct EDD on business relationships or transactions involving high-risk third countries identified by the EU Commission and requires obliged entities to carry out enhanced monitoring of such transactions. As outlined in the IA, approximately 2000 businesses are estimated to have a customer base of between 1.3 and 12.2 million people. The department estimates one-off transition costs to be between £5.9 million and £367.3 million. The department also explains that there may be ongoing costs which it was unable to monetise, but has explained that it will attempt to gather more data when it conducts its review of the MLRs.

6. National Register of Bank Account Ownership

The department intends to go beyond the EU minimum requirements for this measure. As mentioned in the IA, 5MLD requires that the UK establish a centralised automated mechanism, which allows identification of natural and legal persons which hold or control bank accounts, payment accounts or safe-deposits held by credit institutions within the UK.

As outlined in the IA, for businesses carrying on the activities for which the EU Directive will only be transposed, between 420 and 435 businesses will be in scope. The department estimates transition costs to be between £129.4 million and £1,731 million and annual costs to be between £8.8 million and £96.8 million.

As outlined in the IA, for businesses carrying on the activities for which the department intends to go beyond the EU minimum requirements, between 65 and 85 businesses will be in scope. The department estimates transition costs to be

between £20 million and £314.7 million and annual costs to be between £1.4 million and £17.8 million.

7. Requirement to publish an annual report

The department intends to only transpose the EU Directive for this measure. As outlined in the IA, 5MLD requires self-regulatory bodies to publish an annual report including information on their supervisory activity. 22 businesses are estimated to be in scope. The department estimates annual costs of publishing the annual report to be between £29,612 and £44,423.

8. Additional technical amendments to the MLRs

Under this measure, the department discusses additional technical amendments to MLRs: the requirement to be registered, complex network structures, criminality checks, new technologies and group policies.

- a. Requirement to be registered - The department intends to go beyond EU minimum requirements by amending regulation 56 of the MLRs so that Money Service Businesses (MSBs) and Trust or Company Service Providers (TCSPs) can only practice legally once their application has been determined. As outlined in the IA, 318 MSBs and 98 TCSPs will be in scope. The department estimates the total opportunity cost to MSBs and TCSPs of waiting for their application to be processed will be between £7.1 million and £46.1 million.
- b. Complex network structures - The department intends to only transpose the EU Directive by amending regulation 24 of the MLRs to require agents to be made aware of their obligation to train employees. This cost has not been monetised.
- c. Criminality checks - The department intends to only transpose the EU Directive by amending regulation 26 of the MLRs to clarify that self-regulated bodies should conduct criminality checks or have sufficient information in their possession to determine whether or not a beneficial owner or manager applying for approval in a relevant sector has had a criminal conviction. The department has provided an overall scale of the annual costs to business but has not provided an estimate of the total cost.
- d. New technologies - The department intends to go beyond EU minimum requirements by amending MLRs to make it explicit that financial institutions are required to undertake risk assessments prior to the launch or use of new products, new business practices and delivery mechanisms. The department does not anticipate any additional costs to business.

- e. Group policies - The department intends to go beyond EU minimum requirements by amending MLRs to meet FATF Recommendation 18.2(b) which states that financial groups should be required to implement group-wide programmes against money laundering and terrorist financing. As outlined in the IA, 167 businesses will be in scope. The department estimates transition costs of updating and implementing their group policies to be between £13.4 million and £53.5 million.

Quality of submission

The department's assessment of the overall impacts of the proposals, including the impacts on business, is now fit for purpose. The department explains that exempting small and micro businesses (SMBs) from the regulation or providing mitigating measures for SMBs would not achieve the policy objective as these businesses may be at risk from money laundering. The RPC considers the department's SaMBA to be sufficient. The department has conducted sensitivity analysis to account for the wide range of estimated costs which the RPC considers proportionate. There are, however, several areas of the IA which the department should consider improving.

