

The Money Laundering and Terrorist Financing (High-risk Third Countries) (HRTC) (Amendment) (no.2 Regulations 2023)

Lead department	HM Treasury (HMT)
Summary of proposal	This legislation will update the UK's HRTC list to reflect the latest country additions and removals made by the (Financial Action Task Force) FATF in 2023.
Submission type	Impact assessment (IA) – 23 rd October 2023
Legislation type	Secondary legislation
Implementation date	2023
Policy stage	Final
RPC reference	RPC-HMT-5295(1)
Opinion type	Formal
Date of issue	15 November 2023

RPC opinion

Rating¹	RPC opinion
Fit for purpose	As originally submitted, the IA was not fit for purpose, due to the RPC assessing the IA as having an inconsistent assessment of costs and benefits over two different appraisal periods, and unsupported assumptions relating to the calculation of the EANDCB. The IA now contains a proportionate assessment of the direct impacts on business, appraised consistently over an appropriate ten year period. The department has tested key assumptions and provided a suitable counterfactual estimate. The SaMBA is proportionate and fit for purpose, although the IA would benefit from addressing the data discrepancy to identify the most accurate number of SMBs that will be impacted by the proposal.

¹ The RPC opinion rating is based only on the robustness of the EANDCB and quality of the SaMBA, as set out in the [Better Regulation Framework](#). RPC ratings are fit for purpose or not fit for purpose.

Business impact target assessment

	Department assessment	RPC validated
Classification	Qualifying regulatory provision (IN)	Qualifying regulatory provision (IN)
Equivalent annual net direct cost to business (EANDCB)	£3.3 million (initial IA estimate) £49.9 million (final IA estimate)	£49.9 million (2019 prices, 2020 pv)
Business impact target (BIT) score	£249.6 million	£249.6 million
Business net present value	-£429.7 million	
Overall net present value	-£429.7 million	

RPC summary

Category	Quality ²	RPC comments
EANDCB	Green	The department identifies the main direct costs and benefits of the proposal, estimated to cost business £49.9 million per year. This estimate has increased from the EANDCB estimate in the original submission, which was £3.3m. The main reason for this increase is the appropriate move to an appraisal period of 10 years for both costs and benefits. Although the IA relies on several uncertain assumptions and data proxies, the department is transparent about the key risks and uncertainties throughout the IA, testing them through sensitivity analysis. The department correctly identifies the counterfactual position, netting off the existing impact of EDD from the cost and benefits in the IA.
Small and micro business assessment (SaMBA)	Green	Evidence suggests there are not disproportionate burdens on SMBs from the regulation, although the IA would benefit from further detailing this evidence from the consultation and review. The IA justifies why SMBs cannot be exempt from the proposal, guided by FATF standards, as they still hold money laundering and terrorist financing risks and identifies some methods of mitigation for SMBs, including an advisory notice.
Rationale and options	Good	The IA establishes a strong rationale for intervention. The IA clearly outlines the problem under consideration, through evidencing the risk of money laundering in the UK and the need for the UK to align

² The RPC quality ratings are used to indicate the quality and robustness of the evidence used to support different analytical areas. The definitions of the RPC quality ratings can be accessed [here](#).

		<p>its list with the FATF. The IA does not discuss any non-regulatory options, stating that they are not feasible due to the fact that the money laundering regulations are the framework underpinning the UK's response to money laundering and terrorist financing.</p>
Cost-benefit analysis	Good	<p>The IA clearly sets out the methodology underpinning the cost-benefit analysis but would benefit from comparing the costs and benefits in the body of the IA to present the overall NPV and business NPV. The IA is transparent about the key risks and assumptions underpinning the cost-benefit analysis and has done well to conduct sensitivity analysis. The sensitivity analysis could be improved by testing the impact of some assumptions individually.</p>
Wider impacts	Satisfactory	<p>The department states that there may be a wider equalities impact for individuals whose national origin or nationality is a high-risk third country. The IA could expand on this potential impact, presenting any evidence on the impact on different customer nationalities from previous removals or additions to the HRTC list. The IA details some potential indirect trade costs from the proposal, but could expand on this evidence, and compare the difference in trade volumes between the countries that have been removed and added to the list to present an indicative overall estimated trade impact.</p>
Monitoring and evaluation plan	Satisfactory	<p>The IA references a review of MLRs that took place in 2022. As the IA states that the next review will likely follow a similar approach, the department should include further detail on the 2022 review within the IA, including examples of the qualitative and quantitative data gathered and the metrics and key research questions used. Furthermore, although the IA anticipates that the next review will follow a similar approach, it could provide more detail on how the review will be adapted to focus the review on the proposed measure.</p>

