Title: Transposition of the Fifth Anti-Money Laundering Directive **IA No:** N/A **RPC Reference No:** RPC-HMT-4432(1) **Lead department or agency:** HM Treasury **Other departments or agencies:** Home Office, National Crime Agency, HM Revenue and Customs, Financial Conduct Authority	**Impact Assessment (IA)** **Date:** 21/10/2019 **Stage:** Development/Options **Source of intervention:** EU **Type of measure:** Secondary legislation **Contact for enquiries:** Agnes Chauvet (agnes.chauvet@hmtreasury.gov.uk)

Summary: Intervention and Options

RPC Opinion: GREEN

Cost of Preferred (or more likely) Option (in 2019 prices)			
Total Net Present Social Value	**Business Net Present Value**	**Net cost to business per year**	**Business Impact Target Status**
£-673.5m	£-673.5m	£78.2m	Qualifying provision

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

Amendments to the Directive on the prevention of the use of the financial system for money laundering or terrorist financing (4MLD) were agreed and published in the Official Journal of the EU in June 2018. These amendments to the Directive must be transposed into domestic legislation by January 2020 to meet obligations to the EU and the underpinning standards of the Financial Action Task Force (FATF) which sets the international standards in this area.

What are the policy objectives and the intended effects?

The Government's objective is to make the make the UK's financial system difficult to exploit for illicit finance purposes while minimising the burden on legitimate business. The aim of the proposed legislative changes is to deter crime and terrorism by making it more difficult for criminals to benefit from the proceeds of their crime and easier to detect and investigate criminal or terrorist abuse of the financial system. The proposed approach to transposition intends to make the regulations as effective and proportionate as possible, while maintaining compliance with EU and FATF standards.

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 the amending Directive places a legal obligation to transpose on the UK. Option 1 is to legislate to ensure compliance with the Directive ensuring that HMG engages potential exemptions where possible; consults on effective application of the proportionate and risk-based approach wherever possible. Option 2 is to copy out the Directive ensuring that HMG engages potential exemptions when possible and make additional changes to meet the FATF standards, FATF recommendations from the UK's mutual evaluation report in 2018 and address gaps in the supervision regime. 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 implement recommendations from the FATF mutual evaluation report on the UK.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** /2025

Does implementation go beyond minimum EU requirements?		Yes		
Is this measure likely to impact on international trade and investment?		Yes		
Are any of these organisations in scope?	**Micro** Yes	**Small** Yes	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)		**Traded:**	**Non-traded:**	

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: John Glen Date: 21/01/19

Summary: Analysis & Evidence

Policy Option 2

Description: Additional amendment of the regulations to meet FATF standards and gaps identified in the supervision regime (NB – Costs and benefits relating only to the additional amendment of the regulations)

FULL ECONOMIC ASSESSMENT

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
2019	2019	10	**Low:** Optional	**High:** Optional	**Best Estimate:** -1738.4

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate	222.9		63.6	766.2

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

The key monetised costs will be the transitional and annual costs of compliance for crypto-to-crypto exchange facilities, cryptoasset ATMs, peer-to-peer exchange facilities and initial coin offerings which are not covered by EU regulations. In addition, there will be an opportunity cost to businesses affected by the change to the requirement to be registered, costs associated with the clarification of the regulations on group policies and expanding the scope of the register of bank account ownership.

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

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate	0.0		0.0	**0.0**

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

We do not anticipate that there will be any direct monetised benefits to businesses.

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

The proposed changes will ensure that the UK meets the international standards set by FATF and fill gaps to the AML regime identified by AML supervisors. The MLRs provide a disincentive to crime 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 businesses, with beneficial effects on inward investment, and access to foreign markets by UK companies. Increased take up of electronic identification processes would have significant benefits including increased convenience for customers, cost savings for firms, increased competition, reduced economic crime and increased financial inclusion.

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

BUSINESS ASSESSMENT (Option 2)

Direct impact on business (Equivalent Annual) £m:			Score for Business Impact Target (qualifying provisions only) £m:
Costs: 89.0	**Benefits:** 0	**Net:** 89.0	391.2

Summary: Analysis & Evidence

Policy Option 1

Description: Transposition of the amending Directive on the prevention of the use of the financial system for money laundering and terrorism financing (minimum requirements) and clarifications of 4MLD requirements.

FULL ECONOMIC ASSESSMENT

Price Base Year 2019	PV Base Year 2019	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	**High:** Optional	**Best Estimate:** -1707.9

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate	1160.0		63.3	1707.9

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

The key monetised cost for new regulated entities will be the transition costs of familiarising themselves with their new legal obligations and setting up policies and procedures to comply with the regulations and training staff, as well as ongoing costs related to customer due diligence. The cost for regulated firms may include familiarisation costs as well as increased ongoing compliance costs.

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

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate	0.0		0.0	**0.0**

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

We do not anticipate that there will be any direct monetised benefits to businesses.

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

The proposed changes will ensure that the UK is at a level playing field with the EU and have wider benefits to society by making it harder for criminals to exploit the UK's financial system to launder the proceeds of their crimes. New technology services which are not currently regulated for anti-money laundering purposes are becoming increasingly popular as alternative financial systems. Recent terrorist attacks have brought to light emerging new trends in the way terrorist groups finance and conduct their operations. The 5th EU Money Laundering Directive (5MLD) Directive seeks to keep up with the new trends and technologies and improve the transparency of financial transactions, corporate and other legal entities as well as trusts and legal arrangements to counter money laundering and terrorist financing more effectively and proportionately with the risk.

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

BUSINESS ASSESSMENT (Option 2)

Direct impact on business (Equivalent Annual) £m:			**Score for Business Impact Target (qualifying provisions only) £m:**
Costs: 198.4	**Benefits:** 0.0	**Net:** 198.4	871.9

Evidence Base

I. Problem Under Consideration

1. The money laundering threat to the UK remains high and is constantly evolving. The size of the UK's financial and professional services sector, the openness of our economy and the attractiveness of London's real estate to investors makes the UK unusually exposed to international money laundering risks.[1]

2. Although there are no definitive estimates of the total value of criminal money generated and laundered in the UK, the National Crime Agency estimates the scale of money laundering impacting the UK economy to be more than £100bn annually. Criminals continue to exploit the UK and overseas corporate vehicles such as nominee directors, shell companies and trusts to conceal beneficial ownership information.[2]

3. Globally, the UN estimated global criminal proceeds at 3.6% of GDP (around US$2.1trillion) in 2009 and the amount of money laundered at close to 2.7% of the global GDP (around US$1.6trillion).[3]

4. Money laundering is a key enabler of serious and organised crime. The Home Office estimates that UK organised crime generated £13bn and that its social and economic cost to the UK was approximately £37bn in the financial year 2015-16. The scale of money laundering in the UK includes the illicit proceeds of a range of serious crimes including large scale drug dealing and human trafficking.

5. The government assesses the threat to the UK from international terrorism as substantial, which means an attack is likely. The UK is a high-priority target for Islamism extremists. Despite the current main focus on terrorism emanating from Syria and Iraq, the majority of terrorist attacks plots in the UK have been planned by British residents including the London Bridge attacks, the Manchester Arena bombing and the 7/7 bombing.[4]

6. The UK does not typically see large-scale coordinated fundraising activity for terrorist groups. However, recent terrorist attacks across Europe have demonstrated that the costs of planning a terrorist attack can be very low. Therefore, tackling financial activity and making use of financial intelligence continues to be a hugely valuable tool for law enforcement's fight against terrorism.[5]

II. Rationale for Intervention

7. New technology services which are not currently regulated for anti-money laundering purposes are becoming increasingly popular as alternative financial systems. Recent terrorist attacks have brought to light emerging new trends in the way terrorist groups finance and conduct their operations. The 5th EU Money Laundering Directive (5MLD) Directive seeks to keep up with the new trends and technologies and improve the transparency of financial transactions, corporate and other legal entities as well as trusts and legal arrangements to counter money laundering and terrorist financing more effectively and proportionately with the risk.

