Title: Transposition of the Directive on the prevention of the use of the financial system for money laundering or terrorist financing. **IA No:** **Lead department or agency:** HM Treasury **Other departments or agencies:** Home Office, National Crime Agency, HM Revenue and Customs, Financial Conduct Authority, Gambling Commission	Impact Assessment (IA) **Date: 16/02/2016** **Stage:** Development/Options **Source of intervention:** EU **Type of measure:** Secondary legislation **Contact for enquiries:** Katherine Newall (katherine.newall@hmtreasury.gsi.gov.uk)

Summary: Intervention and Options

RPC Opinion: GREEN

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, Two-Out?**	**Measure qualifies as**
£-240.13m	£-232.52m	£26.59m	No	IN

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

The Directive on the prevention of the use of the financial system for money laundering or terrorist financing (4AMLD) was agreed and published in the official journal in June 2015. This Directive must be transposed into domestic legislation by June 2017 to meet obligations to the EU, and the underpinning requirements of FATF which sets the international standards in this sphere. The Directive was a successful outcome for the UK, delivering a requirement for all Member States to establish Company Beneficial Ownership registers analagous to our own Persons with Sigificant Control Register, and securing exemptions for certain sectors of the gambling industry and e-money sector. Alternatives to regulation are not available.

What are the policy objectives and the intended effects?

The Government objective is to make the financial system a hostile environment for illicit finance while minimising the burden on legitimate business. The Government strategy is to deter crime and terrorism, detect and investigate criminal or terrorist abuse of the financial system and to disrupt criminal and terrrorist activity. Delivery is underpinned by the principles of effectiveness, proportionality and engagement. The proposals for consultation are intended to ensure that the Regulations are as effective and proportionate as possible, while meeting the EU and underpinning FATF recommendations in preparation of the UK Mutual Evaluation by FATF in 2017, and facilitating our response to the findings in the National Risk Assessment.

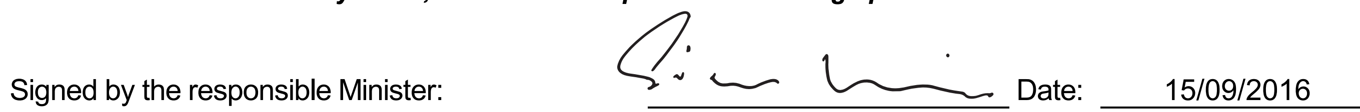
What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

The baseline scenario (Option 0) is to take no action. However, in practice it will not be possible to do nothing as 4AMLD places a legal obligation to transpose on the UK. Option 1 is to legislate to ensure compliance with 4AMLD, but ensure that HMG: engages potential exemptions where possible; consults on effective application of the proportionate and risk-based approach wherever possible; and maintains compliance with the FATF standards in preparation for our mutual evaluation in 2017.
This is the preferred option. This will ensure that we meet our legal obligations to the EU while benefitting from potential exemptions where applicable and are well-prepared for our FATF assessment in 2017.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** 07/2022

Does implementation go beyond minimum EU requirements?			Yes		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** Yes	**< 20** Yes	**Small** Yes	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** N/A	**Non-traded:** N/A	

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.



Signed by the responsible Minister: Date: 15/09/2016

Summary: Analysis & Evidence — Policy Option 1

Description: Transposition of the Directive on the prevention of the use of the financial system for money laundering or terrorist financing.

FULL ECONOMIC ASSESSMENT

Price Base Year 2015	PV Base Year 2015	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: £-335.74	**High:** £-129.29	**Best Estimate:** £-240.13

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	44.7		12.1	**142.2**
High	191.3		20.6	**341.6**
Best Estimate	118.0		17.2	**249.5**

Description and scale of key monetised costs by 'main affected groups'

No finalisemonetised costs at this stage. We expect additional costs from a series of areas, but are consulting on benefiting from potential exemptions, and on the most effective way of ensuring a risk-based proportionate approach to minimise cost burdens on legitimate business whilst ensuring an effective regime and protecting the financial system from the costs of MT/ TF. The Government will seek to gather evidence during consultation to provide a fuller picture of these in the final stage IA.

Other key non-monetised costs by 'main affected groups'

The costs for the regulators may involve initial costs of expanding remits should we decide that additional sectors will be covered following consultation (staff, IT, office space) and ongoing costs of supervision. These costs will be funded by fees paid by the regulated population.
The costs for regulated firms may include familiarisation costs and ongoing compliance costs for any sectors brought under the regulations as well as increased compliance costs

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	Optional		0.7	**5.8**
High	Optional		1.5	**12.9**
Best Estimate			1.1	**9.4**

Description and scale of key monetised benefits by 'main affected groups'

Very few monetised benefits at this stage. The government will seek to gather evidence during consultation to provide a fuller picture of these in the final stage impact assesment. Although estimates are difficult, the NCA believes that £billions of illicit money flows through the UK each year. Any reduction in that flow will result in significant societal benefits.

Other key non-monetised benefits by 'main affected groups'

Transposition of the Directive will aid the detection and prosecution of crime related to money laundering and terrorist financing, reducing ensuing harm to society. The MLRs provide a disincentive to crime by reducing the profitability and funding available to finance future criminal activity. They also protect the integrity of the financial system and the reputation of UK business, with beneficial effects on inward investment, and access to foreign markets by UK companies.

Key assumptions/sensitivities/risks	**Discount rate (%)**	3%

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs: 27.7	**Benefits:** 1.1	**Net:** -26.6	No	IN

Evidence Base

Problem under consideration:

1. The 4th Directive on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing (2015/849/EU) was published in the Official Journal of the European Union in June 2015. The Directive must be transposed into domestic law by June 2017. It sets common regulatory standards that Member States are required to meet in order to:
   a. Protect the integrity, stability and reputation of the financial sector, coordinating measures at EU level to prevent money launderers and financers of terrorism from taking advantage of the freedom of capital movement in the EU.
   b. Ensure that sectors at high risk of money laundering know their customers, apply an appropriate risk-based level of customer due diligence including ongoing monitoring (in some prescribed cases enhanced due diligence must be undertaken), and can identify the beneficial owner (to prevent criminals from hiding their identity behind a corporate structure).
   c. Ensure any suspicious activity is reported to the National Crime Agency (NCA) in the form of a Suspicious Activity Report (SAR).
   d. Take a risk-based, proportionate approach to target the risks of money laundering, using evidence-based decision-making.
2. The Directive seeks to restrict the flow of illicit finances. Estimates vary on how much criminal money is generated and laundered within and through the UK but a 2012 EU-sponsored study estimated that about €25bn a year is laundered from UK crime (*Project ECOLEF: The Economic and Legal Effectiveness of Anti-Money Laundering and Combatting Terrorist Financing Policy – Nov 2012*).
3. The Home Office judges that in 2010/11, UK organised crime generated about £13bn, of which they estimate about £10.5bn is laundered. This figure excludes 85% of fraud and other non-organised crime. Money laundering is also a key enabler of serious and organised crime, the social and economic costs of which are estimated to be £24bn a year (*Home Office (2013): Understanding Organised Crime: Estimating the scale and the social and economic costs*).
4. Globally, the European Commission points to global criminal proceeds potentially amounting to some 3.6% of GDP; around US$2.1 trillion in 2009 (*EC (2013): Impact Assessment – proposal for the prevention of the use of the financial system for the purposes on money-laundering)*. The best available international estimate of the amounts used in just money laundering would be equivalent to some 2.7% of global GDP or US$1.6 trillion in 2009 (*UNODC (2011): Estimating illicit financial flows resulting from drug trafficking and other transnational organised crimes)*. And illicit flows out of low income countries, particularly in Africa, are often claimed to be more than the aid the developed world provides. The Africa Progress Panel chaired by Kofi Annan in 2013 suggested that the annual loss to Africa between 2008 and 2010 was $38bn, and that between 1970 and 2008 $1.8 trillion were lost from the continent.
5. The National Crime Agency believes that billions of pounds of illicit finance flow through the UK each year and the UN has found that in a study of 150 ‘grand corruption’ cases, almost 1 in 5 corporate vehicles used to launder money were UK-related.