Response to initial review

As originally submitted, the IA was not fit for purpose for three reasons:

1. The department had incorrectly appraised the costs of conducting EDD for new countries and the benefits from removing EDD for old countries over two different appraisal periods. The department should have presented the ongoing costs and benefits in the same appraisal period and a ten-year appraisal period is the default appraisal period in alignment with Green Book guidance.
2. The IA did not provide enough clarity on the counterfactual. The IA referenced that some international firms already applied EDD measures to the six countries being added to the UK's list but did not consider the new EDD costs or benefits in relation to this existing position.
3. The department made several assumptions in the analysis which were uncertain and needed to be further tested, including the assumptions on the number of firms, customers and the familiarisation assumptions.

A number of changes have been made to address the points made in the IRN:

1. The department has moved to an appraisal period of 10 years for both costs and benefits. Although countries are often de-listed by the FATF within 3 years, further legislation would be required to affect that de-listing, so a 10-year appraisal period is appropriate for consistency.
2. The department has estimated the counterfactual using data collected by the FCA through its REP-CRIM questionnaire on jurisdictions viewed as high-risk.
3. The department has tested the significance of all key assumptions by conducting sensitivity analysis, using arbitrary percentage adjustments and upper and lower estimates when available.

Summary of proposal

The National Crime Agency assesses it is a realistic possibility that over £100 billion is laundered every year through the UK or through UK corporate structures. To help mitigate this threat the UK's current Money Laundering (ML) and Terrorist Financing (TF) Regulations require regulated sectors to apply Enhanced Due Diligence for customer relationships and transactions with links to High Risk Third Countries (HRTC).

The UK's policy is to align its HRTC list with that of the global anti-money laundering and counter terrorist financing (AML/CFT) standard setter, the Financial Action Task Force (FATF). This legislation will update the UK's HRTC list to reflect the latest country additions and removals made by the FATF in 2023. These changes are important as the countries identified by FATF have significant AML/CFT deficiencies and updating UK's list will require that regulated sectors have appropriate controls in place to identify and prevent ML and TF.

The department considers two options:

Option 1) Update the UK's High Risk Third Countries list to reflect FATF changes (preferred). The UK's list will be updated and brought into line with the most recent FATF list, ensuring the UK's response is proportionate to identified international threats to the global financial system and Government commitments to align the UK's HRTC list with that of the FATF². Acting now is important to ensure there are no further delays in the UK aligning with internationally identified risks in order to ensure that the UK's regulated sectors are applying enhanced scrutiny and due diligence to customer relationships and transactions with these high-risk jurisdictions. This will safeguard the UK's reputation as a safe place to conduct business and maintain confidence in the financial system. Aligning the UK's list with the FATF's list is the preferred option and supported by the regulated sector.

Option 2) Do nothing – i.e., do not update UK's High Risk Third Countries list. The UK's list is outdated and therefore out of step with the FATF's assessment of high-risk jurisdictions. Further delays will undermine the UK's risk-based approach to economic crime threats as the response would no longer be proportionate to the country threats. For example, firms would have to continue undertaking EDD on Albania, Cayman Islands, Jordan, and Panama who have rectified their systemic AML/CFT deficiencies identified by the FATF – leading to unnecessary costs for UK firms. Similarly, regulated sectors would not need to apply enhanced due diligence for six countries that FATF has identified as having major deficiencies in their AML/CFT regimes.

