



Research report

Understanding the businesses that HMRC supervise under the Money Laundering Regulations.

Staff and stakeholder consultations, primary customer research and using insight to improve performance.

Understanding the businesses that HMRC supervise in respect of the Money Laundering Regulations
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Research requirement and Context (background to the project)

Context

HMRC is one of 28 supervisors under the Money Laundering Regulations. These regulations place obligations on relevant businesses to have risk-based systems and policies in place to prevent the business from being used for money laundering and terrorist financing. HMRC's Money Laundering Regulations Team (MLR Team) commissioned this research to collect in-depth analysis of customer attitudes and behaviours and to review stakeholders' perceptions of the effectiveness of HMRC's MLR supervision. This insight was then to be used to devise a customer-centric approach to supervision, in line with HMRC's wider strategy.

Research requirement

The overall objective of this project was to help HMRC's MLR team to:

- make decisions about how to develop a customer-centric strategy to improve its effectiveness as a supervisor
- identify and address any stakeholder concerns
- determine how best to maximise compliance at the lowest possible cost to HMRC and the customer.

This project was commissioned to improve understanding of the businesses HMRC supervises. By producing customer segmentation, the MLR team could introduce a differentiated approach to its customers. This would help maximise the effectiveness of their supervision in the most efficient and effective way.

Who did the work (research agency)

The research was conducted by Quadrangle.

When the research took place

Phase 1 took place between January 2011 and March 2011; Phase 2 between February and April 2011; Phase 3 between March and August 2011; and Phase 4 between November 2011 and March 2012.

Method, Data and Tools used, Sample

Phases 1 and 2 were designed as a scoping stage for HMRC, supervisors and customers to review evidence and explore the context and objectives outlined above with external customers. This provided the MLR Team with fuller understanding of customer and stakeholder perceptions that could be addressed by using the outcomes of Phases 3 and 4.

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Phases 1 and 2 were also helpful in understanding how the regulations were working in practice and potential areas of difficulty.

Phase 3 was an extensive quantitative analysis of customers to enable the MLR Team to develop a customer-centric approach.

Phase 4 was designed to:

- use staff knowledge and experience (supported by research agency expertise) to exploit the findings from the first three phases
- produce an outline change plan to be implemented over a realistic timeframe
- enable HMRC to introduce a differentiated customer-centric approach to MLR supervision
- develop improved systems and processes to enhance performance.

Details of each phase are given below:

1. **Phase 1** involved scoping and exploring how HMRC and other supervisors manage compliance in the customer groups for which they are responsible. It included:
 - Desk research
 - HMRC MLR team stakeholder consultations and workshops
 - HMRC MLR team staff workshops
 - Review of the approaches taken by other supervisors e.g. the Financial Services Authority and professional bodies.
2. **Phase 2** comprised qualitative research with customers, including:
 - 38 in-depth interviews with MLR-registered businesses from all HMRC's customer sectors:
 - 19 Money Service Businesses (MSB) – covering Money Transfer, Cheque Cashing and Currency Exchange activities
 - 7 High Value Dealers (HVD)
 - 6 Accountancy Service Providers (ASP)
 - 6 Trust or Company Service Providers (TCSP).
 - 13 in-depth interviews with MLR-registered Money Service Business premises:
 - covering Money Transfer, Cheque Cashing and Currency Exchange activities

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The fieldwork details for MLR-registered businesses or premises were as follows:

- 45-60 minutes each, by face-to-face or telephone
 - undertaken with the person responsible for ensuring that the business was MLR-registered and that the business was compliant with the regulations
 - covered a range of business sizes
 - regional coverage: London, Manchester, Leeds, Nottingham
 - sampled from HMRC's register of supervised businesses
- 15 in-depth interviews were also conducted with Money Service Business customers as end users, covering Money Transfer, Cheque Cashing and Currency Exchange activities. Each interview lasted 30-45 minutes and was conducted face-to-face or by telephone, with regional coverage of London and the South East.
3. **Phase 3** comprised customer profiling and modeling based on quantitative research, leading to a segmentation of registered businesses and premises. The details of this extensive quantitative research are summarised below.
- 1,694 computer-assisted telephone interviews (CATI) with MLR-registered businesses across all four of MLR's business sectors;
 - 565 face-to-face interviews with Money Service Business registered premises:
 - 25 minute questionnaire
 - with the person responsible for ensuring that the business was MLR registered and compliant with the regulations
 - national coverage sampled from HMRC's register of supervised businesses

The survey was undertaken using a sample from HMRC's MLR register, which only comprised businesses registered at that time. This sample did not represent the potentially wider population that would include any unregistered businesses. As there was no reliable view of how many in-scope businesses were not registered, the data cannot be weighted to be fully representative of the total population. Hence only un-weighted data is presented, where the sample average is the best available view of the population.