Rationale for intervention:

6. 6. 4AMLD must be transposed into domestic law by June 2017. It is also necessary to consider the source of the standards that 4AMLD seeks to enact. The Financial Action Task Force (FATF) is the international organisation responsible for drawing up principles, policies and guidance to combat the threat from money laundering and terrorist financing globally. The UK is a leading member of FATF. The FATF Recommendations represent the minimum standards required to combat effectively money laundering and terrorist financing. Countries or regions (like the EU) may decide to go further than the international standards as the UK has done in the field of company beneficial ownership transparency

7. While 4AMLD seeks to update European law to take into account the most recent update of the FATF Recommendations (2012), we must ensure that any derogations we apply do not put us in contravention of the international standards. While FATF has no financial penalties to impose on errant members, it does carry out extensive evaluations of AML/CFT regimes and will evaluate the UK from Oct 2017 – Oct 2018. If the FATF Mutual Evaluation Report (MER) were to find the UK regime's to be substantially deficient it would have serious reputational implications for the UK as a leading financial centre. MERs are public documents and used extensively by global companies and law enforcement when deciding where to do business and how to interact with entities in other jurisdictions.
8. The last Mutual Evaluation of the UK was completed in 2007. The UK achieved a rating of Fully Compliant in 24 out of the FATF's old 40+9 recommendations, and was judged largely compliant in a further 12 ratings. Subsequent implementation of changes to the UK regime through the 2007 Money Laundering Regulations further strengthened the UK regime. However, the revisions to the FATF Recommendations and Methodology adopted in 2012 and 2013 expanded FATF's remit to look specifically at effectiveness as well as technical compliance. Beginning in 2017, the UK will need to prove to a team of international assessors not only that we have the right laws, regulations and guidance in place, but that the actions taken by Government, law enforcement, regulators and the private sector are effective at reducing the level of money laundering and terrorist financing in the UK.
9. Furthermore, under the Presidency of the UK, G8 Leaders agreed at Lough Erne in June 2013 to step up the fight against corruption globally, agreeing principles to tackle the misuse of companies and legal arrangements for money laundering purposes. The Prime Minister has made tackling illicit financing a key plank of his international agenda and will host a global anti-corruption summit in Q2 2016. The UK has already taken forward measures to make the beneficial owners of companies public through the Small Business, Enterprise and Employment Act 2015 which establishes a central registry of people with significant control of UK companies. This is a key requirement of FATF and 4AMLD and the UK has shown global leadership by moving quickly on this.
10. This impact assessment examines the best way to transpose the Directive, seeking to benefit from any potential exemptions, but also ensuring that the UK is not exposed to the risk of falling short of meeting FATF requirements.

Policy objectives and options:

11. In transposing 4AMLD we will also be fulfilling the UK's G8 anti-corruption commitments and meet international standards on AML/CFT laid down by FATF. Effective AML/CFT regulations will serve to make the UK a hostile environment for illicit finances, protecting the UK's reputation as a safe place to do business and maintaining confidence in the financial system with associated benefits to inward investment and access to foreign markets by UK corporates. By updating the regulations we will also aid the detection and prosecution of crime and provide a disincentive to crime by reducing profitability/funding with obvious societal benefits.
12. Transposition will also ensure that the UK enjoys a level playing field with the rest of the EU in regard to AML/CFT regulations. We want to take advantage of any derogations or areas where options are offered in order to minimise costs on legitimate businesses while also making sure that we meet our international commitments.
13. In meeting these commitments, we will consider those areas where we might go further than the minimum requirements set out in the Directive, for example in considering whether the ML/TF risks of letting agents should be mitigated by bringing them into scope. Any decisions on these areas will involve a careful balancing of the potential costs to business, the potential benefits from increased oversight and the likely affect of the decision of the UK's performance in its FATF MER in 2017/18.
14. The Government will need to legislate in order to implement these standards in the UK.
    a. **Option 0:** 'Do Nothing'. Under this option the UKs AML regulations would not be updated. This would lead to infraction proceedings by the European Commission and the UK would be judged non-compliant with FATF standards, damaging the UK's reputation as a legitimate and trustworthy place to do business.

b. **Option 1:** Transpose the Directive as required but ensure the UK benefits from potential exemptions where possible. We will consult on the changes that 4AMLD will require, gathering evidence of likely effects in areas where we are able to exercise choices or take advantage of derogations. We will seek to meet FATF and the Directive requirements in a way that minimises red tape burdens.

c. Option 1 is the preferred option.

The challenge of cost-benefit analysis work:

15. As part of earlier reviews into the Money Laundering Regulations, cost-benefit analysis work was reviewed. Industry has difficulty in identifying costs caused as a result of the money laundering regulations, particularly around customer due diligence (or knowing your customer) as many of these costs a prudent business would pursue in any case as a matter of commercial practice, to comply with UN or EU sanctions, or to protect themselves and their customers from fraud for example. Financial institutions in particular often gather data on customers in order to more effectively market other products to them.

16. Throughout the preparation of this impact assessment, HMT has sought views from regulated businesses and industry representatives as to potential costs and how to reduce red tape. We have repeatedly been told that they are unable to isolate the costs of the Regulations from other related costs and that they do not believe it is useful to do so although they welcome continued efforts to identify costs and benefits of specific changes where feasible.

17. Because of the nature of the approach that underpins the regulations, it is extremely difficult to know exactly what actions regulated businesses will take in order to comply. The risk-based approach (RBA) is embedded in the FATF standards and 4AMLD. At its heart, this demands that all regulated entities develop a detailed understanding of the specific money laundering and terrorist financing risks that their particular business is vulnerable. This will vary across businesses within the same sector depending on the nature of their customers, the precise products and services they offer, their internal systems and their physical location.

18. Once the entity is fully aware of its risks, it must then train its staff to understand them and detect suspicious activity that may represent an attempt to launder money. In this way it can avoid establishing relationships with criminal enterprises and provide detailed, up to date evidence to law enforcement authorities which can pursue them.

19. Regulated entities must ensure that they know who they are doing business with. This means understanding who their customer is and verifying that what they are being told is true. When dealing with a corporate or legal entity, it means establishing the beneficial owner. The regulated entity must also understand what the nature of the business relationship is so that it can monitor transactions to make sure that they are consistent with its understanding of the relationship. Where business models are particularly complex or susceptible to money laundering risks, regulated entities will have to look more closely to satisfy themselves that the relationship is legitimate.

20. The lengths to which regulated entities must go in order to satisfy themselves of their customer's identity, the nature of the relationship and money laundering risks are not set out in legislation. Indeed, this would be contrary to the RBA. The RBA expects entities to take steps in line with their perception of the risks rather than setting out a 'tick-box' approach. This makes it extremely challenging to put a figure on the costs of doing due diligence checks. This might be very low for a customer that is locally based with a simple ownership structure. For another customer in the same line of business which is based abroad or online with a more complex ownership structure, more significant resource may have to be invested. Because due diligence is based on the regulated entity's understanding of, and appetite for, risks it is likely that two different entities when dealing with exactly the same customer would devote different levels of resource to checks and monitoring.

21. Ongoing monitoring is also difficult to cost. Where the relationship conforms exactly to initial expectations, the cost may be negligible. But where unexpected transactions and behaviours are seen, considerably more may be spent in order to understand them and confirm that they are not suspicious. The quality of the initial due diligence checks may also play a role if they did not fully tease out the nature of the customer's business. In this case, ongoing monitoring costs might be

incurred which wouldn't have been if the regulated entity had properly understood the customer from the start.