8. Amendments to the Directive on the prevention of the use of the financial system for money laundering or terrorist financing were agreed and published in the Official Journal of the EU in June 2018. These amendments to the Directive must be transposed into domestic legislation by January 2020. The Directive sets out the common regulatory framework for

[1] Home Office (2016) Action Plan for Anti-Money laundering and counter-terrorism finance
[2] National Crime Agency (2019) National Strategic Assessment of Serious and Organised Crime
[3] UNODC (2011) Estimating Illicit Financial Flows Resulting from Drug Trafficking and Other Transnational Organised Crimes.
[4] Home Office, HM Treasury (2017) National risk assessment of money laundering and terrorist financing 2017.
[5] Home Office, HM Treasury (2017) National risk assessment of money laundering and terrorist financing 2017.

member states to address the collection of money or property for terrorist purposes and identify, understand and mitigate the risks related to money laundering and terrorist financing. In particular, the amending directive seeks to:

- Mitigate the risks of virtual currencies being exploited for terrorist financing or money laundering purposes. The anonymity of virtual currencies allows their potential misuse for criminal purposes and in the absence of appropriate regulations exchange service and custodian wallet providers are under no obligation to report suspicious activities. It also brings the art sector and letting agents with a monthly rent over EUR 100,000 within the scope of regulated entities.
- Ensure that regulated businesses who are engaged in business relationships or transactions involving high-risk third countries have appropriate mitigating measures in place when weaknesses in the Anti-Money laundering and counter terrorist financing (AML/CTF) regime of the third countries concerned are identified.
- Mitigate the risk of general-purpose prepaid cards by further reducing the limits and maximum amounts under which obliged entities are allowed not to apply customer due diligence measures. Although prepaid cards have legitimate uses their anonymity makes them vulnerable to being used for financing terrorist activity.
- Ensure that member states' Financial Intelligence units can obtain necessary information relating to their functions in a timely manner to effectively combat money laundering and terrorist financing. This includes access to national data allowing the identification of the holders, proxy holders and beneficial owners of banks and payment accounts and safe deposit boxes.
- Ensure that corporate and legal entities incorporated in member states hold and can obtain adequate, accurate and current information on beneficial ownership to prevent criminal form hiding their identity behind corporate structures. This includes ensuring that information on beneficial ownership of trusts and similar arrangements is recorded and accessible to those with a legitimate interest.
- Take into account the latest technical developments enabling remote or electronic identification.

9. The Financial Action Task Force (FATF) is the international organisation responsible for drawing up principles, policies and guidance to combat the threat of money laundering and terrorist financing globally. The UK is a leading member of the FATF. FATF recommendations represent the minimum standards required to combat money laundering and terrorist financing effectively. Countries may decide to go further than these international standards as the UK has previously done in the field of company beneficial ownership transparency.

10. With regards to cryptoassets, the FATF standards go further than the Directive and oblige members to regulate a range of other activities and exchange points for AML/CTF purposes that are not captured by 5MLD.The government therefore intends to follow the latest international FATF standards in its approach to regulating crypto assets.

11. In December 2018, the FATF released its last mutual evaluation report (MER) of the UK's AML/CTF regime, its level of compliance with the FATF 40 recommendations. The MER judged the UK largely compliant and noted significant improvements in the UK's AML/CTF framework. The government is committed to implement FATF standards and fill any gaps in the Money Laundering Regulations (MLRs) and the UK's AML/CTF regime identifies in the MER. Therefore, the government envisages a series of legislative changes to improve the efficiency of the UK's AML/CTF supervision regime and comply with FATF standards on customer due diligence.

12. This impact assessment examines approaches to transpose the Directive, seeking to benefit from any potential exemptions while ensuring that the UK meets FATF standards.

III. Policy Objectives and options

13. Effective AML/CTF regulations will contribute to making the UK a hostile environment for illicit finance, protecting the UK's reputation as a safe place to conduct business and maintaining confidence in the financial system with associated benefits to inward investment and access to foreign market by UK firms. Updating the regulations will help improve the detection and prosecution of crime and provide a disincentive to crime by reducing the profitability of illicit activities.

14. In its approach to transpositions, the government seeks to take advantage of any derogations to minimise costs on legitimate business while making sure regulations are proportionate with the risks of money laundering and terrorist financing and meet our international commitments.

15. The government will need to legislate to implement the directive and comply with the international standards of the FATF on AML/CTF.

- **Option 0:** 'Do nothing'. Under this option the UK would not transpose the Directive. This would breach the UK's legal obligation to transpose and would not meet FATF standards. It would damage the UK's reputation as a legitimate and trustworthy place to do business.
- **Option 1:** Transpose the Directive as required, ensuring the UK benefits from potential exemptions where possible, minimising burdens on legitimate businesses while ensuring regulations are proportionate with the risk of money laundering and terrorist financing. We consulted on the changes required by the amending Directive, gathering evidence on their likely effects in areas on which there is discretion.
- **Option 2:** Transpose the Directive as required and fill gaps identified in the FATF MER of the UK and other gaps identified in the supervision regime where required. This would strengthen the UK's AML/CTF regime and uphold the UK's reputation as a trustworthy place to do business.
- Option 2 is the preferred option.

Summary of option 1 and 2:

Proposed change	Option 1: copy out minimum EU requirement (EANDCB 1)	Option 2: copy out and go beyond 5MLD requirements (EANDCB 2)
1. New Obliged Entities: Tax adviser, letting agents, art sector	-Expand the definition of tax adviser, - Bring letting agents in scope in relation to transactions for which the monthly rent amounts to EUR 10,000 or more -Bring art market sector participants in transactions exceeding EUR 10,000, regardless of whether the transactions are carried out in cash. - Bring cryptoassets providers engaged in exchange services between virtual currencies and fiat currencies into the scope of regulations.	Extend the scope of cryptoasset businesses covered by the regulations to crypto-to-crypto exchange facilities, cryptoasset ATMs, peer-to-peer exchange facilities and initial coin offerings which are not covered by EU regulations

2. Electronic Money	Reduce the threshold for which CDD measures be applied to e-money products, meaning e-money firms will have to conduct CDD measures to 150 EUR.	
3. Customer due diligence	**Electronic identification:** sets out the circumstances under which secure, remote or electronic identification processes may be taken into account when undertaking customer due diligence. **Identifying senior** managing officials: 5MLD extends customer due diligence requirements for obliged entities to verify the identity of senior managing official, when the customer is a body corporate and the beneficial owner cannot be identified.	
4. Beneficial ownership requirements	5MLD requires that whenever an obliged entity enters into a new business relationship with a company or trust and verifies their identities, they must collect either: proof of registration on this register; or an excerpt of the register.	
5. Enhanced due diligence : high risk third countries	5MLD expands the scope of persons whom obliged entities must conduct EDD on to business relationships or transactions involving high-risk third countries identified by the EU Commission and requires obliged entities to carry out enhanced monitoring of such transactions.	Change the regulations to meet FATF recommendation 10.13 which requires financial institutions to include the beneficiary of a life insurance policy as a relevant risk factor in determining the need for EDD.
6. Trust Registration Service	5MLD expands the scope of the TRS by requiring trustees or agents of all UK express trusts to disclose beneficial ownership information about the trust, regardless of its tax status.	

7. National Register of Bank Account ownership	5MLD requires that the UK establish a centralised automated mechanism – such as a central registry or electronic data retrieval mechanism – which allows identification of natural and legal persons which hold or control bank accounts; payment accounts; or safe-deposit held by credit institutions within the UK. The mechanism will retrieve ownership information on those accounts, and that information held on such mechanisms is "directly accessible in an immediate and unfiltered manner to national FIUs", as well as national competent authorities for fulfilling their obligations under 5MLD.	implement the bank account register with a widened scope: we could include all building societies and SDB providers that are not credit institutions, placing costs on around 65-80 additional businesses. However, this would ensure that the tool is more effective and delivers greater benefit, while also minimising the risk of unintended market distortions.
8. Requirement to publish an annual report	5MLD requires self-regulatory bodies to publish an annual report containing information on their supervisory activity, including number of supervisory visits and enforcement action undertaken.	
9. Additional Technical Amendments to the MLRs:	**Complex network structures**: Amend Regulation 24 of the MLRs to require agents to be made aware of their obligation to train employees. (Clarification of 4MLD obligations) **Criminality checks**: Amend regulation 26 to clarify that self-regulated bodies should conduct criminality checks or have sufficient information in their possession to determine whether beneficial owner or manager applying for approval in a relevant sector has had a criminal conviction. (Clarification of 4MLD obligations)	**Change to the requirement to be registered:** Amend Regulation 56 of the MLRs so that MSBs and TCSPs can only practice legally once their application has been determined. **New technologies**: Amend the MLRs to make it explicit that financial institution is required to undertake risk assessments prior to the launch or use of new products, new business practices and delivery mechanisms as already specified in the JMLSG guidance. **Group policies:** Amend the MLRs to meet FATF Recommendation 18.2(b) which states that financial groups should be required to implement group-wide programmes against money laundering and terrorist financing, including, when necessary for AML/CTF purposes, the provision of customer, account and transaction information from branches and subsidiaries.