Figure 1 below details the sample achieved across the four business sectors, namely:

- Accountancy Service Providers (ASPs)
- High Value Dealers (HVDs)
- Trust or Company Service Providers (TCSPs)
- Money Service Businesses (MSBs)

It also shows the services the various MSB sub-sectors offer to customers, i.e.:

- Money transmitting
- Currency exchange
- Cheque cashing

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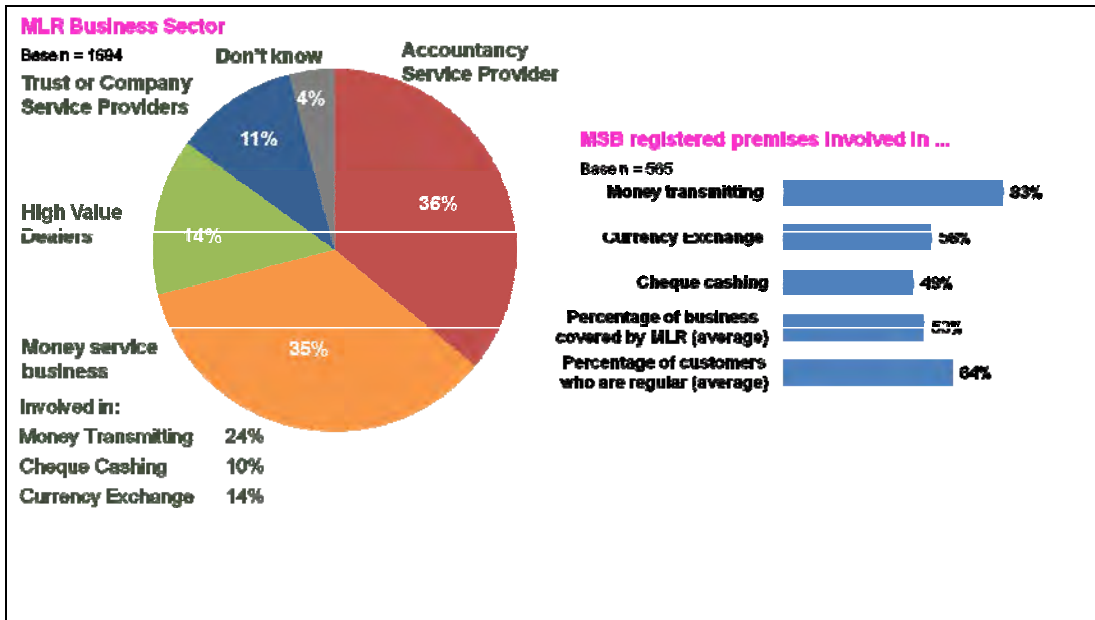


Fig. 1

- Phase 4** of the programme comprised eight workshops involving staff from across MLR and facilitated by Quadrangle. It used stakeholder, customer and staff understanding taken from earlier phases to develop concepts for new systems and processes which could be used to enhance HMRC's MLR supervision.

Main Findings

Findings from Phases 1 and 2: Knowledge audit, stakeholder consultations and staff workshops; and qualitative research with registered businesses

Overview of ten key findings

1. There was recognition that the MLR Team in HMRC had a unique, dual role in helping to tackle money laundering and terrorist financing – the threat of which was the driving force behind the 2007 Money Laundering Regulations:
 - as a supervisor responsible for registering suitable traders and maximising their compliance
 - working with HMRC and law enforcement partners to take appropriate action against traders that fail to register, fail to comply with the obligations or facilitate money laundering or terrorist financing.
2. There was a perception that HMRC had the most difficult business sectors to supervise and dealt with many disparate types of customer. Its remit had grown with the new regulations (MLR 2007) and stakeholders felt that some staff did not have extensive experience in the compliance roles that they were undertaking.
3. There was no reliable information about the number of in-scope businesses that were not on the register, hence there was an incomplete picture of the potential population to be supervised.
4. It was the view of some stakeholders that there were businesses on HMRC's register that would not be deemed competent or properly run businesses by other regulatory bodies or trade associations, and there were concerns that these might not be visited or inspected by HMRC and would therefore pose a risk.
5. It appeared to both businesses and staff that the primary focus was on the process of registration and that the compliance approach was concerned too much with administrative process rather than the central purpose of the regulations. There was a view that HMRC's desire to not over-burden businesses – particularly SMEs – had resulted in the regime being perceived as not very robust.
6. Stakeholders viewed HMRC as being quite tough in its administration and enforcement of tax regimes and in comparison, its MLR supervision was seen as being less tough than expected.
7. Stakeholders felt that the MLR Team's purpose was unclear and there was a perception that the team lacked strategic direction in delivering its role under the 2007 Regulations:
 - *to maintain a register of in-scope businesses*
 - *effectively monitor customers... and take the necessary measures for the purpose of securing compliance*