Issues addressed following RPC's initial review

As initially submitted, the IA contained several issues that meant the RPC did not consider it fit for purpose. The initial review notice also highlighted further areas for improvement. In response, the department has revised the IA. As originally submitted, the assessment was not fit for purpose for the following reasons:

1. **Second EANDCB required:** In its original IA, the department described nine amendments it intends to implement and explained out of these nine amendments, its intention to implement minimum EU measures for five amendments and to go beyond the minimum EU requirements for the rest of the amendments. The department initially submitted only one EANDCB. The RPC advised the department to submit two EANDCBs; one which relates to the measures where the department intends to implement minimum EU requirements and a second one covering the measures where it intends to go beyond EU minimum requirements. The department has now submitted the required two EANDCBs in its revised IA. It has also reduced the number of areas to which amendments are being made from nine to eight.
2. **Small and Micro Business Assessment (SaMBA):** In its original IA, the department provided insufficient evidence for the elements which go beyond EU minimum requirements and how these elements will impact on SMBs. The department has now provided further details of the impacts and has explained

why it is unable to exempt SMBs or provide mitigating measures for them. The RPC notes that while the SaMBA is now sufficient, the department could further improve its assessment by obtaining a more robust estimate of number of SMBs that will be affected.

- 3. Unmonetised Costs:** In the original IA, there were several areas where the department did not monetise the costs for respective amendments. The RPC is pleased to see that the department has now provided estimates for the following sections; transition costs for the cryptoassets businesses measure, number of firms affected within the electronic money measure, trust registration service costs in the EDD measure, number of firms impacted within the national register of bank account ownership measure, costs to business within the requirements to be registered measure and costs to business within the group policies measure. In the initial review notice for the original IA, the RPC also advised the department to monetise the unmonetised costs within the beneficial ownership requirements measure; the department has explained why it is unable to monetise this cost. The RPC recommends that the department should still attempt to estimate this cost to improve its assessment.
- 4. Unmonetised Benefits:** In the original IA, the department did not monetise benefits and did not provide clarity as to which benefits directly impacted businesses and which were indirect. The RPC advised the department to monetise the benefits that directly impacted businesses or to provide justifications for not being able to quantify them. The department has now clarified in its revised IA that all benefits are indirect and therefore has not monetised them. Although the failure to quantify indirect benefits does not impact the EANDCB, the RPC still recommends that the department should provide an estimate of indirect benefits.
- 5. Unjustified Assumptions:** There were several unjustified assumptions in the department's original IA which the department has now addressed by providing further justifications, these were:

 - the department's estimated number of cryptoasset businesses and the baseline transition costs that did not include other cryptoasset businesses within the scope of the proposed changes;
 - the department assumed firms and sole practitioners will need between 1 and 3 hours to make a Disclosure and Barring Service (DBS) application and self-regulatory supervisory bodies would need an additional hour to process a DBS check;
 - the department estimated that expansion of the EU Directive to cover cryptoasset businesses would affect between 2000 and 4000 previously unregulated businesses;

- the department estimated transition costs and ongoing staff training costs to letting agents without any evidence to support its estimate;
- the department estimated transition unit costs to businesses from updating and implementing their group policies without any evidence to support its estimate – the department has referenced its source for this information; however, the RPC suggests that the department expand on the evidence supporting this estimate; and
- the department provided estimates of number of businesses that will be impacted without providing evidence to support these figures, for example, the department estimated that between 5 and 20 businesses will bear the transition costs of implementing and updating their group policies and that 150 letting agents would be affected.

6. Missing Costs: In its original IA, the department did not provide a reason for considering compliance costs for cryptoasset businesses as an indirect cost to business. The RPC advised the department that it would expect to see this cost treated as direct and that the department should include it in the EANDCB or provide further justifications for excluding this cost from the EANDCB. The department has now included this as a direct cost in both of its EANDCB calculations. The RPC considers this treatment to be correct, but recommends that the department should be clearer in the revised IA that it has considered these compliance costs to be direct costs.