IV. The Challenges of cost-benefit analysis work

16. This impact assessment is informed by evidence gathered through the consultation, engagement with regulators and relevant stakeholders form regulated sectors as well as publicly available government and private research on the costs of AML compliance.

17. 5MLD and the FATF standards are underpinned by the risk-based approach which requires obliged entities to have a detailed understanding of the money laundering and terrorist financing risks within their sector and their own vulnerability to those risks. Once they understand the risks, they must apply appropriate procedures to mitigate their risks including verifying the identity of their customers and understanding the purposes of their activity (customer due diligence). The money laundering and terrorist financing risks vary across regulated sectors and the regulations do not prescribe how regulated entities should carry out customer due diligence checks. As a result, the policies and procedures regulated businesses adopt to comply with the MLRs vary greatly depending on the sector, the size of the business, the nature of their customer base and their risk appetite. This approach ensures businesses take measures to manage risks proportional with the risks whilst minimising burden on legitimate customer and giving businesses flexibility in their approach to compliance.

18. Because of the nature of the risk-based approach and the flexibility it gives businesses in how to comply with the regulations, it is extremely difficult to know what actions businesses will take to comply with changes in the regulations. This makes cost-benefit analysis of the regulation challenging, particularly in relation to evaluating the monetised costs of customer due diligence challenging

19. Earlier reviews and Impact Assessments of the MLRs have highlighted the difficulty for regulated industries to identify the costs of AML customer due diligence checks. This is partly because customer due diligence checks are integrated into businesses' commercial activities rather than carried out separately. It is also difficult to isolate the costs to businesses incurred by changes to UK law from costs incurred by international considerations. A range of businesses would seek to verify the identity of their customers, monitor high-risk customer and gather data on customers as a commercial and risk management practice. Financial institutions with inadequate customer due diligence standards expose themselves to legal and reputational risks. In particular, businesses that operate in the United States (US) or carry out transactions which may be subject to investigation by the US authorities will often seek to meet US standards. Therefore, businesses' compliance and risk management strategies for money laundering and terrorist financing and their associated costs is not solely influenced by changes in UK law.

20. Government will seek further evidence on the costs and benefits of the MLRs to inform its review of the regulations due in 2022.

V. Monetised and Non-Monetised Costs and Benefits

21. This section discusses each aspect of the 5th EU Money Laundering Directive (5MLD) in turn, identifying different options and approaches to transposition when available and estimating their cost and benefit to society.

22. Based on data collected from AML supervisors in the latest Treasury annual returns covering the period between 6 April 2017- 5 April 2018, we estimate that at least 91,696 businesses were within the scope of the regulations. However, new businesses have registered since that date and the total number of regulated businesses is likely to be between 91,969-100,000. 5MLD also broadens the scope the regulated sector to include letting agents with monthly rents over £10,000, art sector participants for transactions over EUR10,000 and cryptoassets. Based on HMRC's analysis and engagement with stakeholders from new obliged sectors we estimate that 2000 previously unregulated art market participants and 150 letting agents will now be in scope of the directive. In addition,

the FCA estimates that 80 cryptoasset businesses will register but it is possible that there will be more. Therefore, we estimate that the expansion of the scope of the directive will affect at least 2230 previously unregulated businesses. In total, this represents between 3-4% of businesses in the UK.

23. The government launched an 8-week consultation on 15 April 2019 entitled "Transposition of the Fifth Money Laundering Directive". It outlined how the government intended to implement the Amending Directive. The consultation closed on 10 June 2019, with the government receiving over 200 responses from a cross-section of stakeholders including supervisors, industry (including cryptoasset businesses, art market participants and letting agents), civil society organisations, academics and government departments. The government also ran a series of events during the consultation period where stakeholders were given the opportunity to take part in interactive discussions about the proposals and issues in the consultation document. A copy of the consultation is available at: https://www.gov.uk/government/consultations/transposition-of-the-fifth-money-laundering-directive .

24. Responses to the consultation were broadly supportive of the overall policy objectives of the Amending Directive. Comments, evidence, and views from stakeholders received as part of this consultation process were taken into consideration and informed final government decisions on transposition. For example, there was significant engagement from respondents on the scope of the new AML/CTF regime for cryptoassets. Respondents unanimously agreed that publishers of open-source software and, by extension, non-custodian wallet providers, should not be brought into scope of AML/CTF regulation and the government is legislating accordingly. The government also took on board significant evidence and agreement that both firms offering exchange services between cryptoassets and fiat currency and between cryptoassets should be required to fulfil AML/CTF obligations. There was also broad agreement that firms involved in the issuance of new cryptoassets and cryptoasset ATMs should be required to fulfil AML/CTF obligations.

1. New Obliged Entities

1.1 Expanding to definition of tax adviser

25. The current MLRs define a 'tax adviser' as 'a firm or sole practitioner who by way of business provides advice about the tax affairs of other persons, when providing such services. 5MLD expands the scope of obliged entities to include any other person that undertakes to provide, directly or by means of by means of other persons to which that other person is related, material aid, assistance or advice on tax matters as principal business or professional activity. This is intended as a technical amendment to prevent avoidance of the regulations by relevant persons who should already be regulated for AML purposes.

Monetised and non-monetised costs and benefits

26. Consultation responses did not highlight any activities which would be caught within this amendment and were not previously captured by the regulations. Therefore, we do not anticipate that there will be costs to businesses.

1.2 Letting Agents

27. 5MLD brings estate agents, including letting agents in relation to transactions for which the monthly rent amounts to EUR 10,000 or more, into the scope of the Directive. Estate agents are already in scope of the UK's MLRs, and letting agents are already within scope where they carry out estate agency activity. However, 5MLD expands the scope within the residential property sector to include the letting agency sector for high value transactions with a monthly rent of EUR 10,000 or more.

Options considered

- **Option 0 - Do Nothing**: This would breach the legal obligation to transpose. Under this option the ML/TF risks in relation to high-value lettings would not be mitigated through letting agents being subject to the MLRs, allowing for vulnerabilities in the UK's AML/CTF regime.
- **Option 1- Copy out:** Transposing the 5MLD amendment to extend the scope of the regulated sector to include letting agents in relation to transactions for which the monthly rent amounts to EUR 10,000 or more for residential properties.
- **Option 2 - Go beyond 5MLD requirements:** The government consulted on lowering the monthly rent threshold for which properties would be in scope of the regulations. This would significantly expand the number of regulated bodies in scope.
- **Option 1 is the preferred option, based on feedback from the consultation and law enforcement agencies.** Therefore, the government will take a proportionate and evidence-based approach to expanding the regulated sector through a minimal viable transposition of the directive in the property sector.

Monetised and non-monetised costs and benefits

28. In our consultation, we asked letting agents what they saw as the main monetary costs to their businesses of complying with the MLRs. Based on responses to our consultation from the letting agency sector, 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. Newly in scope letting agents will also be required to identify and asses the ML/TF risks to which they are subject and develop appropriate internal controls, policies and procedures to mitigate and effectively manage these risks, including training employees.

29. Many of the newly in scope letting agency firms are already regulated for their estate agency activity. Feedback from industry has highlighted that many of the lettings agents that act in relation to high-value rental properties also conduct estate agency activity. Therefore, they would already be registered with the supervisory authority for the sector, HMRC, and have compliance systems in place. Letting agencies that are already registered as estate agents with HMRC will be required to also indicate their in-scope letting agency activity in their application renewal. These businesses will experience much lower costs than those without experience of compliance with the MLRs. Where appropriate, these letting agents will be able to adapt and extend their current AML/CTF systems and procedures to letting agency work for properties above the EUR 10,000 threshold, as well as all property sales. The monetised and non-monetised costs to these businesses will be lower than the estimates below for businesses without previous compliance experience.

Transition start-up costs[6]:

I. Cost of registration with supervisor: £100

II. New customer premises fee: £300

III. Approval fee: £40 per person

IV. Average Number of Beneficial owners, officers of managers per agency: 1.6

V. Average number of letting agency premises: 1.9

VI. Estimated total number of in-scope letting agents: 150

VII. Cost of writing policy: low estimate: £1000, high estimate: £2000

[6] The supervision costs are based on HMRC's current supervision fees and HMRC's, the cost of writing policies uses estimates of the 4MLD impact assessment as a proxy given the absence of better estimates in the answer to our consultation . The estimate of number of businesses and premises is based on HMRC's analysis and engagement with the sector.