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8. It appeared to stakeholders that the risk process was not sufficiently rigorous or always applied consistently to drive interventions and the visiting programme. There was a perception that too many visits were made to largely compliant businesses and that penalties for non-compliant businesses were not always imposed or followed through.
9. Registered businesses viewed registration and compliance as providing a licence to trade and it was this, rather than a recognised desire to keep society safe, that led most businesses to register. This being their view of regulation, they expected, and would only have confidence in, a regime that dealt firmly with non-compliance and that closed down unregistered and persistently non-compliant businesses.
10. There was a strong desire and willingness by MLR staff and Senior Leadership Team to improve the existing system and widespread agreement on the changes needed to enhance and increase its effectiveness.

Findings from Phase 3: Customer profiling and modelling - an MLR segmentation of registered customers based on quantitative research

The MLR segmentation: Five key dimensions

The five dimensions used to define the MLR segmentation are:

1. Awareness / Knowledge
2. Motivation to comply / Attitude to risk
3. Perception of risk / Fear of punishment
4. Need for help from HMRC
5. Ability to fulfil MLR obligations

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The MLR segmentation of registered businesses

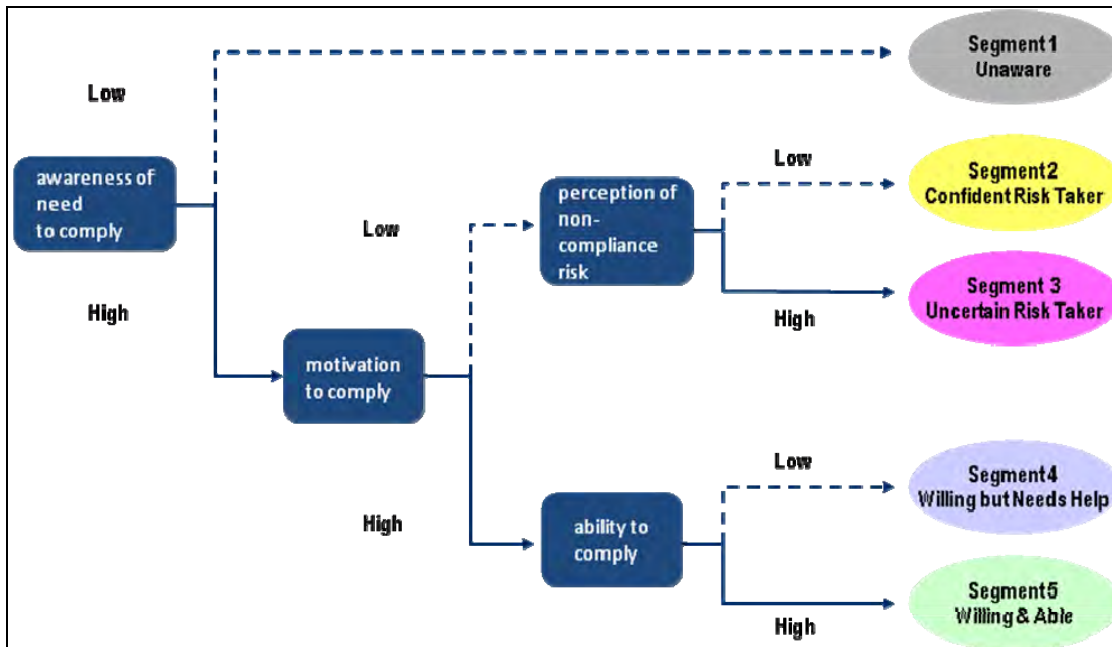


Fig. 2

Details on the profiles of each segment are given below.

Segment 1: Unaware

Who are the Unaware?