22. Costs are also affected by international considerations. The US approach to enforcement in particular is relevant here as it imposes very particular requirements on businesses. Global businesses that operate in the US, or have dealings that may make them eligible to investigation by US authorities, will often look to satisfy these US standards and a decision may be made to use systems designed for US compliance globally rather than operate discrete regimes in different jurisdictions for reasons of efficiency.
23. The Government will seek further views on the costs and benefits of transposing 4AMLD through consultation to build this limited evidence base. At the same time, it should be noted that as part of the BIS "Red Tape Challenge", a comprehensive review of the AML/CFT regime is being undertaken with a focus on supervision, looking to identify areas where the regime is unclear, cumbersome and ineffective. A report is expected by December and we expect this to expand our knowledge base and aid our cost-benefit analysis.

Monetised and non-monetised costs and benefits

24. This section will discuss each chapter of the Directive in turn, identifying areas where there are material changes from the third Directive and where we have options in implementation or the possibility of exercising an exemption.
25. Throughout, it should be borne in mind that around 150,000 businesses are currently within scope of the regulations. That represents fewer than 3% of businesses in the UK.

<u>Chapter I – General Provisions</u>

<u>Potential exemptions for gambling</u>

26. This Chapter sets the scope of the Directive, including entities covered, and definitions. The Directive applies to:
    a. credit institutions, financial institutions, auditors, external accountants and tax advisors, notaries and other independent legal professions, trust and company service providers, estate agents high value dealers, and providers of gambling services. The majority of this Chapter will be copy out, and the majority of these sectors are already covered in the UK by the existing MLRs. The exception is the gambling sector, where currently only casinos are captured. The entire sector is now brought within scope of 4AMLD.
27. However, Article 2 gives potential exemptions for the gambling industry, and for those engaging in financial activity on an occasional or very limited basis, and we will consult on the application of these exemptions:
    a. Article 2 (2) – Sets a potential **exemption for gambling services** (other than casinos) from the MLRs, on the basis of proven low risk, and considering any findings of the Commission in their Supranational Risk Assessment.
    b. Article 2 (3) – States that Member States may decide that persons that engage in a **financial activity on an occasional or very limited basis** with little risk of ML or TF do not fall within the scope of the Directive, with the absolute terms of financial activity threshold set at national level. Conditions around transactions being limited, the financial activity not being the main activity of such persons, and other conditions would still need to be met for the exemption to bite.
28. We intend to use both these exemptions, in line with our intent to minimise burdens where ML/TF risks are low.

Options for gambling exemption:

29. **Copy-out:** Copying out the Directive without use of the exemption would mean that the whole of the gambling sector would be covered by the MLRs. This would mean all gambling services would have to apply Customer Due Diligence measures (CDD) where a transaction equals

€2,000 or more (with a transaction being the collection of winnings, the wagering of a stake or a combination of the two, in either a single or linked operation), and at the point where a business relationship is established.

30. CDD would involve identifying and verifying the customer's identity; identifying the beneficial owner; and conducting ongoing monitoring of the business relationship to ensure that the transactions being carried out are consistent with the gambling provider's knowledge of the customer.
31. Instead we propose to **make use of the exemption for gambling services that present proven low risk.** The Government is seeking further evidence on which services are low risk through the consultation and the work of the Gambling Commission. While the ML/TF National Risk Assessment (published 15/10/15) determined that the gambling sector as a whole was low risk, this assessment only covered casinos (where existing regulation would be expected to mitigate the risks) and high-street betting shops. This is clearly not the same as proven low risk for the purposes of exemption under 4AMLD and further assessment is needed for individual types of gambling activity to ascertain the ML/TF risk and, if judged to be low, to enable us to present evidence to the European Commission justifying an exemption.

Monetised and non-monetised costs:

32. It is difficult to assess the potential **costs** of applying the MLRs across the whole gambling sector, which in addition to casinos is made up of the bookmaking industry (on-course and off-course); the remote sector (primarily online gambling); bingo halls; amusement arcades; and lotteries. In the year to September 2014 the British commercial gambling industry generated a gross gambling yield of £7.1bn. In addition to the costs of training staff and carrying out the due diligence and verification, the gambling sector argue that the loss of anonymity currently associated with gambling in most of these sectors would have a substantial impact on their customer base. If brought into scope, the industry would also have to investigate making technical changes, for example to gambling machines in order to alert staff when someone pays in a large amount of cash and then tries to withdraw 'clean' notes.
33. A private economic analysis of the impact of the land-based betting industry by KPMG finds that, if not exempted, the costs of implementing measures to comply with 4AMLD are uncertain but could be significant. The study extrapolates the potential impacts of 4AMLD based on the impact of having introduced a £50 stake regulation on fixed odds betting terminals (FOBT), after which point customers have to either a) move to account based play and provide personal details (which is taken up by a very small percentage of customers), and/or b) have an interaction with a member of Licensed Betting Operator staff. This resulted in a 6% fall in total stakes on FOBTs and a significant change in gambling behaviour. The study estimates that 4AMLD could result in a decline in turnover of between 6% - 12% among the 6,500 members of the Association of British Bookmakers. There is no estimate of the cost to the 201 independent operators owning 877 betting shops between them, but we might assume a similar effect. The estimates in the KPMG study cover a wide range and reflect the difficulty of inferring changes to customer behaviour. Furthermore, the government expects that sufficient evidence will be gathered to demonstrate low risk and exempt certain products and\or services within the gambling sector from the regulations. It is not possible to indicate at this stage where these exemptions will apply, making it extremely difficult to make a useful estimate of the costs to industry. For the purposes of this impact assessment, the government has not made an assumption of costs for the ongoing impact of the Directive on the land-based betting industry. This is because such an assumption would not give an accurate picture, given that decisions on which products and services should be exempted have yet to be made. We will seek more information through the consultation process, allowing the final stage impact assessment to reflect a fuller understanding of the costs for those products and services that are not exempted.
34. Transition costs would be incurred for updating IT systems and training and are not covered in the above estimate. The Association of British Bookmakers do not feel that it is possible to provide a useful estimate of these costs.
35. In addition to this modelling, operators will have to develop an understanding of what constitutes 'linked transactions'. The €2000 limit applies to linked as well as single transactions, with the

meaning of linked to be decided by each operator on the basis of their knowledge of each customer and their knowledge of the specific ML/TF risks facing their sector. A useful definition of linked transactions cannot be set out in legislation as it would undermine the RBA and risk being found non-compliant by both the EU and FATF.

36. Using the most risk-averse definition of linked transactions to mean a lifetime stake threshold of €2,000, operators have highlighted that around 50% of customers of bookmakers would require monitoring. The costs of introducing a system of membership accounts and transaction linking is unclear, but likely to be significant (including upfront costs such as IT systems, and recurring annual costs e.g. staff). The industry and given an estimate for a basic electronic due diligence check of around 25p. Industry estimates that there are 5-7m customers, assuming that 50% of customers required a basic check under the linked transactions threshold, this would equate to transition costs of between £625,000 and £875,000 for bookmakers to perform due diligence on its existing customer base. It has not been possible to get a useful estimate of annual costs which would take account of new gamblers that would be caught be the requirement. While an operator will often be able to identify a new customer, they will not know if that customer has previously been, or is still, the customer of another operator. The industry is unable to provide an estimate for the number of checks that might be required on an annual basis. Training of staff is estimated to be £1-2m per year, but this includes training for all aspects of working in the industry, not just AML. We expect to get better evidence for this from the consultation.

37. On-course bookmakers have not been the subject of a similarly detailed study, but it is likely that they would encounter practical problems in terms of carrying out CDD checks given the number of customers that place bets in the minutes leading up to a race starting.

38. For much the remote sector, on the other hand, we expect that costs would be minimal. The MLRs already apply to online casinos, but normal practice is for operators in the UK to apply the same procedures to their online betting customers too. The main reason for this is that most online companies offer both gaming and betting products so it is in practice easier to apply the full checks to all customers rather than to monitor them constantly and then apply a break on their play as and when they move from gaming to betting products. Basic customer due diligence such as proof of age and verification of identity is conducted on customers at the point of registration, before a business relationship commences. The checks apply when a customer opens an account and first deposits funds, irrespective of the level of funds. We will seek more information on potential costs to each sector of the industry through the consultation.