VIII. Start-up costs (low estimate) = £100 +(£40 x 1.6) + (£300 x 1.9) + £1000 = £ per 1734 business x 150= £260,000 for sector

IX. Start-up costs (high estimate) = £100 + (£40 x1.6) + (£300 x 1.9) + £2000 = £2743 per business x 150 = £411,450 for sector

Ongoing annual costs[7]:

I. Supervisor renewal fee: £300 (per premises)

II. Average number of letting agency premises: 1.9

III. Estimated total number of in-scope letting agents: 150[8]

IV. Annual cost of staff training: assuming average affected business has 5 FTE and training takes 1 day per year, annual training costs may be 5 days per year at £100-£200 per day. Therefore, low estimate = £500, high estimate = £1000.

V. Annual cost of CDD checks: Unknown - this is highly variable depending on the business's client base, risk appetite, business model and software. –

VI. Annual costs (low estimate) = (£300 x 1.9) + £500 = £3,290 per business x 150= £2.522 million per sector

VII. Annual costs (high estimate) = (£300 x 1.9) + £1000 = £3,790 per businesses x150 =£3.426 million per sector.

30. **non-monetised benefits** : Bringing letting agents for high-value tenancies into the scope of the MLRs will help mitigate ML/TF risks. This will benefit businesses indirectly by maintaining the integrity of the UK's financial system and the UK's reputation as a safe and attractive place to do business. There is a risk of criminal use of letting agency businesses and complicit professional enablers to let property acquired with the proceeds of crime, especially for high-volume transactions. The National Risk Assessment 2017 assessed the abuse of property to pose a medium risk. Letting agents can help mitigate the money laundering risks around property through effective and comprehensive due diligence. The National Risk Assessment 2019 will further outline the risks in the sector.

1.3 Cryptoassets

31. 5MLD requires member states to regulate virtual currency exchanges and custodian wallet providers for the purposes of AML/CTF. Specifically, 5MLD demands "providers engaged in exchange services between virtual currencies and fiat currencies" be brought into the scope of member states' AML/CTF regulation, in order to address the ML/TF risks associated with virtual currencies, which were identified in both the EU's Supranational Risk Assessment and the UK's 2017 National Risk Assessment.

32. Since the 2017 National Risk Assessment, UK law enforcement authorities have increasingly identified cases of cryptoassets (UK preferred terminology) being used to launder illicit proceeds of offline crime. Certain features of cryptoassets including their accessibility online, their global reach and their pseudo-anonymous nature are particularly attractive to criminals and the risks of cryptoassets being used in money laundering are expected to grow as cryptoassets become increasingly accessible.

33. Cryptoassets pose the greatest threat from an illicit finance perspective at the point of exchange where the value can be realised and the true sources of funds can be obscured. Therefore, much like fiat-cryptoasset exchanges and custodian wallet provides, crypto-to-crypto exchange facilities, cryptoasset ATMs, peer-to-peer exchange facilities and initial coin offerings (where issuers offer for sale their new coin for the first time), fuel the risk of illicit activity. These four activities are not covered by 5MLD but FATF guidance does recommend regulating them. We have also consulted on regulating these additional points of exchange as part of our consultation on 5MLD and cryptoasset businesses that

[7] The supervision costs are based on HMRC's current supervision fees annual training costs use estimates of the 4MLD impact assessment as a proxy given the absence of better estimates in the answer to our consultation. The estimate of number of businesses and premises is based on HMRC's analysis and engagement with the sector.

responded were broadly supportive. Respondents overall felt effective regulation would bring legitimacy to the use of cryptoassets. The Government will therefore legislate to bring all of these points of exchange identified into the scope of AML/CTF regulation to address the growing risks associated with cryptoassests comprehensively.

Options

- **Option 0 – 'Do nothing':** This would breach the legal obligation to transpose and would not meet FATF standards. It would damage the UK's reputation as a legitimate and trustworthy place to do business.
- **Option 1 – 'Copy out':** Copy out the Directive and use the proposed 5MLD guidelines to regulate virtual currency exchanges and custodian wallet providers. This would fulfil our obligations to transpose the 5MLD Directive but would leave some cryptoasset activity unregulated, enabling these vulnerabilities to be used for ML/TF.
- **Option 2 –** '**Go beyond 5MLD Requirement':** Extend the scope of regulation to an additional range of points of exchange and broaden the definition of virtual currency to cryptoasset. This will ensure a comprehensive, risk-based approach is being taken to the sector and that the UK meets FATF standards.
- **Option 2 is the preferred option.**

Rationale for extending EU requirements:

34. The online accessibility of cryptoassets, their global reach and their pseudo-anonymous nature mean that cryptoassets can be used to facilitate criminal activity. The Government's proposed approach to regulating the cryptoasset sector will combat the anonymity issue and therefore reduce the appeal of using cryptoassets to launder money. Cryptoasset firms in scope of the regulation will have a duty to conduct due diligence which will enable transactions to be more easily traced back to specific customers. Regulating cryptoasset activities will contribute to giving the industry further legitimacy, which should grow the industry through encouraging new consumers and investments.

35. The fast-moving nature of the cryptoasset market and the corresponding understanding of the ML/TF risks within government has evolved considerably since the EU commission finalised the text of 5MLD in 2018. Government intelligence reports suggest illicit activity is being carried out at various points of exchange, not just through fiat-crypto exchange services or custodian wallet providers, which are captured by 5MLD. This was reflected in October 2018 when FATF adopted changes to its standards to explicitly clarify how they apply to financial activities involving cryptoassets (referred to as virtual assets by the FATF) and the infrastructure that supports their use. FATF recognised that the cryptoasset space had evolved to include a new range of products and services, business models, and activities and interactions that present ML/TF risks. Consultation responses pointed to the fact that 5MLD leaves clear loopholes for illicit actors to exploit other pieces of the infrastructure supporting the exchange of cryptoassets.

Monetised and non-monetised costs and benefits

36. On consideration of the evidence presented by responses to our consultation, the government will bring the following activities within the scope of the updated MLRs:

- Crypto-to-fiat currency exchange (exchanging one cryptoasset for fiat currency, e.g. Bitcoin for Pound Sterling.)
- Crypto-to-crypto exchange (exchanging one cryptoasset for another, e.g. Bitcoin for Ethereum). Global evidence suggests that exchanges that offer only crypto-crypto services constitute approximately three quarters of the total spot-trading market, whilst those that offer fiat-crypto pairs constitute only a quarter of the total exchange market.
- Some peer-to-peer crypto asset exchanges (this relates to a form of cryptoasset exchange which is conducted directly between two individuals, rather than between an individual and a specialized firm). We will capture a limited number of centralized peer-to-peer platforms that arrange the exchange of cryptoassets between one individual and another including crypto ATMs (physical kiosks that allows the exchange of fiat currency and crypto assets)

- Initial Coin Offering (ICO) creators/issuers (ICOs refer to the way in which funds are raised for the development and expansion of a new cryptoasset. If the creator or issuer chooses by way of business to exchange/arrange the exchange of their new cryptoasset for fiat or other cryptoasset then they will have to comply with AML/CTF obligations.)

37. We also use the term “cryptoasset” rather than “virtual currency” in our amendments to the MLRs. This was recommended by consultation respondents to ensure that all relevant activity involving both exchange, security and utility tokens are captured in AML/CTF regulation.

38. **Who will be affected:** The UK is not a major market for cryptoasset trading and accurate data around the size of this emerging industry is still being gathered. The FCA estimates 5-10% of UK consumers possess cryptoassets[9]. In January 2019, the FCA estimated there were are approximately 15 cryptoasset spot exchanges with headquarters in the UK, out of a global market of 231.[10] They appear to have a combined daily trading volume close to \$200m, which accounts for close to 1% of the daily global trade in cryptoassets. Only 4 of these 15 spot exchanges regularly post daily trading volumes above \$30 million, which according to the FCA, represents a low volume relative to the wider global market.[11] The Cryptoasset Taskforce[12] estimated that there are just 56 cryptoasset projects that have used ICOs in the UK, accounting for less than 5% of projects globally and there are only several hundred crypto ATMs active in the UK, but the exact figure is unknown[13]. The number of UK-based peer-to-peer exchange platforms is unknown as are the number of custodian wallet providers, but likely to be very small too.