- Small businesses, more typically accountancy firms and less typically Money Services Businesses
- MLR transactions form a minor part of the business with relatively little revenue value
- They do not see their business as being at risk from money laundering
- MLR has low priority within the business
- Unmotivated to take on MLR responsibilities
- Little awareness of what to do or how to do it
- Under prepared for adapting the business to fulfil MLR regulations
- They have a relaxed attitude to MLR compliance
- Their application of MLR processes and procedures lack rigour

Most likely to be:

- Beginners
- Uninformed
- Unprepared
- Lacking in motivation

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- Lacking in engagement
- Lacking understanding of the rationale behind the MLRs

Primary focus for MLR compliance:

- Help in understanding the basic principles underlying MLR
 - how their business might be used for money laundering
 - how MLR compliance mitigates the threat of money laundering
- Help in understanding what their MLR obligations are
- Help in understanding how to fulfil their responsibilities

Segment 2: Confident Risk Taker

Who are the Confident Risk Takers?

- A high proportion of the business is covered by MLR
- Transactions covered by MLR account for a significantly high revenue value
- However, the business focus is on revenue generation – rather than on MLR compliance
- Are confident in their ability to fulfil MLR obligations
 - have good understanding of their MLR obligations and responsibilities
 - do not find it difficult to comply fully with MLR obligations
- Do not see their business as being at risk from money laundering:
 - are willing to take the risk of not being fully compliant – all the time
 - they do not see the risk of bending the rules
- Do not fear being investigated and the consequences of non-compliance

Most likely to be:

- Confident – even over confident
- Cavalier
- Detached
- Of the view that they are invulnerable

Primary focus for MLR compliance:

- These businesses are possibly at a size where they view their current systems and processes as sufficient
- There is a current need – which as the business grows, will become exacerbated – for MLR to have a higher priority within the business:
 - a greater awareness of the risk of money laundering
 - more rigorous application of MLR processes and procedures
- They also need to be made aware of:
 - the remit of HMRC to ensure compliance
 - the consequences of non-compliance

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Segment 3: Uncertain Risk Taker

Who are the Uncertain Risk Takers?

- Small Accountancy Service Providers are the largest sector; and Trust or Company Service Provider businesses are above the average sector size
- A high proportion of the business is covered by MLR:
 - but MLR transactions account for little revenue value
- Recognise that they are not fully compliant
- Find it difficult to comply because they don't know how to do the processes:
 - risk assessment
 - customer Due Diligence
 - record keeping
- Know it is easy to bend the rules
- Will take the risk of non-compliance
- But also feel that they will eventually be investigated
- Are aware of the consequences

Most likely to be:

- The 'ostrich' – bury their head in the sand
- Lacking in knowledge
- Disempowered – unable to access help
- Nervous and insecure
- Vulnerable to being a victim of money laundering
- Vulnerable to being found to be non-compliant by HMRC

Primary focus for MLR compliance:

- HMRC contact to assess need for an assurance visit
- Initial visit:
 - for help in how do to it – processes
 - to make clear that penalties will be imposed for non-compliance
- Follow-up:
 - to ensure businesses are compliant
 - to impose a penalty if they are non-compliant

Segment 4: Willing but Needs Help

Who are the Willing but Needs Help?

- Small businesses representative of the MLR business sector
- A high proportion of the business is covered by MLR:
 - but MLR transactions account for little revenue value

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- Are highly motivated to comply fully
- Have a good understanding of what they need to do

- But lack the ability to put this in practice – to MLR standards

Most likely to be:

- Aware
- Diligent
- Conscientious
- Unconfident
- Unsure

Primary focus for MLR compliance:

- Need specific help on how to:
 - design an effective process to ensure fulfilment of MLR obligations
 - build confidence and reassurance in their ability to fulfil MLR obligations

Segment 5: Willing and Able

Who are the Willing and Able?

- Larger businesses – and typically Money Service businesses
- A high proportion of the business is covered by MLR
- MLR transaction revenue value is high – twice the average
- MLR has high importance within the business
- Are highly motivated to comply fully
- Know what they need to do for full MLR compliance
- Have the systems and processes to enable them to be fully compliant
- Find it easy to comply fully with MLR obligations
- Ensure staff are trained and are able to report anything suspicious

Most likely to be:

- Knowledgeable
- Able
- Fully compliant
- Self-sufficient
- Of the view that they are risk aware

Primary focus for MLR compliance:

- Reinforcing best practice
- Keeping businesses up-to-date with news/ changes/ updates
- Refresher training

Understanding the businesses that HMRC supervise in respect of the Money Laundering Regulations**Findings from Phase 4: Using stakeholder understanding to improve performance****Background to this phase**

This series of workshops involved a wide cross-section of staff and the Senior Leadership Team. They addressed:

- Clarity of purpose and aim, name and operating principles of the MLR Team
- Developing a Customer Strategy and a Change Plan
- Prioritising system development based on customer understanding.