EANDCB

Impacts

The department identifies that the main direct costs of the proposal are familiarisation costs, one off transition costs of conducting enhanced due diligence (EDD) on existing customers, and the costs of conducting EDD on new customers in relation to the six countries added to the HRTC list. Benefits are identified as the savings from no longer needing to conduct EDD for the four countries removed from the HRTC list. This is estimated to cost business £49.9 million per year. This estimate has increased from the EANDCB estimate in the original submission, which was £3.3m.

The main reason for this increase is the appropriate move to an appraisal period of 10 years for both costs and benefits. Although countries on average remain on the FATF and the UK's list for 2-3 years, removing countries from the HRTC list requires separate legislation (and therefore a separate IA). Therefore, it is reasonable to conclude that a ten-year appraisal period should be used for this IA. Here, the net saving associated with the country's potential removal from the list will be realised within the appraisal period of the IA that covers the impacts of their removal.

It is worth noting that the estimated transitional costs and annual costs associated with the proposal have also decreased since the original submission, as the department has now netted off the counterfactual compliance activity, taking better

account of existing EDD measures undertaken by businesses. This has reduced the rate at which the EANDCB has increased since the first submission.

The IA explains within the non-monetised costs that requirements, regarding account closures and the customer opportunities to challenge these, are being strengthened (para 34). The IA could provide more details about the expected impacts on business as a result of this strengthened requirement with monetisation where possible.

Assumptions

Although the IA relies on several uncertain assumptions and data proxies, the department is transparent about the key risks and uncertainties throughout the IA. The department has tested the significance of all key assumptions by conducting sensitivity analysis, using arbitrary percentage adjustments and upper and lower estimates when available. The sensitivity analysis could be improved by testing the impact of some assumptions individually, such as the assumption on the number of firms affected by the HRTCs. This would allow the IA to set out the isolated significance of these assumptions and identify which assumptions are most uncertain and influential to the overall EANDCB estimate.

The department assumes that the number of new customers in HRTCs per year remains constant over the ten-year appraisal period, at 2% of existing customer data. This is based on data provided by a sample of banks in South Africa and Nigeria. Although the IA states that this assumption has been tested with sector experts, the IA could benefit from applying further sensitivity analysis to test the impact of this 2% increasing over time.

Furthermore, IA could be improved by confirming whether non-wage uplifts are correctly applied to the median wage data in its assessment of familiarisation costs.

Counterfactual

The department correctly identifies the counterfactual position, using data collected by the FCA through its REP-CRIM questionnaire on jurisdictions viewed as high-risk to net off the existing impact of EDD from the cost and benefits in the IA.

SaMBA

The department has identified that approximately 26% of the entities in scope of the MLRs were sole practitioners in 2021 to 2022, of which the majority were independent legal and accountancy professionals. However, the IA also references data from Professional Body Supervisors that shows a large majority of firms subject to MLRs are small and micro sized entities. Although there are different definitions of sole practitioners and small and micro entities, the IA would benefit from addressing

this discrepancy between the two data sets to identify the most accurate number of SMBs that will be impacted by the proposal.

The IA states that although the cost of introducing EDD for new HRTCs is likely to result in relative higher costs for SMBs, evidence from consultations and the last MLRs review shows that most sole practitioners are less likely to have subsidiaries or branches in HRTCs, suggesting there are not disproportionate burdens on SMBs from the regulation. The IA would benefit from further detailing this evidence from the consultation and review. The IA goes on to justify why SMBs cannot be exempt from the proposal, guided by FATF standards, as they still hold money laundering and terrorist financing risks and identifies some methods of mitigation for SMBs, including an advisory notice.

Medium-sized businesses assessment

In addition to the existing SaMBA, the IA should also assess the potential impact of the proposal on medium-sized businesses (with 50-499 employees). The department should also provide details of any disproportionate impacts, targeted exemptions or suggested mitigations for medium-sized businesses.

Rationale and options

Rationale

The IA establishes a strong rationale for intervention. The IA clearly outlines the problem under consideration, through evidencing the risk of money laundering in the UK and the need for the UK to align its list with the FATF.

The IA mentions that the UK's list has been updated three times per year since 2021, but there has been delays in reflecting the FATF changes from February and June 2023, due to the significant materiality of the two countries added and the need for government to collect additional data. The IA could provide further detail on how this lack of data has been mitigated for this proposal.