39. This is the first time the UK will formally regulate the cryptoasset industry in any form and so there has been limited opportunity by a government department or supervisor to formally collect data on the industry. 5MLD came into force in June 2018 and we finalised the scope of our regime in the autumn of 2019, after a period of consultation. Our consultation did try to gather more information on the number of cryptoasset firms currently operating in the UK, but respondents were not able to give an accurate figure, given the nascent and rapidly evolving nature of the sector. In October 2019, the FCA estimated there would be between 80 -100 UK applicant firms in total who are likely to register with the FCA[14] to carry out cryptoasset activity and have to comply with the MLRs, this remains the most accurate figure to date. The FCA estimated there are approximately 15 cryptoasset spot exchanges, with headquarters in the UK providing which are likely crypto to fiat currency exchange services some of them which may also be custodian wallet providers both of which are activites regulated under the minimum EU requirements (option 1) as well as custodian wallet providers. However we do not have a precise estimate of the number of firms acting as custodian wallet providers. The FCA will collect data on cryptoasset business activities upon registration but as explained above there has been limited opportunity for government department and supervisors to collect data on the industry and we cannot currently provide a definitive breakdown of the number of cryptoasset firms per category. This make it difficult to estimate how many firms would be regulated under minimum EU requirements as opposed to the number of firms which would be regulated if the minimum EU requirement are extended. Therefore, our best estimate is that between (80-15 =)65 and (100-15)=85 additional businesses would fall within scope of the regulation if we pursued option 2.

40. **Cost:** We expect that transition costs to cryptoasset businesses will arise from training staff and hiring compliance specialists to set up an AML/CTF compliance framework. Respondents estimated that for a new firm setting up after the AML/CTF regime goes live, it would take 6-12 months to set up an AML/CTF framework with a specialist supporting that

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[9] Guidance on Cryptoassets Consultation Paper CP19/3* January 2019, Financial Conduct Authority.

[10] Guidance on Cryptoassets Consultation Paper CP19/3* January 2019, Financial Conduct Authority.

[11] Guidance on Cryptoassets Consultation Paper CP19/3* January 2019, Financial Conduct Authority.

[12] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/752070/cryptoassets_taskforce_final_report_final_web.pdf

[13] https://coinatmradar.com/country/225/bitcoin-atm-united-kingdom/

[14] Recovery of costs of supervising cryptoasset businesses under the proposed anti-money laundering regulations: fees proposals

process costing £600-£1200 per day (between £109,500-£438,000 per business). [15] This would give us a transitional cost between (365/2 = 182,5) day x £600 = £109,500 and 365 x £1,200 = £438,000 per business. [16]

Option 1: We know there are approximately 15 cryptoasset businesses carrying out activities that would be regulated under the minimum EU requirement, this would mean a baseline transition cost between 15 businesses x £109,500 = £1.642m– 15 businesses x £438,000= £6.570 m for the sector under option 1.

Option 2: We estimate that there are between 65-85 additional cryptoasset businesses likely to fall in scope of the regulations under option 2, this would mean a baseline transition cost between 65 businesses x £109,500 = £7.117m and 85 businesses x £438,000= £37.230m for the sector under option 2.

41. However, calculations are further complicated by the fact that the industry developed its own AML/CTF measures in order to build the legitimacy of the industry and gain access to banking services. This includes the development of customer onboarding regimes, investigatory monitoring tools/systems and databases of customers. Many firms therefore may already be partially compliant with incoming AML/CTF obligations. The existence of non-specific crypto firms offering a variety of services, including but not limited to those related to cryptoassets complicates the evaluation of the costs to the sector as a whole.

42. Ongoing costs to cryptoasset firms will occur from carrying out continued due diligence and verification of their customer base and AML supervision fees. The AML supervision fees for cryptoasset businesses will be determined through an FCA consultation. Many respondents to our consultation in mid-2019 argued that for a typical cryptoasset UK firm, individual firm annual compliance costs will be very similar to an e-Money institution or small bank/fin-tech firm. A recent Lexis Nexis study[17] stated that 33% of fintech firms have an AML compliance budget of over £1million. UK e-money institutions have a median number of staff dedicated to compliance of approximately 4.5 FTE. The ONS median cost for quality assurance and regulatory professionals in 2018 was £43,549[18].

Option 1: We assume cryptoasset businesses will require a similar number of compliance staff on a full time basis (37.5h/week) and based on this median salary, we estimate the annual AML salary costs for the 15 cryptoasset businesses carrying fiat to crypto exchanges services in the UK which would be regulated under option 1. This gives us an estimated annual cost of £43,549 x 4.5FTE= £195 970,5 per business and £195 970.5x 15 =£ 2.939 m for regulated firms under option 1.

Option 2: We assume cryptoasset businesses will require a similar number of compliance staff on a full time basis (37.5h/week) and based on this median salary we estimate the annual AML salary costs for the 65-85 additional cryptoasset businesses which would be regulated under option 2. This gives us an estimated annual cost of £43,549 x 4.5FTE= £195 970,5 per business and between £195 970.5x 65 =£ 12.738m and £195 970.5x 85 = £16.657m additional for regulated firms under option 2.

43. However, this is a low estimate as it does not include other ongoing compliance costs such as the maintenance of databases and other relevant systems or one-off compliance cases in the case of Initial Coin Offerings.

44. **Wider benefits:** We do not anticipate that the propose changes will have direct monetised benefits on businesses. However, responses to our consultation indicated that regulation by government will give the industry more legitimacy, thereby creating a foundation for the future growth of the sector This change may also create indirect benefits to businesses business by creating opportunities for firms specialised in helping firms comply with their regulatory obligations.

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[15] Submission to HMG Consultation on the Transposition of the Fifth Anti-Money Laundering Directive, June 2019

[16] Submission to HMG Consultation on the Transposition of the Fifth Anti-Money Laundering Directive, June 2019

[17] Money Laundering Exposed: Fintech Vs Money Laundering. August 2019. LexisNexis

[18] https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/bulletins/annualsurveyofhoursandearnings/2018

45. **Impact on trade:** Some cryptoasset firms have expressed the fear of regulatory arbitrage. The loss of anonymity may mean customers opt to use non-UK firms instead, particularly given the ease of access to them via the internet. However, the recently updated global standards on AML and CTF (set by the FATF) mean that similar degrees of regulation could be implemented by other countries, reducing the opportunities for customers to commit regulatory arbitrage by avoiding business with regulated UK firms. For example, the United States already regulate cryptoasset businesses which act as money transmitters (or money service businesses) as set out in the FINCEN guidance. Similarly, once 5MLD is implemented into Dutch law, all undertakings providing exchange services between cryptocurrencies and fiat currencies will fall within the scope of AML regulations. Therefore, the introduction of these measures should not negatively impact the number of customers a cryptoasset firm has and therefore their income.

1.4 Art Market Participants

46. Art market participants are already regulated (as high value dealers) for AML/CTF purposes if they receive payments in cash of at least EUR 10,000 in total or from a series of linked transactions. This relatively narrow definition means that many art intermediaries are currently not regulated for AML/CTF purposes. 5MLD expands the scope of obliged entities to include art market participants for transactions exceeding EUR 10,000, regardless of whether the transactions are carried out in cash. 5MLD's definition of art intermediaries includes art galleries, auction houses and certain free port operators.

Options considered

- **Option 0 – 'Do Nothing'**: This would breach the legal obligation to transpose. Under this option the ML/TF risks in relation to high-value art market transactions would not be mitigated through art market participants being subject to the MLRs, allowing for vulnerabilities in the UK's AML/CTF regime.
- **Option 1- 'Copy out':** Transposing the 5MLD amendment to extend the scope of the regulated sector to include art market participants in relation to transactions at or above the EUR 10,000 threshold.
- **Option 2 – 'Go beyond 5MLD requirements':** The government consulted on lowering relevant transaction threshold for which art transactions would be in scope of the regulations and expanding the scope to include antiques and collectors' items. This would significantly expand the number of regulated bodies in scope.
- **Option 1 is the preferred option, based on feedback from the consultation and law enforcement agencies.** Therefore, the government will take a proportionate and evidence-based approach to expanding the regulated sector through a minimal viable transposition of the directive in the art sector.

Monetised and non-monetised costs and benefits

47. **Cost:** In our consultation, we asked art market participants what they saw as the main monetary costs to their businesses of complying with the MLRs. Based on responses from the sector, art market participants will bear the costs of familiarising themselves with the regulations, setting 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. Newly in scope art market participants will also be required to identify and asses the ML/TF risks to which they are subject and develop appropriate internal controls, policies and procedures to mitigate and effectively manage these risks, including training employees. Some of the new art market participants will currently be regulated for their high value dealer activity, when acting in relation to transactions in cash over EUR 10,000. The monetised and non-monetised costs to these businesses will be lower than the estimates below for businesses without previous compliance experience. Although feedback from industry indicates that most of the newly in scope art market participants will not have previous experience of compliance with the MLRs, many firms do conduct due diligence as part of existing commercial practices.

Impact on trade

48. 5MLD brings art market participants in scope of the regulations across EU member states. However, art market participants are not yet regulated for AML purposes in other major markets such as the US or Hong Kong. The MLRs require obliged entities to carry out due diligence on customers, which will create additional costs on art market participants which may be passed onto customers and is also likely to increase the time required to complete the purchase of a work of art. This may put UK art market participants at a disadvantage against certain competitors based outside the EU.