39. Exempting certain sectors or products would result in saving these potential costs. Through consultation, we expect to be able to make a fuller assessment of the likely costs that each sector might incur as well as building an evidence base to decide which sectors\products present a low risk and should be exempted.

Monetised and non-monetised benefits:

40. Casinos are already regulated due to the large quantities of cash that exist within the system. The preponderance of cash and the anonymity afforded by some forms of gambling make them susceptible to abuse by those seeking to move illicit finance.

41. Although the UK's National Risk Assessment found gambling as a whole to be low risk, we will seek evidence through the consultation and work being taken forward by the Gambling Commission to analyse different elements of the sector and establish the risk of each one and whether we could justify exempting it from the regulations.

42. The non-monetised benefits for regulating some parts of the gambling industry, much like casinos, are largely to combat the anonymity and predominantly cash-based transactions that exist in on-course and off-course betting shops. This is compounded when considering accessibility to multiple premises in one street or area where those seeking to move illicit finance can break down their transactions to a sufficient level that could avoid arousing suspicion. Adult Gaming Centres (AGCs) are similarly anonymous, though the volume of cash-based transactions are likely to be less than other parts of the industry. Some concerns have been raised over the anonymous and high return nature of some gaming machines that exist in a number of parts of the industry. The application of customer due diligence in high-risk gambling activities or sectors would reduce the vulnerability of money laundering given that the transactions would be more

easily traced back to the customer, flagged if there are several transactions that appear to be linked and thus deter criminals from attempting to use the industry as a means to “clean” proceeds from criminal activity.

43. As more thorough and updated training of staff is likely to be generated from compliance with the Directive, it could result in more awareness of suspicious activity occurring and add a further deterrence for criminals. Finally, regulation of the high-risk areas of the gambling industry will further the UK’s aim of making the financial system an increasingly hostile environment for illicit finances.

Setting the threshold for limited business activity

44. 4AMLD allows member states to exempt persons that engage in financial activity on an occasional or very limited basis. A threshold may be set below which 4AMLD will not apply as there is little risk of money laundering. All of the following criteria must be met:
    a. Financial activity is limited in absolute terms
    b. Financial activity is limited on a transaction basis
    c. The financial activity is not the main activity of such persons
    d. The financial activity is ancillary and directly relate to the main activity of such persons
    e. The financial activity is provided only to the customers of the main activity of such persons and is not generally offered to the public
    f. The main activity of such persons is not one of those covered in article 2(1) setting out the scope of the directive.
45. The current thresholds set out in existing MLRs are:
    a. Annual turnover: no more than £64,000
    b. Single or a series of linked transactions up to £1,000
46. The firms that are potentially affected by this option are those that offer financial services (such as bureaux de change) as an ancillary service to their main activity. The Government estimates that this could be up to 2000 firms

Options for setting the threshold for limited business activity

47. **Copy out:** Copying out the Directive and using the existing threshold limits (set in 2007) would not result in any additional costs or benefits to business.
48. Instead, we propose to **increase the existing threshold limit** to ensure a proportionate approach is being taken. The current limit of £64,000, set in 2007, was based on the then VAT registration threshold. If the VAT link were maintained, this would lift the threshold to £82,000. However, the VAT threshold cannot be increased (except to take account of inflation) without the consent of the European Commission, making it an inflexible threshold. Removing the VAT link would give government the flexibility to adjust the threshold more easily in line with understanding of ML/TF risks.
49. We intend to consult on using a higher limit of £100,000. The 2010 Federation of Small Businesses (FSB) annual survey reports that 18% of FSB members have a turnover of less than £100,000. Assuming that the FSB membership is representative of the whole SME population, then 972,000 businesses might have a turnover of up to £100,000.

Monetised and non-monetised costs:

50. **Costs** for changing this threshold are expected to be minimal and transitional only. They may include the costs for supervisors to publicise the higher threshold and identify which firms this would apply to. The Government welcomes information to further inform these estimates.
51. Removing these businesses from the Regulations may increase the risk of ML and TF by making them more attractive to those seeking to avoid detection. We will seek evidence through the

consultation of the risks of very small businesses being targeted by sophisticated criminals who seek to exploit a lack of insight or expertise in order to launder illicit funds.

Monetised and non-monetised benefits:

52. The 2010 FSB annual survey shows that 5% of their membership have a turnover between £50,000 and £100,000. We use this as a proxy for the percentage increase in exempt businesses that might benefit from the increased threshold of £100,000. As around 150,000 businesses are supervised from AML/CFT purposes and ONS data shows that 99.3% of all private sector businesses are SMEs, we make an upper bound estimate of 150,000 x 5% = 7,500 businesses that might benefit from the increased threshold.
53. However, the 150,000 supervised business are unlikely to follow the broader business population demographic above given the nature of activities that are supervised. There are likely to be fewer small businesses represented. ONS figures show that 55% of businesses are registered for VAT, assuming that 55% of the supervised population are larger VAT registered businesses, then the 150,000 population eligible for exemptions falls to around 67,500. Using the 5% figure derived above, we estimate a lower bound of 3,375 businesses that might benefit from the increase threshold.
54. The main monetary benefits of this approach are the potential savings to firms through not needing to comply with the Regulations. The Government has estimated that this could lead to a total saving of up to £200 per business, although we will seek to improve this figure through consultation. This would give a potential benefit of 3,375 x £200 = £675,000 to 7,500 x 200 = £1,500,000

<u>Risk-based approach</u>

55. Article 4 of the Directive directs Member States to ensure that the scope is extended in whole or in part to professions and sectors where there is a high risk of ML/TF. All the areas covered by the AML/CTF National Risk Assessment area already covered by the regulations, other than virtual currencies. The Government is consulting separately on how best to include virtual currencies in the MLRs.
56. Government will also consider bringing letting agents within scope of the regulations. Currently, only estate agents are supervised. The Directive makes it clear that letting agents can be considered to be estate agents for the purposes of regulation, but does not make this an explicit requirement.

Options for bringing letting agents into scope

57. **Do nothing:** copying out the Directive and not bringing letting agents into scope would not involve any additional costs or benefits to business.
58. However, we propose to **consult on the costs and benefits of bringing letting agents into scope**. Lettings agents may be an attractive target for criminals seeking to disguise or hide the proceeds of crime. For example, criminals may seek to use an agent to accept payments and forward mail connected with criminal activity such as scam holiday lets or mortgage or benefit fraud; tenants may seek to launder cash, and politically exposed persons relocating to the UK may launder criminal funds through lets. In order to ensure that we are adopting a RBA, we will seek information on the potential risks of the various activities that letting agents carry out.

Monetised and non-monetised costs:

59. **Costs** for bringing letting agents into scope are unclear. There are approximately 17,000 letting agents in the UK but there is no available data on how many also do estate agency business and so are already captured by HMRC supervision.
60. Costs to letting agents would be those incurred for initial set up of a system for carrying out CDD checks and ongoing training of staff. CDD measures include verifying a customer's identity;

identifying the beneficial owner of a customer where relevant; assessing and obtaining information on the purpose and intended nature of the business relationship; and conducting ongoing monitoring of the business relationship.