A fundamental driver was the recognition that HMRC's MLR supervisory regime had not only to be robust and fit for purpose but needed to be seen as effective and have the confidence of customers and other stakeholders.

Main principles were to:

- Devise solutions that could be delivered in the short to medium term
- Be aspirational but not 'blue skies'
- Take account of resource constraints on capital investment in IT programmes or organisational structure (whilst recognising that developments in these might help)
- Recognise the requirement not to overburden customers.

Outputs

The outputs from the Phase 4 workshops took the form of recommendations for change, informed by the customer insight and segmentation delivered under Phases 1-3 of the research, and also taking account of the legal and administrative context within which the regime operates. The recommendations were endorsed by the MLR Senior Leadership Team.

Clarity of purpose and aim, name and operating principles of the MLR Team

The first two workshops made recommendations on a new name for the MLR Team in addition to a statement of purpose and operating principles. These are set below.

The purpose of the MLR Team, and a name that better describes what we are there for:

The Anti Money Laundering Supervisor.

Deterring, detecting and disrupting money laundering and terrorist financing by supervising businesses to comply with the Money Laundering Regulations and supporting law enforcement.

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Our aim is to be respected as:

An effective supervisor, helping to make the UK a hostile environment for money laundering and terrorist financing.

Our operating principles to do this are:

Ensuring that the businesses we supervise maintain and improve their defences protecting them against money laundering and terrorist financing

Maintaining an accurate and comprehensive register of businesses that are carrying out services that require them to be registered and supervised by HMRC

Checking that businesses are compliant with anti-money laundering and terrorist financing legislation and penalising the non-compliant to compel them to alter their behaviours

Auditing and inspecting businesses using a risk based approach

Working with law enforcement agencies to deter, detect and disrupt money laundering so they can successfully prosecute criminal businesses

Raising awareness of the risks businesses face and their obligations under the regulations

Supporting and educating businesses on how best to comply with their obligations by providing them with clear information and guidance

Working in co-operation with representatives of the business community, other anti money laundering supervisors and the Treasury as the regulatory authority

Minimising the burden of bureaucracy that businesses have to deal with

Enhancing our understanding of our customers, their business and their customers

Analysing information from within HMRC and other stakeholder organisations to obtain a detailed understanding of the risks the market faces

Being visibly consistent, even-handed and fair

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Customer Strategy and Change Plan

A major recommendation from Phase 4 was to introduce a Change Plan to detail:

- Customer Strategies:
 - a generic approach and core systems for aspects that are common to all businesses
 - a differentiated approach tailored to size and sector of business
 - a segmented approach tailored to address different attitudes/ behaviours/ needs.
- A summary of planned projects and a timeline to:
 - present the changes already in train in a more coordinated way
 - help prioritise and rationalise projects to aid effective delivery

System development based on customer understanding

The insight obtained from the previous phases of research highlighted the need for a rigorous and robust approach to MLR supervision. To achieve this, the workshops addressed a number of priorities for change:

- A revised registration process:
 - better and updated information
 - ability to 'suspend' businesses, de-register and reinstate to differentiate between the compliant and (persistent) non-compliant
 - payment of fees to be a compliance factor
 - additional information collected to be used to feed into the risking process
 - registration questions to be mandatory
- Improved information and data sourcing
 - exploiting data and intelligence: from within MLR, across HMRC and external sources
 - feeding multiple data variables (and sources) into risk scoring
- A customer engagement system
 - customer pack on registration setting out purpose, principles and what support is available
 - first contact by telephone with the dual purpose of assessment and engagement
 - ongoing interventions (telephone and/or visit)
 - new Trading Information Statement (sector specific) – initial six month version, with annual update issued with fee renewal
 - work towards achieving electronic (online) information capture
- A customer profiling system:

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- business characteristics used to feed into a headline risk score
 - identification of the most important risk factors within each sector, with specific rules created for each
 - an overall risk score to be calculated for each business on the register to drive intervention decisions, based on a wide range of sources, including intelligence and customer capability
- A risk and compliance framework, comprising:
 - headline risk criteria derived from HMRC and other data to drive a traffic light system (high-medium-low risk)

In Summary

This research has delivered in-depth analysis of customer attitudes and behaviours and a customer segmentation that has improved HMRC's understanding of the businesses it supervises for MLR. This will support the development of a customer-centric approach to MLR supervision to maximise compliance and improve efficiency. The MLR Senior Leadership Team will use the results of this research to underpin the changes it intends to introduce to the supervisory regime and is building implementation of the recommendations into its business plans.