Transition start-up costs[19]:

I. Cost of registration with supervisor: £100

II. New customer premises fee: £300

III. Approval fee: £40 per person

IV. Estimated average number of beneficial owner, officer and manager per art market participant: 1.5

V. Average number of art market participant premises:1.5

VI. Estimated total number of in-scope art market participants: 2000

X. Cost of writing policy: £1000- £2000

VII. Start-up costs (low estimate), per business and per sector: £100 + (£40x1.5)+ (£300x 1.5)+ £1000=£1550 per business, £1610x 2000= £3.220 million for sector

VIII. Start-up costs (high estimate), per business and per sector: £100+(£40x1.5) +(£300x1.5) +2000=£2550 per business, £2610x2000=£5.220 million for sector

Ongoing annual costs[20]**:**

IX. Supervisor renewal fee: £300 (per premises):

X. Average number of art market participant premises: 1.5

XI. Estimated total number of in-scope art market participants: 2000

VIII. Annual cost of staff training: low estimate: high estimate: assuming average affected business has 5 FTE and training takes 1 day per year, annual training costs may be 5 days per year at £100-£200 per day. Therefore, low estimate = £500, high estimate = £1000.

XII. Annual cost of CDD checks: unknown- this is highly variable depending on the business's client base, risk appetite, business model and software.

XIII. Annual cost (low estimate): (£300x1.5)+£500=£950 per business, 1.9M for sector

XIV. Annual cost (high estimate): (£300x1.5)+£1000=£1450 per business, 2.9M for sector

49. **Wider benefits:** We do not anticipate that there will be direct benefits to businesses however there are wider indirect benefits of bringing art market participants into the scope of the MLRs as this will help mitigate ML/TF risks in the sector and further strengthen the sector's international reputation for integrity.

2. Electronic money

[19] The supervision costs are based on HMRC's current supervision fees and HMRC's, the cost of writing policies uses estimates of the 4MLD impact assessment as a proxy given the absence of better estimates in the answer to our consultation . The estimate of number of businesses and premises is based on HMRC's analysis and engagement with the sector.

[20] The supervision costs are based on HMRC's current supervision fees annual training costs use estimates of the 4MLD impact assessment as a proxy given the absence of better estimates in the answer to our consultation. The estimate of number of businesses and premises is based on HMRC's analysis and engagement with the sector.

50. 5MLD requires member states to reduce the threshold for which CDD measures be applied to e-money products, meaning e-money firms will have to conduct CDD measures on a greater proportion of transactions. At present, 4MLD allows Members States to exempt some low risk e-money products from certain CDD measures. 5MLD limits the conditions in which member States may apply this exemption as follows:

4MLD – CDD exempt if meets all the below:	5MLD CDD exempt if meets all the below:
Maximum amount stored electronically is ***EUR 250*** (or if the amount stored can only be used in the UK, EUR 500).	Maximum amount stored electronically is ***EUR 150.***
The payment instrument is not reloadable or is subject to a maximum limit on monthly payments of ***EUR 250*** which can only be used in the UK.	The payment instrument is not reloadable or is subject to a maximum limit on monthly payments of ***EUR 150*** which can only be used in the UK.
The payment instrument is used exclusively to purchase goods and services.	The payment instrument is used exclusively to purchase goods and services.
Anonymous e-money is not used to fund the payment instrument.	Anonymous e-money is not used to fund the payment instrument.
Any redemption in cash, or cash withdrawal does not exceed ***EUR 100.***	Any redemption in cash, or cash withdrawal does not exceed ***EUR 50.***

51. 5MLD also imposed the following additional requirements:

- Financial and credit institutions acting as acquirers operating in EU member states can only accept payments carried out with anonymous prepaid cards issued in non-EU countries where these countries impose requirements equivalent to those set out in 5MLD in relation to e-money. This means anonymous card issuers located in non-EU equivalent states must be deemed by UK firms to be subject to requirements in their national legislation which have an equivalent effect to the MLRs,
- Not to allow payments carried out using anonymous prepaid cards.

52. These changes will help to mitigate some of the risks associated with e-money, which the 2017 National Risk Assessment assessed to be medium risk for both money laundering and terrorist financing. General purpose prepaid cards have legitimate uses and constitute an instrument contributing to social and financial inclusion. However, anonymous prepaid cards are easy to use in financing terrorist attacks and logistics. The changes introduced by the Directive aim to deny terrorists this means of financing their operations by further reducing the limits and maximum amounts under which obliged entities are allowed not to apply certain customer due diligence measures.

53. ***Who will be affected:*** This will affect the e-money sector (predominantly fintech companies) and merchant acquirers. There are currently 183 authorised e-money institutions and small e-money institutions registered with the FCA. Whilst they may not all offer pre-paid card services, this can be considered an upper-limit on the estimated number of firms affected.

54. ***Non-Monetised Costs:*** Reducing the amount at which CDD checks apply should not incur Transition costs. E-money Providers already have the infrastructure and resources to conduct CDD checks. Ongoing costs will come from extending the number of customers e-money businesses are conducting checks on. However, it is difficult to estimate the additional ongoing costs as it has not been possible to estimate the scale of the e-money customer base for e-money products storing between £150-£250.

55. Consultation respondents flagged concerns about the costs that will be involved to assess whether anonymous card issuers outside the EU are subject to equivalent MLRs. Many respondents thought this would be costly as firms would have to obtain sufficient legal advice and would need to implement technological solutions to block payments from these cards. However, others noted that some e-money firms are already beginning to develop

systems to identify and block non-compliant anonymous card traffic. Therefore, costs will vary depending on the approach already being taken by each e-money provider or merchant acquirer.

56. **Non-monetised benefits***:* We do not anticipate that there will be direct monetised benefits to businesses. However, the change will bring wider benefits to society as a whole and may have indirect benefits to businesses. The anonymity of prepaid cards makes them an appealing vehicle to launder illicit funds or use to finance terrorist activity. Preventing payments from anonymous prepaid cards and reducing the thresholds at which CDD must occur will reduce the appeal of using it to launder money or finance terrorism and benefit businesses indirectly by upholding the UK's reputation and financial integrity. Some respondents suggested that by requiring e-money firms to implement these measures, it could lead to an increase to the level of innovation and development in the market, providing better and more effective solutions for customers and regulators, whilst lowering costs overall. Respondent to our consultation did not provide evidence on the potential scale, speed of innovation or quantified its benefits to the sector and as a result attempts to monetise these benefits would be speculative.

3. Customer Due Diligence

3.1 Electronic Identification

57. 5MLD sets out the circumstances under which secure, remote or electronic identification processes may be taken into account when undertaking customer due diligence. These electronic identification processes include those set out in regulation (EU) No 910/2014, in particular with regard to notified electronic identification schemes. There is no material change in UK law as there is nothing in existing law forbidding the use of secure, remote or electronic identification processes.

58. 5MLD provides for the use of secure, remote or electronic identification processes where these are "regulated, recognised, approved or accepted at national level by the national competent authority". In practice, it is supervisors who determine the suitability of the CDD practices of their supervised entities. Rather than requiring explicit regulation, recognition, approval or acceptance by supervisors of specific technologies or identity providers, which would not be in keeping with CDD requirements elsewhere in legislation, the Government has opted for a more flexible approach, by setting out high level principles in legislation for what constitutes "secure" remote or electronic identification processes, and leaving further detail to guidance.

Monetised and non-monetised costs and benefits

59. Respondents to the Government's consultation on the transposition of 5MLD agreed that increased take up of electronic identification processes would have significant benefits. These benefits include increased convenience for customers, cost savings for firms, increased competition, reduced economic crime and increased financial inclusion. The changes to the Money Laundering Regulations are part of a broader Government ambition to encourage the use of Digital ID. Given that the changes do not mandate the use of electronic identification processes, or permit anything new that was not previously permitted, it is not possible to determine the extent to which changes in behaviour will be directly attributable to the legislation as opposed to other work to address barriers to adoption.

60. Estimates exist for the overall economic benefits of universal widespread adoption of advanced digital ID (e.g. McKinsey estimate of 3% of UK GDP in 2030) for multiple applications, not limited to CDD for AML purposes. However, it is not possible to put a figure on economic benefits of this legislative change in isolation as there are a number of factors that could affect the growth in usage of remote or electronic identification processes. Other factors mentioned in consultation responses include questions of liability for accuracy of CDD information and compatibility with existing IT architecture. The Government has established a Digital Identity Unit to look at broader issues.