61. However, those letting agents that also operate as estate agents will experience much lower costs as they will already have such systems in place. The expected costs will, therefore, be lower than estimated below, but as there is no useful estimate of how many letting agents also act as estate agents we are not able to offer a useful estimate of this reduction. We will seek more information from the industry through the consultation. While we have received rough estimates for the costs that letting agents might incur, these are difficult to break down and likely include other costs not associated with the regulations. For the purposes of this impact assessment, we have used estate agents as a proxy, given their similar area of activity. These figures are for estate agent compliance and have simply been applied to letting agents, as such they should be treated with caution:

    a. Transitional start-up costs:

        i. Cost of registration with supervisor: £100

        ii. New customer premises fee: £110 (per premises)

        iii. Average number of estate agent premises: 1.9

        iv. Total number of estate agents: 8500

        v. Cost of writing policy: low estimate: £1000, high estimate: £2000. Industry indicates it is not possible to estimate the costs of this. This assumption has been made for the purpose of this assessment.

        vi. Start-up costs (low estimate) = £100 + (£110 x 1.9) + £1000 = £1309 per business x 17,000 = £22,253,000

        vii. Start-up costs (high estimate) = £100 + (£110 x 1.9) + £2000 = £2309 per business x 17,000 = £39,253,000

    b. Ongoing annual costs:

        i. Supervisor renewal fee: £110 (per premises)

        ii. Average number of estate agent premises: 1.9

        iii. Total number of estate agents: 8500

        iv. Annual cost of staff training: Low estimate: £500; High estimate: £1000: industry indicates it is not possible to estimate the costs of this. To avoid assuming a zero cost for this measure and for the purpose of this assessment the following costs have been used: Assuming an average affected business has 5 full time staff and training takes 1 day per year, annual training costs may be 5 days per year at £100-200 per day = £500-1000.

        v. It is not possible to estimate the annual cost of CDD checks. We will seek more information through the consultation on how many customers an average letting agent might deal with in a year and the cost of carrying out checks. We will also seek an estimate of the cost of checks, but this will likely be difficult to achieve given that this is variable depending on the businesses client base, risk appetite, business model and software.

        vi. Annual costs (low estimate) = (£110 x 1.9) + £500 = £709 per business x 17,000 = £12,053,000

        vii. Annual costs (high estimate) = (£110 x 1.9 + £1000 = £1209 per business x 17,000 = 20,553,000

62. Costs to a supervisor for taking on supervision of letting agents are unclear. If it were decided to bring letting agents into scope, potential supervisor(s) would need to be identified and then undertake significant research on the nature of the sector in order to properly consider the compliance resource that would be required to effectively supervise.

Monetised and non-monetised benefits:

63. The National Risk Assessment of Money Laundering and Terrorist Financing notes that money laundering through estate agencies is currently an intelligence gap. Investment in real estate is attractive both to legitimate customers and those wishing to use the sector for criminal purposes. The expansion of the UK letting industry makes it increasingly attractive to criminals seeking to launder funds, or provide other facilities to support criminality. Unlike estate agents, letting agents handle large volumes of client money. There is a risk of criminal use of letting agency professionals and complicit professional enablers to let property acquired with the proceeds of crime.
64. Bringing letting agents into the scope of the regulations would be expected to help to mitigate money laundering and terrorist financing risks. Although there has been little recent work on letting agents, work carried out by SOCA in 2006 suggests that they are vulnerable to money laundering because:
    a. The industry is cash-rich and offers easy potential for proceeds of crime to be laundered,
    b. Rental rates are set by the letting agent, allowing easy under or over-payment,
    c. Intelligence shows that serious organised criminals use letting agents, which suggests they are vulnerable to exploitation by criminal groups.

Chapter II – Customer Due Diligence- Section I – General Provisions

Customer Due Diligence and e-money

65. Chapter II sets out when obliged entities must apply customer due diligence measures:
    a. identifying the customer and verifying identity,
    b. identifying the Beneficial Owner and verifying identity,
    c. assessing the purpose and intended nature of the relationship, and
    d. conducting ongoing monitoring of the relationship, including scrutiny of transactions and where necessary the source of funds.
66. Article 12 allows a potential exemption from points (a), (b) and (c) of the CDD requirements for certain e-money products, where all of the following conditions are met:
    a. The payment instrument is not reloadable, or has monthly payment limits of €250;
    b. The maximum amount stored electronically does not exceed €250 (or for electronic money instruments only used in that Member State, €500);
    c. The payment instrument is used exclusively to purchase goods or services;
    d. The payment instrument cannot be funded with anonymous electronic money;
    e. The issuer carries out sufficient monitoring of the transactions to enable the detection of unusual or suspicious transactions.

Options for a partial exemption for e-money

67. **Do nothing:** by not taking advantage of the derogation, all e-money products would be subject to customer due diligence provisions.
68. Instead, we propose to consult on whether the MT/TF risks presented by e-money products are sufficiently low to allow us to take advantage of **the potential exemptions offered for e-money.** The exemption limits for non-reloadable e-money instruments are higher than those already applied in the UK in the 2007MLRs (which set a maximum amount stored at €150). However, for rechargeable instruments, the current MLRs set a limit of €2,500 total transactions in a calendar year, except when an amount of €1,000 or more is redeemed in the same calendar year by the electronic money holder.
69. Article 15 allows for Simplified Due Diligence where the business relationship or transaction presents a lower degree of risk. SDD is defined as ensuring that entities carry out sufficient

monitoring of the transactions and business relationship to enable the detection of unusual or suspicious transactions. We plan to consult on whether any further e-money products present a sufficiently low risk to benefit from these simplified due diligence measures.

Monetised and non-monetised costs and benefits

70. As the e-money sector is already subject to AML/CFT regulations, we do not expect any new costs associated with setting up systems for carrying out CDD and ongoing monitoring. We will consult in order to gain a better idea of whether any more products will be brought within scope and what the administrative costs of doing so would be.
71. If thresholds for CDD are set too low, this counteracts the ease and speed of use which attracts customers to the e-money sector, reducing business. The new monthly payment limit in 4AMLD means that, whereas previously e-money holders could carry out one or many transactions up to €2,500 in a calendar year, they will now be limited to €250 per month. While this means that the annual threshold is effectively now €3,000 it may be that the monthly limit will dissuade customers from taking up the e-money product. Those customers that wish to spend more than €250 in a single month will need to take up a product without those limits which will require undergoing CDD checks. The direct cost of carrying out CDD on a customer is estimated as £3-£10 by the E-Money Association (EMA).
72. Data from EMA suggests that there is a significant drop-off rate (up to 50%) experienced when CDD is initiated at the outset of a relationship rather than when a customer is committed to the product.
73. It is difficult to understand what effect of customer choices the changes in the derogation offered by 4AMLD will be, but it may be that more customers will be put off by the introduction of a €250 monthly limit that will be gained by the increase to a €3,000 annual limit. If the customers dissatisfied with the €250 limit experience the suggested 50% drop off rate when alternative products without a limit but requiring CDD are offered, this will represent a loss of business to e-money providers.
74. The Government will consult to build up a better understanding of the risks of this sector and the likely behaviour of customers in order to make an estimate of potential costs.

<u>Chapter II – Section 2 – Simplified Customer Due Diligence</u>

Application of Simplified Due Diligence

75. The Directive sets out that Member States may allow the application of SDD in areas of lower risk, considering types of customers, geographic areas, and particular products, services, transactions or delivery channels as set out in Annex II of the Directive.
76. This represents a change from 3AMLD where a number of customers and products were specifically subject to SDD and set out as such in regulation 13 of the current MLRs, in overview:
    a. Where the customer is:
        i. a credit or financial institution which is subject to the requirements of the money laundering directive;
        ii. a credit or financial institution situated in a non-EEA state which imposes requirements equivalent to those laid down in the money laundering directive; and is supervised for compliance with those requirements;
        iii. a company whose securities are listed on a regulated market subject to specified disclosure obligations;
        iv. an independent legal professional and the product is an account into which monies are pooled;
        v. a public authority in the United Kingdom or an overseas public authority subject to certain conditions.
    b. Where the product is:

i. a life insurance contract with an annual premium of no more than €1,000 or a single premium of no more than €2,500;
ii. an insurance contract for the purposes of a pension scheme where the contract contains no surrender clause and cannot be used as collateral;
iii. a pension, superannuation or similar scheme where contributions are made by an employer or by way of deduction from an employee's wages and the scheme rules do not permit the assignment of a member's interest under the scheme;
iv. a child trust fund

c. Any product or transaction meeting the conditions set out in schedule 2 of the MLRs (setting out various thresholds, stipulations around transparency and limits on use.