Options

The IA considers two options, the preferred option to update the UK's High Risk Third Countries list to reflect FATF and a do-nothing option. The IA explains why the do-nothing option is not sufficient, as it would not align with FAFT updates and would mean the regulated sector continues to apply EDD to countries that are recognised as making improvements in their AML/CFT regime, whilst not applying EDD to new high-risk countries.

The IA does not discuss any non-regulatory options, stating that they are not feasible due to the fact the money laundering regulations are the framework underpinning the UK's response to money laundering and terrorist financing. As the proposal is to update Schedule 3ZA (the HRTC list), within the money laundering regulations, the IA considers that there is not a further non-regulatory option to achieve this. The IA could provide more information for the lay reader on the existing money laundering regulations and how they relate to the HRTC list.

Cost-benefit analysis

Methodology

The IA clearly sets out the methodology underpinning the cost-benefit analysis. The department uses the same formula to present all the costs and benefits associated with conducting EDD. This (mostly) three-part calculation is based on the number of firms required to conduct EDD, the number of their customers or transactions and the average EDD cost per customer. The IA helpfully details examples of this calculation for different countries throughout the IA.

IA presents the total costs and benefits for both options relative to the counterfactual and includes a high and low range to reflect uncertainty. However, the IA would benefit from summarising the total costs and benefits against each other to present the NPV and business NPV in the body of the IA.

Data

The IA uses a range of different data sources to support its cost-benefit analysis, utilising data provided by a sample of banks and previous consultations. The IA also relies on proxies, such as the number of financial firms with overseas operations and the number of UK nationals and companies in HRTCs. The IA appears to use the best data available and does well to discuss the limitations of the different data sources. The IA could be improved by including the detail about the data proxies in the body of the IA, rather than referencing it in footnotes (such as Footnote 21).

Uncertainty, risks and assumptions

The IA is transparent about key risk and assumptions underpinning the cost-benefit analysis. The department has tested the significance of uncertain assumptions appropriately with sensitivity analysis and illustrates how this affects the overall costs and benefits. As mentioned in the EANDCB section, the sensitivity analysis could be improved by testing the impact of some assumptions individually.

Wider impacts

Equalities

The department states that an equalities assessment will be made available alongside the IA, and that there may be a wider impact for individuals whose national origin or nationality is a high-risk third country, or for those who have family ties to a high-risk third country. The IA states that the government has sought to mitigate these impacts by issuing guidance to regulated firms to clarify that “nationality” in itself is not a basis to be subject to enhanced due diligence, and that firms should consider the intensity with which they undertake due diligence depending on the risk attributed to a customer. The IA could expand on this potential impact, presenting any evidence on the impact on different customer nationalities from previous removals or additions to the HRTC list.

Trade

The IA details some potential indirect trade costs from the proposal, as businesses might transfer the additional EDD costs for the new countries to their clients in HRTCs. The IA also references the fact that this impact will result in the opposing benefit impact for countries removed from the list. The IA compares the volume of trade and investments flows between the UK and countries added and removed from the list of HRTCs to show which countries would receive the largest indirect trade benefits or costs. As the trade impact is essentially the same in both directions for countries added or removed from the list, the IA could expand on this evidence, and compare the difference in trade volumes between the countries that have been removed and added to the list to present an indicative overall estimated trade impact.

Monitoring and evaluation plan

The IA references a review of MLRs that took place in 2022, representing a comprehensive assessment of the UK's AML/CFT supervision regime and EDD requirements for businesses conducting business with HRTCs. As the IA states that the next review will take place no later than 2027 and will likely follow a similar approach, the department should include further detail on the 2022 review within the IA, including examples of the qualitative and quantitative data gathered and the metrics and key research questions used. Furthermore, although the IA anticipates that the next review will follow a similar approach, it could provide more detail on how the review will be adapted to focus the review on the proposed measure, for example being more specific about how to focus the review on HRTC for this regulation, rather than MLR as a whole and identifying how the causality between the proposed measure and the review will be established. This will allow the department to accurately evaluate the effectiveness of the proposal and measure the success of the objectives.

Regulatory Policy Committee

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