Other areas addressed in the final IA

Several other areas for improvement in the original IA were noted in our initial review. The RPC is pleased to see the department has now addressed these points, and considers the department's approach to be proportionate:

- representation of options:* the RPC suggested that the department provide a table that describes the costs of each of the amendments and a summary table that explains which sections of the eight amendments are part of each of the two EANDCBs;
- reference to IA on 4MLD and consultation:* the RPC advised that the department provide further detail on responses gathered at consultation stage and discuss how 5MLD builds upon its previous impact assessment;
- sensitivity analysis:* the RPC advised the department to use sensitivity analysis for transition costs related to regulation of cryptoasset businesses and transition costs of businesses updating and implementing group policies as the department explained that the likely costs are expected to be higher than the department's estimates;

- d. *rationale for extending EU requirements*: for the amendments where the department decided to go beyond the EU minimum requirements, the RPC advised the department to provide further detail to justify its decision; and
- e. *further unjustified assumptions*: the RPC advised the department to provide further supporting evidence within the cryptoassets section, where the department did not provide sufficient justifications to support its statement that its approach to going beyond the EU minimum requirements for cryptoasset businesses will be replicated worldwide or that 15 exchanges would not be adversely impacted by going beyond the EU minimum requirements.

Areas for improvement

While the department has addressed the points identified in the original review, the IA would be strengthened by further development of the following points identified as areas for improvement:

- 1. Evidence to Support Assumptions:** The department has made several assumptions for which it should provide further supporting evidence or explain why it is unable to obtain that information:
 - a. in the initial IA, the department did not provide any evidence to support its estimate of transition start-up costs to letting agents. Although the department has referenced this estimate, it should provide further evidence to justify this assumption; and
 - b. in the original IA, the department did not provide any evidence to support its estimate of transition start-up costs to art market participants. Although the department has now referenced this estimate, it should provide further evidence to justify this assumption.
- 2. Estimating Costs:** In the following sections, the department has not monetised costs, as the department states costs were either minimal or data was not available from consultation responses. The RPC recommends that the department should further evidence these costs:
 - a. costs to businesses for the electronic money measure;
 - b. costs in the identifying senior managing official section, within the CDD measure; and
 - c. costs in the complex network structures section, within the additional technical amendments to the MLRs measure.
- 3. Monitoring and Evaluation (M&E) plans:** The RPC advised the department that they should provide an M&E plan for its PIR. Although the department has explained that it will review the policy in 2025, the RPC advises that the department make it clearer in their IA, their commitment to conducting a PIR.

4. Clarity in Option Descriptions: The RPC advised the department to provide further clarity on the reason behind implementing different options for different amendments. Although the department has provided a summary page for both options, the RPC recommends that the department also explain, for each of the respective amendments, which option it intends to implement. In addition, on the summary pages, the department has amended the description for its preferred option and has changed the description for its preferred option's monetised costs, with no justification to support this change. The department should provide further clarity to justify this change. For the summary page of option 1, the department has explained that the non-monetised benefits for option 1 will be different to the department's preferred option. Given that the department's preferred option is going beyond the minimum EU requirements to meet international FATF standards, the RPC would advise that the department provide further clarity to justify the reason behind option 1's non-monetised benefits being different to the department's preferred option.

Departmental assessment

Classification	Qualifying regulatory provision (IN)
Equivalent annual net cost to business (EANDCB)	£237.7million (initial estimate) – qualifying £78.2 million (final estimate) – qualifying £174.4 million (final estimate) – non-qualifying
Business net present value	- £673.5 million
Overall net present value	- £673.5 million

RPC assessment

Classification	Under the framework rules for the 2017-19 parliament, qualifying regulatory provision (IN) To be determined once the framework rules for the current parliament are set
EANDCB for non-qualifying regulatory provision (implementation of minimum EU requirements)	£174.4 million - subject to validation once the framework rules for the current parliament are set
EANDCB for qualifying regulatory provision (implementation of additional amendments in addition to minimum EU requirements)	£78.2 million – subject to validation once the framework rules for the current parliament are set

Small and micro business assessment	Sufficient
Business impact target score	£391.0 million – subject to validation once the framework rules for the current parliament are set
RPC rating (of initial submission)	Not Fit for Purpose

Regulatory Policy Committee

One Committee Member did not participate in the scrutiny of this case to avoid a potential conflict of interest.