77. 4AMLD does not specifically set out that SDD is appropriate in specific instances, in line with revised FATF principles. However, it sets out a non-exhaustive list of factors that should be considered when deciding whether SDD is appropriate:
    a. public companies listed on a stock exchange and subject to disclosure requirements (either by stock exchange rules or through law or enforceable means), which impose requirements to ensure adequate transparency of beneficial ownership;
    b. public administrations or enterprises;
    c. customers that are resident in geographical areas of lower risk (other member states, countries with effective AML/CFT regimes, countries with little corruption/criminality);
    d. life insurance policies for which the premium is low;
    e. insurance policies for pension schemes if there is no early surrender option and the policy cannot be used as collateral;
    f. a pension, superannuation or similar scheme that provides retirement benefits to employees, where contributions are made by way of deduction from wages, and the scheme rules do not permit the assignment of a member's interest under the scheme;
    g. financial products or services that provide appropriately defined and limited services to certain types of customers, so as to increase access for financial inclusion purposes;
    h. products where the risks of money laundering and terrorist financing are managed by other factors such as purse limits or transparency of ownership (e.g. certain types of electronic money);
78. While specific exemptions have been withdrawn, many of the areas previously expressly subject to SDD are now considered to be indicators of potentially lower risk, where SDD would apply. Article 15 and 16 of 4AMLD allow a broad interpretation of risk, allowing both member states and obliged entities to make assessments of products and customers that can be subject to SDD. This is in line with updated FATF standards which promote a risk based approach, allowing individual jurisdictions and entities to make decisions about the level of risk they face and the required level of due diligence.
79. The European Supervisory Authorities (ESAs) are required, by June 2017, to issue guidelines on the risk factors to be taken into consideration and the measures to be taken in situations where SDD measures are appropriate. The ESAs launched a consultation on 21 October 2015 on draft joint guidelines on simplified and enhanced customer due diligence and the factors credit and financial institutions should consider when assessing the money laundering and terrorist financing risk associated with individual business relationships and occasional transactions. The consultation will close on 22 January 2016 with the publication of final guidelines following at a date TBC. These guidelines will serve to inform the government's decisions on whether to specifically subject certain products and customers to SDD.

Options for simplified due diligence

80. **Do nothing:** simply copying out the Directive would give no exemptions from CDD in legislation, leaving decisions as to whether to apply SDD solely down to business, albeit with industry specific guidance produced by the supervisors and the ESAs.

81. Instead, we propose to **seek evidence through consultation around the risks posed** by customers and products listed above, as well as any others that may be suggested, so as to make a properly evidenced decision as to whether any/all of them should be included in legislation as specifically warranting SDD.

Monetised and non-monetised costs and benefits

82. It is difficult to assess the likely costs and benefits of these changes. Should the consultation provide evidence to continue to set out these products and customers as being subject to SDD in legislation, then there will be no extra costs associated. However, removing a specific requirement for SDD does not necessarily mean that products and customers will be subject to CDD. Businesses would be in a position to make their own risk assessments and there might be variations, with some choosing to use SDD and others CDD measures in different situations.
83. **Costs** are likely to result from businesses having to undertake more detailed risk assessments for any areas that are no longer subject to SDD measures in legislation. These costs are likely to vary between sectors and individual firms as some may decide to make one risk assessment and subject entire classes of product or customer to SDD, while others may decide to make decisions on a case-by-case basis. We will seek to gain a better understanding of how different sectors will react through the consultation.
84. Further costs will come from the extra measures required by carrying out CDD rather than SDD. However, the precise actions required under SDD and CDD are not laid down, businesses are expected to vary them according the risk in each specific circumstance. For example, a business may carry out the ongoing monitoring requirement to differing levels of frequency and intensity (perhaps monitoring transactions over a certain level only) for various customers, all of whom are subject to SDD.
85. **Benefits** will accrue to business should any further areas be identified that should be subject to SDD in the legislation in terms of requiring a less intensive risk assessment. Assuming effective understanding of the risk based approach in the supervised population and adequate guidance produced by the various supervisors, the removal of particular products and customers from the legislation as being automatically subject to SDD could represent a stronger application of the risk based approach demanded by FATF as decisions on risk would be taken at a lower level by those closest to, and better able to understand, the risks. This may contribute to a successful result in the UK's MER in 2017/18.

Chapter II – Section 3 – Enhanced Due Diligence

Application of Enhanced Due Diligence

86. There is no scope for introducing exemptions for the Enhanced Due Diligence section of the Directive, which sets out that EDD must be applied when dealing with entities in high risk third countries, cross border correspondent relationships with third-country respondent institutions, and Politically Exposed Persons (PEPs), so the Government has to copy out the Directive here or carry a heavy infraction risk.
87. The Directive takes the application of EDD further than the existing regulations:
    a. Domestic PEPs, their family members and close associates are now captured where previously only foreign PEPs were caught;
        i. Given this goes further than the FATF requirements, and given many domestic PEPs in the UK will carry a low ML/TF risk, the Government will consult on the best way of ensuring a proportionate risk-based approach to the application of Enhanced Due Diligence
    b. The definition of correspondent relationships has been expanded from banks to cover credit and financial institutions offering similar services;
        i. This is in line with the updated FATF recommendations
    c. 'High-risk third countries' can be nominated by the Commission in delegated acts and EDD will be required when dealing with entities and natural persons from those countries;

Monetised and non-monetised costs

88. With respect to relationships with PEPs, obliged entities will be required to:
    a. Obtain senior management approval for establishing or continuing business relationships with such persons;
    b. Take adequate measures to establish the source of wealth and source of funds that are involved in business relationships or transactions with such persons; and
    c. Conduct enhanced, ongoing monitoring of those business relationships.
89. The number of domestic PEPs has been estimated at 22,000 by one UK bank. Carrying out EDD for these customers is likely to be more expensive that CDD measures, but it is currently unclear exactly how much more. For example, the measures taken to establish source of wealth for a domestic PEP will depend on the degree of risk of ML/TF perceived by the business in question and might range from simply asking the PEP to confirm the source through to investigating several independent data sources. Likewise, obtaining senior management approval for a business relationship does not necessarily require a decision at board-level. Someone at a lower level with sufficient understanding of the businesses' risk appetite and procedures with the authority to do may take such a decision.
90. Estimating costs for CDD or EDD measures is extremely difficult given that the nature and extent of checks will vary according to perceived risk and an institution may go well beyond what is required by law if it has decided to take a blanket approach to checks. The individual institutions risk appetite, customer base and access to software (there are a number of software solutions on the market) will all have an influence on the cost of carrying out checks and monitoring. Various financial institutions have offered informal estimates of £3-15 as the average cost of initial CDD measures, but these should be treated with caution. For the purposes of this impact assessment we have used these figures to make estimates for costs of EDD, below. However, it is important to remember that different banks will likely cite different average costs for CDD depending on their size, business model and risk appetite. We will seek more information through the consultation.
91. We have assumed that EDD measures are twice that of CDD (giving a range of £6-30) and further assumed that each PEP will have relationships with two different financial institutions as well as nine family members and close associates who will each have relationships with two financial institutions, making a total of 20 relationships that will be subject to EDD. This gives a lower bound estimate of 20x6 = £120 and an upper bound estimate of 20x30 = £6000 total cost of initial measures for each PEP and their family and close associates. This would give a total cost of between £2,640,000 and £132,000,000 to the industry as a whole if the entire domestic PEP population is to be subject to initial EDD checks on adoption of 4AMLD. However, we believe that a number of domestic PEPs have already been subject to EDD checks by international financial institutions which have adopted a single, global approach to AML/CFT compliance. We will also consult on how to encourage a risk-based approach to identification of PEPs and the EDD measures applicable to them.
92. Ongoing costs will depend on how many new PEPs come into existence each year and how often they establish new business relationships with financial institutions. The government has been unable to establish useful estimates for these ongoing costs and will seek more evidence through the consultation.
93. Costs of ongoing monitoring are much harder to average as the extent of monitoring varies according to the perceived risks, the activities of the PEP (e.g. how many 'unexpected' transactions occur), and the businesses understanding of the PEP and their relationship. We will seek to expand the evidence base for costs through the consultation.
94. With respect to the expanded definition of correspondent banking relationships, industry has so far indicated that this is unlikely to lead to quantifiable increased costs. As the 2012 FATF standards have already adopted this definition, key markets such as the US have adopted it. Therefore, financial institutions doing business with the US or carrying out transactions requiring US dollar clearing have already adopted this definition. It is unclear if there are smaller financial

institutions looking to operate correspondent relationships that are not working to this definitions. We will seek to expand our understanding through the consultation.