3.2 Identifying senior managing official

61. Obliged entities must already carry out customer due diligence as set out in part 3 of the MLRs. 5MLD extends customer due diligence requirements for obliged entities to verify the identity of senior managing official, when the customer is a body corporate and the beneficial owner cannot be identified. Currently, if the obliged entity has exhausted all possible means of identifying the beneficial owner of a body corporate and has not succeeded, it must keep a written record of actions taken to identify the beneficial owner. 5MLD goes further and requires an obliged entity to verify the identity of the senior person in that body corporate in addition to keeping a written record of actions taken to identify the beneficial owner.

Monetised and Non-monetised costs and benefits

62. The international standards which respectively underpin 5MLD and the FATF standards are based on the risk-based approach which requires obliged entities to have a detailed understanding of the money laundering and terrorist financing risks within their sector and their own vulnerability which will vary across sectors. Once they understand the risks, they must apply appropriate procedures to mitigate their risks, including verifying the identity of their customers and understanding the purposes of their activity.

63. The money laundering and terrorist financing risks vary across sectors and in accordance with the risk-based approach, the regulations do not specify how obliged entities should carry out customer due diligence checks. Businesses may comply with their obligations in many ways depending on their understanding of the risk in their sectors, the nature of their business and customers and their risk averseness. This makes it difficult to evaluate the overall cost of customer due and the impact of individual changes of the regulations.

64. There is a lack of comprehensive data on the costs of customer due diligence. Most existing studies focus on the financial sector and their overall AML compliance costs:

- In 2015, in its answer to the Government's Cutting Red Tape Review of the effectiveness of the AML regime, the British Bankers' Association estimated that its members were spending at least £5 billion annually collectively on AML/CTF compliance.[21] However, this figure is likely to have increased following the implementation of 4MLD.
- More recently, the FCA found that 2000 of its regulated businesses collectively employ at least 11,500 full time equivalent staff in financial crime roles with an estimated salary bill of £650 million annually. [22]
- A 2016 Thomson Reuters survey found that financial institutions spent on average $60million on customer due diligence and that some were spending up to $500 million.[23] It is unclear whether these numbers represent costs at group or country level.
- In 2019, LexisNexis surveyed 204 UK firms including small and large representatives of the banking industry, representatives of the fintech sector, the legal profession, real estate and the gambling industry. They found that AML costs varied significantly among respondents. 1% spent more than 50 million or more on AML compliance, 16% between 5 million - 50 million, 62% between £250,000 – 5 million, 17% between £50,000-250,000, 3% less than £50,000 and the rest could not provide an estimate.[24]

65. A private survey conducted by the Law Society in 2016, including respondents from law firms and sole practitioners (28.7%), found that in 2016, approximately 52% of respondents has between 1-5 FTE employees undertaking CDD work, and 22% had between 6-20 FTE. The total annual salary cost of employees undertaking CDD including people operating a dual function was between £0-£199,999 for 61.3% of respondents and 21.6% sent above £200,000. However, it is unclear for the data what proportion of employees was solely dedicated to conducting CDD and in the case of dual function, what proportion of these

[21] https://www.bba.org.uk/policy/bba-consultation-responses/bba-response-to-cutting-red-tape-review-effectiveness-of-the-uks-aml-regime/

[22] https://www.fca.org.uk/publication/research/financial-crime-analysis-firms-data.pdf

[23] https://www.thomsonreuters.com/en/press-releases/2016/may/thomson-reuters-2016-know-your-customer-surveys.html

[24] https://risk.lexisnexis.co.uk/insights-resources/white-paper/on-the-frontline-the-uks-fight-against-money-laundering

employees' time was dedicated to CDD vs other functions. The majority of respondents spent between £0-£250,000 annually on maintaining CDD systems.

66. The lack of comprehensive data on the costs of CDD across sectors and the nature of the risk-based approach underpinning the regulations make it extremely difficult to monetise the overall cost of CDD of the cost of the proposed change to the regulation.

67. In the consultation, we asked stakeholders for views on the proportionality and likely impact of these changes. Respondents did not provide monetised estimates of the costs of this proposed change. However, many respondents, including representatives of financial institutions and the legal and accountancy professions, indicated that they already adopted this approach and others noted that the costs associated with this requirement would be minimal. Therefore, we expect that the proposed changes will incur minimal transition and ongoing costs. Under the current regulations, most businesses would already seek to understand their customers' ownership and control structures since complex ownership structure is a factor business must consider when determining whether to carry out EDD.

68. **Non-monetised benefits:** We do not anticipate that this change will have direct benefits on businesses. However, it may have indirect benefits and wider benefits to society as a whole. Corporate vehicles with complex ownership and control structure as are often used by criminals to disguise the origin of funds. Making the proposed changes to customer due diligence requirements will ensure companies understand the ownership and control structures of their corporate customers. This will help regulated businesses assess the money laundering and terrorist financing risk of individual corporate customers and identify instances when a customers' ownership and control structure is unnecessarily complex and may serve illicit purposes. This will help maintain the UK's financial integrity and its reputation as a safe place to do business and indirectly benefit businesses.

4. Obliged entities: beneficial ownership requirements

69. Article 14 of 4MLD requires obliged entities to verify the identities of their customers and beneficial owners before establishing a business relationship or carrying out a transaction. 5MLD now requires that whenever an obliged entity enters into a new business relationship with a company and verifies their identities, they must collect either: proof of registration on this register; or an excerpt of the register.

70. Secondly, 5MLD also requires obliged entities to apply CDD when they have any legal duty in a calendar year to contact the customer for reviewing their relevant beneficial ownership information, or where the obliged entity has this duty under the EU Directive on Administrative Cooperation in the Field of Taxation (DAC2), which was transposed into UK law via the International Tax Compliance regulations, placing a common reporting standard (CRS) reporting obligation on UK financial institutions.

71. Thirdly, 5MLD requires obliged entities to report to Companies House the discrepancies between the information it holds and that on the publicly accessible PSC register.

Monetised and non-monetised costs and benefits

72. It is difficult to evaluate the costs associated with implementing this measure as it will be part of an obliged entity's wider customer due diligence checks costs which firms find difficult to estimate and may vary considerably across sectors. As outlined above there is a lack of comprehensive data on the costs of customer due diligence. Most existing studies focus on the financial sector and their overall AML compliance costs. In their answer to our 4MLD consultation and during informal engagement regulated firms highlighted the difficulty for regulated industries to identify the costs of AML customer due diligence checks. This is partly because customer due diligence checks are integrated into businesses' commercial activities rather than carried out separately.

73. It is also difficult to provide an estimate of the overall costs of customer due diligence to obliged entities as firms' obligations are underpinned by the risk-based approach which requires obliged entities to have a detailed understanding of the money laundering and

terrorist financing risks within their sector and their own vulnerability to those risks. Once they understand the risks, they must apply appropriate procedures to mitigate their risks including verifying the identity of their customers and understanding the purposes of their activity (customer due diligence). The money laundering and terrorist financing risks vary across regulated sectors and the regulations do not prescribe how regulated entities should carry out customer due diligence checks. As a result, the policies and procedures regulated businesses adopt to comply with the MLRs vary greatly depending on the sector, the size of the business, the nature of their customer base and their risk appetite.

74. Based on responses from regulated firms to the 5MLD consultation, it's clear that many firms already undertake checks on beneficial ownership as part of existing CDD practices. No data was provided on the cost of such checks and there is no evidence available on how the cost varies in relation to the complexity of the ownership structure of the relevant firm. We envisage that the onus would be on customers to provide the relevant evidence to obliged entities. Therefore, we anticipate that this measure will lead to only a minimal increase in time spend on CDD and CDD costs and it would not be proportional to attempt to monetise them. It is envisaged that the onus will be on the company to provide proof of registration to obliged entities, upon the obliged entity's request. For companies, the Companies House register is public, so they can obtain the relevant information free of charge. Responses to the 5MLD consultation did occasionally point to additional costs arising from performing CDD each year, but these were general concerns and were not quantified. The reporting of discrepancies will further improve the quality of information on the PSC Register, with benefit for the many firms who make use of the register. The process for reporting discrepancies will be designed to minimise the burden on obliged entities.

5. Enhanced Due Diligence

75. Under current regulations, obliged entities must conduct EDD and monitoring on natural person or legal entities established in high-risk third countries. 5MLD expands the scope of persons whom obliged entities must conduct EDD on to business relationships or transactions involving high-risk third countries identified by the EU Commission and requires obliged entities to carry out enhanced monitoring of such transactions. 5MLD specifies that obliged entities should obtain additional information on the customer and beneficial owner, the intended nature of the business relationship, the source of funds and wealth of the customer and beneficial owner, the reason for the transaction for these business relationships and transactions. Obliged entities will also be required to obtain the approval of senior management to establish or continue a relationship involving a high-risk third country.