Monetised and non-monetised benefits

95. Research from the World Bank (*Stolen Asset Recovery, PEPs, A policy paper on strengthening preventative measures, World Bank, 2009*) suggests that between $US20 billion and US$40billion is taken from developing countries by corrupt leaders and applied for their own personal use, outside of their home country. It also acknowledges that not all PEPs are corrupt, those that are will likely be a small proportion of PEPs. There is little in the way of public assessment of the actual risks posed by domestic PEPs of money laundering in the UK, making it difficult to assess the risks from the sector as a whole and tackle them in a proportionate manner. Part of the rationale for looking more closely at foreign PEPs is the need to look closely at why such an individual is doing business in another jurisdiction, which does not apply to domestic PEPs. Given this limited evidence base, government plans to transpose the domestic PEP requirement in the most proportionate and commensurate way possible.

Chapter III – Beneficial Ownership Information

Registers for Beneficial Ownership Information

96. The Directive requires Member States to use central registers to hold beneficial ownership information for corporate and legal entities incorporated in their territory. Member States can make the registers public, or at a minimum ensure competent authorities, law enforcement, obliged entities and others with a “legitimate interest” have access to the information.
97. The Government is already on track to deliver the Prime Minister’s G8 commitment to establish a publicly accessible central register of company beneficial ownership information. The Department for Business, Innovation and Skills (BIS) consulted on the People with Significant Control (PSC) regime in 2013, 2014 and 2015, the legislative framework was established in the Small Business, Enterprise & Employment Act 2015 and the regime will become operational in 2016.
98. The government will continue to consider how the PSC regime should develop in order to meet the requirements of 4AMLD. This will include deciding how best to make the register comply with the requirement to be kept current and to cover a wider range of legal entities, beyond companies and limited liability partnerships.
99. The Directive also directs Member States to require trustees of any express trust governed under their law to obtain and hold adequate, accurate and up-to-date information on beneficial ownership regarding the trust. Further, Member States are required to establish a central register to hold this beneficial ownership information for those trusts that generate a tax consequence. This register must contain adequate, accurate and up-to-date information and allow timely, unrestricted access by competent authorities and law enforcement.
100. The government intends that HMRC will implement the register for trusts generating a tax consequence as the most proportionate approach, given that HMRC already collects tax information from such trusts.

Monetised and non-monetised costs and benefits for the register of companies

101. The government has already impact assessed the overall PSC regime here: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/434546/bis-15-320-enhanced-transparency-of-company-beneficial-ownership-enactment-impact-assessment.pdf - this enactment stage Impact Assessment has a green rating from the RPC. Two further, smaller, aspects of the regime have been assessed separately, these Impact Assessments have not yet been published but also have green ratings from the RPC.
102. The government will continue to seek further evidence of the costs and benefits of any changes that need to be made to the PSC regime for compliance with the Directive.

Monetised and non-monetised costs and benefits for the register of trusts

103. We do not anticipate there being any costs to business or trustees to holding beneficial ownership information as trustees should already hold this information. Only trusts that generate a tax consequence are caught by the register and such trusts already provide tax returns to HMRC. Information will be provided to HMRC through a new digital on-line service that will allow customers to register new trusts and to confirm that their details are up to date or amend them as required. It is expected that existing data on HMRCs self-assessment system will be migrated over to the new digital platform.

104. The cost of establishing the trust register is not yet known. HMRC Solutions Architects are currently working up expected costs which are not expected to be agreed before the end of November 2015.

105. HMRC have also commissioned internal work to quantify benefits of the trusts register, but do not expect to have usable data until April 2016.

106. Through the consultation, the government will continue to gather further views on the best way of ensuring that the information in the register meets the Directive's requirements, weighing up the requirements for and benefits of adequate, accurate, and up-to-date information with the associated costs.

Chapter VI – Policies, procedures and supervision

Supervision – fit and proper test

107. The current MLRs require that a "person who effectively directs" a trust and company service provider (TCSP), a gambling service provider or a money service business (MSB) is subject to a fit and proper person test. The Directive will require that this test be extended to cover "persons who hold a management function … or are the beneficial owners" of these entities, with the exception of MSBs.

108. The Directive does not define what a "management function" is, but the government's view is that a management function goes beyond senior management to cover those who have a substantial role in:

a. the making of decisions about how a significant part of the entity's activities are managed or organised

b. the actual managing or organising of a significant part of those activities

Options for supervision – fit and proper test

109. The government must extend the fit and proper test to those holding a management function. The optionality here comes from the definition of management function. The government will seek views on the definition set out above through the consultation and will consider other views.

110. MSBs are currently subject to a fit and proper test. However, HMRC figures (as at end-October 2015) show that the sector operates through a network of 45,468 agents, many of whom have relationships with more than one MSB. These agents are not subject to fit and proper tests but the National Risk Assessment identifies the use of agents as an AML/CFT vulnerability because they present a fraud risk and can be vulnerable to exploitation by criminals.

111. Consequently, the government will consult on whether the supervisor (HMRC) should be given the discretionary power to apply fit and proper tests to the agents of MSBs and to prevent those that do not pass a test from acting as MSB agents. Early, informal indications from some MSBs are that this measure would be welcomed as fit and proper status is seen as a valuable endorsement from HMRC.

Monetised and non-monetised costs and benefits

112. We assume that the definition of management function outlined above is agreed. HMRC supervises 2,085 MSBs and 2,594 TCSPs while the Gambling Commission regulates 2935 gambling service providers. HMRC's experience is that each regulated business currently has just over two individuals subject to fit and proper tests. It is difficult to be sure whether changing the focus to individuals with a management function will significantly affect this number although HMRC believes that there will be no significant change. The government will seek to gain a better picture through the consultation and has not attempted to make an estimation at this stage.

113. The majority of MSB agents are small businesses, often sole traders. If HMRC was given the power to subject MSB agents to fit and proper tests, around 50,000 more individuals would potentially subject to such a test. HMRC would not seek to impose tests on all agents, but would take a risk based approach. Through the consultation we will seek to gain a better understanding, but it seems reasonable to assume that 10% of the agent population might be tested initially with around 1% of the population being testing each year after that to account for new entrants etc. The government, therefore, might expect 5000 fit and proper tests in the first year and a further 500 tests per year. A single test costs £50 which would result in an initial cost of £250,000 and annual costs of £25,000. HMRC would also need to assess costs and resourcing before making a decision as to whether to charge for these tests.

114. **Benefits** would accrue from businesses that are at risk of exploitation for money laundering and terrorist financing being owned and managed by people considered to be fit and proper. While difficult to quantify, this is expected to make it more difficult to launder money through these sectors. A further benefit to MSBs themselves would be increased confidence in how well the industry is regulated, which could result in MSBs finding it easier to access financial services from banks.

Supervision – criminality test

115. The Directive introduces a new criminality test for:

a. auditors, external accountants and tax advisors;

b. notaries and other independent legal professionals;

c. estate agents.

116. Supervisors will be required to take necessary measures to prevent criminals convicted in relevant areas or their associates from holding a management function in, or being the beneficial owners of, these entities. This means supervisors must take steps to find out whether someone holding a management position, or seeking to hold one, has been convicted of a relevant offence.

117. As discussed above, the Directive does not set out what constitutes a management function and the government will adopt the same approach to the issue here as with fit and proper tests.

118. The Directive does not set out what is meant by 'relevant areas', so the government takes the most proportionate view that this means convictions in areas relevant to money laundering and terrorist financing. We will consult on specific offences that should be considered relevant, but it may be that the supervisors of relevant sector are best placed to decide what relevant convictions are.

119. Similarly, the Directive does not define associates. However, the government takes this to mean criminal business partners and close family as defined for PEPs (Spouse, parents, and children).

120. The government also believes that there is a case for extending the criminality test to High Value Dealers (HVDs). Law enforcement has identified that organised crime groups have been involved in large-scale criminality using trade-based money laundering involving high value goods. HMRC also reports HVDs being used by criminals involved in alcohol fraud. Organised crime groups have been known to register companies as HVDs to provide an appearance of legitimacy when involved in money laundering or terrorist financing. The NRA identifies the following risks:

a. HVD businesses are being used to launder the proceeds of crime, exploiting the 'bank quick drop' system;

b. low levels of compliance with the Regulations and POCA by negligent HVD operators are enabling criminals to launder the proceeds of crime;

c. low levels of SAR reporting across the sector;

d. the low number of registrations, which suggests there may be a level of under-registration.

121. The NRA also says “HMRC indicates that there is a significant challenge to raise awareness amongst businesses selling goods and who accept large cash payments for single transactions as they may be liable to register and to be supervised by HMRC under the Regulations. The low number of registered HVDs also makes it more difficult to establish a fully informed risk assessment of the wider sector”.

Options for supervision – criminality test

122. The government must introduce a criminality test in order to comply with the Directive. The optionality arises from the definition of what constitutes a management position, what constitutes a relevant offence, the definition of associates and the possibility of bringing HVDs into scope. The government will consult on these issues in order to more fully understand the costs and benefits.

123. The government realises that this requirement will mean that a large number of criminality tests will need to be administered. Therefore, we believe that a two year transition period would be needed to allow the currently regulated population to go through these tests. We will consult on whether this length of time is sufficient.

Monetised and non-monetised costs and benefits

124. **Costs** will flow from the application of the criminality tests. These cost £100 when carried out by HMRC and we assume this cost for all supervisors. This would be charged to the business in question.

125. We estimate that there are around 64,000 audit, external accountant and tax advisor businesses; 12,000 notaries and independent legal professional firms; 9,000 estate agency businesses; and 1,000 registered HVDs. The beneficial owner(s) of each of these will need to undergo a criminality test. It is difficult to be sure how many individuals will be identified as holding a management function as many of these may be small firms where the beneficial owner is also the key manager. For the purposes of this risk assessment, government assumes that 2 people from each business will need to undergo a criminality test in the transition period, with 5% of the population needing to be tested annually on an ongoing basis to take account of new businesses and changes in ownership/staff. The government will consult to improve our understanding of the costs. Using these assumptions, the initial cost during the transition period would be (86000x2) x £100 = £17.2m with the annual cost being £860,000.

126. **Benefits** are expected to flow from excluding criminals from owning or managing businesses that can play important roles in enabling money laundering and terrorist financing. The National Risk Assessment identified significant intelligence gaps in law enforcement agencies’ understanding of how money is laundered through professional service sectors but finds that this type of laundering is particularly relevant to major frauds and serious corruption. It identified cases where complicit professionals have facilitated money laundering through the purchase of property with criminal proceeds and the creation of complex corporate structures and offshore vehicles to conceal the ownership and facilitate the movement of criminal assets.

Supervision – professional body supervision for estate agents

127. Currently, estate agents are supervised by HMRC. The Directive allows for self-regulation and the Government may decide to appoint professional bodies to supervise estate agents for AML purposes.

Options for supervision – professional body supervision for estate agents

128. **Do nothing:** this would mean not appointing professional body supervisors and HMRC remaining the AML supervisor for all estate agents.

129. Instead, the government intends to consult on the benefits of allowing professional body supervision in order to gain a better understanding before making a decision. Should such self-regulation be allowed, it is likely that a number of bodies would seek to establish themselves as supervisors but that HMRC would continue to supervise those estate agents that do not belong to a professional body.

Monetised and non-monetised costs and benefits

130. **Costs** from allowing self-regulation would accrue to HMRC and the businesses that it supervises. It is extremely unlikely professional body supervisors would capture the entire estate agency industry, therefore HMRC would have to continue to regulate estate agents not captured by such bodies and to police the regulatory perimeter for unauthorised estate agents. Supervision of the remaining estate agents would require continued spend on fixed costs such as IT systems which cannot be managed down proportionately in accordance with the size of the supervised sector, implying that HMRC would need to increase the fees charged to the regulated sector to cover fixed costs as some estate agents moved to a new supervisor.

131. Registration fee income from estate agents generates 20% of HMRC's fee revenue, based on annual per-premises registration fees (16,129 estate agency premises out of a total 77,917 premises on the register in September 2015 = £1.7m pa at £110 per premises).

132. Assuming that all estate agents moved to new supervisors then HMRC would lose £1.7m income. There would be some reduction is costs due to HMRC having fewer visits to conduct etc, but these would likely be offset by the increased work involved in policing the regulatory perimeter and remaining fixed costs associated with IT etc. This would have to be covered by annual fees from the remaining population of businesses supervised for AML purposes and would amount to £27.50 per premises (£1.7m divided by the remaining 61,789 premises).

133. Of course, this is an extreme calculation as a number of estate agents would remain supervised by HMRC and it is likely that some savings would be realised through needing less staff. But it is impossible to gather more accurate information on costs at this stage as it is unclear which professional bodies would apply to become supervisors, if they would be successful and what proportion of the sector they would cover.

134. Further **costs** might also be incurred by having multiple supervisors for a single sector. The National Risk Assessment identified inconsistencies between supervisors and it is possible that adding more supervisors to the picture would further complicate issues such as information sharing and consistency of approach.

135. **Benefits** might be expected to flow from professional body supervision where the supervisor has a more detailed knowledge of the sector and is able to more effectively assess and mitigate risks.

136. However, it is not possible to be certain about the potential costs and benefits of professional body supervision. The National Risk Assessment found that the current supervisory landscape, which includes a number of professional bodies, suffers from inconsistent supervision and difficulties in information sharing. The government has committed to addressing this issue and will undertake work to assess what the proper form of the supervisory system should be. This work will gather better evidence for the effectiveness, or otherwise, of professional body supervision.

Impact on Micro-businesses

137. The global standards set out by FATF and the EU Directive do not allow for the exemption of micro-businesses or any exemptions based on size. Money laundering and terrorist finance risks do not vary by size of business and experience shows that criminals often target smaller businesses. Consequently, micro-businesses will be in scope of transposition of the Directive.

Conclusion

138. The government takes threats from money laundering and terrorist financing very seriously and is committed to tackling it domestically and internationally. The National Risk Assessment of Money Laundering and Terrorist Financing risks found that, as the UK is a global financial centre, the same factors that make the UK an attractive place for legitimate financial activity – its political stability, advanced professional services sector, and widely understood language and legal system – can also make it an attractive place through which to launder the proceeds of crime.

139. Therefore the UK is exposed to money laundering and terrorist financing risks which the Government seeks to mitigate through the Anti-Money Laundering regime which has a clear aim: to make the UK financial system a hostile environment for illicit finances, whilst minimising the burden on legitimate businesses and reducing the overall burden of regulation.

140. The Directive represents an important step in bringing the EU into line with the internationally agreed standards laid out by FATF which will be assessed during the UK's mutual evaluation scheduled in 2017/18.

141. The government intends to implement the Directive in a proportionate and effective way that meets the aim to clamp down on illicit flows while minimising burdens as set out above. To achieve this, we will gather evidence through the public consultation process in Q1 2016 and aim to publish a response to this in Q2 2016 before legislation is prepared. The evidence gathered during the consultation and ongoing engagement with stakeholders will be of vital importance in ensuring that we make the most proportionate decisions, within the boundaries defined by the Directive, during transposition.