76. 5MLD also provides member states with the option to impose and additional requirement for obliged entities to ensure that whenever customers make a first payment involving a designated high-risk third country, that payment is carries out through an account in the customer's name with a credit institution subject to the Directive's customer due diligence standards.

77. In addition to 5MLD, FATF recommendation 10.13 in its mutual evaluation of the UK requires financial institutions (FIs) to include the beneficiary of a life insurance policy as a relevant risk factor in determining the need for EDD. The UK FATF Mutual Evaluation Report identified a deficiency in the fact that 'while there is a general requirement for FIs to take into account customer risk factors in deciding whether to apply enhanced CDD (…), there is no specific requirement in the MLRs or in the industry guidance (non-binding JMLSG guidance) for FIs to include the beneficiary of a life insurance policy as a relevant risk factor.' We intend to address this deficiency by explicitly including 'beneficiary of a life insurance policy' as a relevant risk factor for considering conducting enhanced due diligence. This means mean that if a FI considers that the beneficiary of a life insurance policy presents a high risk of money laundering or terrorist financing, that FI would be required to undertake the enhanced due diligence measure set out in regulation 33.

Options:

- **Option 0-do nothing:** This would breach the legal obligation to transpose. This option would not comply with FATF standards.
- **Option 1:** Copy out the Directive, opting out of optional requirements. This would fulfil our obligation to transpose 5MLD but would not implement the recommendations of FATF.
- **Option 2:** Our preferred option is to copy out the Directive option out of optional requirements and amend the MLRs to comply with recommendation 10.13 of FATF.

Monetised and non-monetised costs and benefits

78. **Monetised Costs** Under the new regulations, obliged entities would be required to carry out enhanced customer due diligence ‘in any business relationship with a person established in a high risk-third country or in relation to any relevant transaction where either of the parties to the transaction is established in a high risk third country identified by the European Commission. This covers business relationships and transactions involving:
    - a legal person incorporated, having its principal place of business or in the case of a financial institution its principal regulatory authority in a listed high-risk third country
    - an individual resident in that country, but not merely having been born in that country.
79. Furthermore, the EDD measures taken should include:
    - obtaining additional information on the customer and beneficial owner, the intended nature of the business relationship, the source of funds and wealth of the customer and beneficial owner, the reason for the transaction for these business relationships and transaction.
    - obtaining the approval of senior management to establish or continue a business relationship involving a high-risk third country.
    - conducting enhanced monitoring of the business relationship by increasing the number and timing of controls applied and selecting patterns of transactions that need further examination.
80. The current regulations already require businesses to carry out EDD and monitoring on natural person or legal entities established in high-risk third countries. The new regulations specify what measures EDD should involve and add a requirement for businesses to carry out EDD on transactions. However, businesses would only need to carry out EDD for relevant transactions when they do not already have a business relationship with the party of the transaction established in a high-risk country as they would already have carried it out when establishing that relationship, unless they consider the transaction requires further examination.
81. Estimating the cost of CDD and EDD measure is difficult given that the nature and extent of checks will vary according to perceived risks and institutions may go beyond the minimum legal requirements depending on their risk-appetite and their application of the risk-based approach. Businesses’ approach to risk and access to software solution will influence the costs of carrying out checks and monitoring. This also makes evaluating the cost of the proposed changes difficult as some businesses may already carry out the checks required by the amended regulation and others may need to review their approach to EDD. As a result, the extent to which the changes will increase EDD cost it is unclear.
82. An FCA analysis of data from 2000 supervised firms including all UK-based banks and building societies found that respondents had a total of 549 million customer. The data also shows that 1,247,935 relationships involve customers linked to high-risk jurisdiction (0.23% of all customer relationships), an average of approximately 629 high-risk customer relationship per firm. [25] The total size of the FCA’s population supervised for AML purposes

[25] FCA (2018) Financial crime: analysis of firms’ data. https://www.fca.org.uk/publication/research/financial-crime-analysis-firms-data.pdf.

was approx. 19,620 in 2017-18.[26] If all FCA supervised firms had an average of 629 high-risk customer relationships, the FCA population would have in total approximately 12, 2 million high-risk customer relationships (629*19620). However, the n=2000 sample is unlikely to be representative of the entire FCA population as it includes most of the largest firms supervised by the FCA which are likely to have a higher number of customer relationships in high risk third countries. We therefore estimate the FCA population has between 1,3 million-12.2 million customer relationships from high-risk third countries.

83. Carrying out EDD for these customers is likely to be more expensive than CDD but it is currently unclear how much more. For example, the number and timing of controls taken to conduct enhanced monitoring of the business relationships and selecting patterns of transactions that need further examination will depend on the degree of ML/TF risk perceived by the business in question and the nature of the control may range from asking the customer to confirm information already held by the business to investigating several independent data sources. Likewise, obtaining senior management approval for a business relationship does not necessarily require a decision at board level.

84. As part of our 4MLD consultation, various financial institutions offered informal estimates of £3-£15 as the average cost of initial CDD measures.[27] However, this estimate should be treated with caution. Different banks will likely cite different average costs for CDD depending on their size, business model, customer base and risk appetite. We assume that EDD measures are between one and a half times and twice as expensive as CDD £4.5-£30 and that firms supervised by the FCA carry out EDD checks on each high-risk customer in year one to decide whether to continue the relationship. This gives a transition cost of between £4.5x 1.3million customers from high risk country=£5.85 million and £30x12,2million customers from high risk countries=367,3 million for the industry as a whole (on average between £298.5- £18,719 per firm). This is an estimate of the cost to UK based businesses; however, overseas branches and subsidiaries will be required to apply similar standards.

85. Ongoing costs will depend on what proportion of the total of high-risk customers banks would monitor yearly, how many new business relationships with high-risk customer they conclude and how many relevant transactions requiring additional EDD are carried out each year. The government was unable to establish an accurate estimate of the number of business relationships and transactions on which financial institutions would conduct EDD annually and will seek more evidence on the impact of the regulations as part of its review of the MLRs due in 2022.

86. With respect to explicitly including 'beneficiary of a life insurance policy' as a relevant risk factor for considering conducting enhanced due diligence, consultations responses indicated that this is unlikely to lead to a quantifiable increase in cost. The addition of 'beneficiary of a life insurance policy' as a relevant factor to consider EDD would not require firms to conduct EDD automatically on beneficiaries of life insurance policies, but rather decide on a risk-based approach whether EDD is required. It is unlikely that this clarification of the legal requirements on EDD will lead to a substantial change in firms' risk-based approach and the number of EDD checks carries out is likely to remain similar.

87. **Non-monetised costs**: In their response to our consultation, some representatives of the financial sector were concerned that the amendment to EDD regulations with regards to customers and transactions linked to high-risk third countries could have unintended consequences for charities generally operating in non-high risk countries supporting projects in high-risk third countries, nationals of high-risk countries making low level payments home for family support and students whose families are in high-risk countries and pay school fees in the UK due to some financial institutions taking overly conservative measures fearing regulatory sanctions.

26

HMT (2019) Anti-money laundering and counter-terrorist financing; supervision report 2017-2018. https://www.gov.uk/government/publications/anti-money-laundering-and-counter-terrorist-financing-supervision-report-2017-to-2018

27 HMT (2017) Impact Assessment: Transposition of 4MLD. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/564813/impact_assessment_transposition_of_4MLD.pdf

6. National Register of bank account ownership

88. 5MLD requires that the UK establish a centralised automated mechanism – such as a central registry or electronic data retrieval mechanism – which allows identification of natural and legal persons which hold or control bank accounts; payment accounts; or safe-deposit held by credit institutions within the UK. The mechanism will retrieve ownership information on those accounts, and that information held on such mechanisms is "directly accessible in an immediate and unfiltered manner to national FIUs", as well as national competent authorities for fulfilling their obligations under 5MLD.

Options:

- **Option 0**-do nothing: we could choose not to implement the requirement, but this would put the UK in breach of EU Legislation.

- **Option 1**: implement it with the minimum scope: we could limit the scope solely to those accounts required by the directive as a bare minimum (i.e. all accounts identifiable by IBAN and safe deposit boxes provided by credit institutions). This would minimise the direct cost to the private sector by minimising the number of firms affected but could reduce the benefits by displacing risk to other parts of the sector. It could also have the unintended consequence of distorting the market, with indirect costs to the private sector and consumers.
- **Option 2**: implement it with a widened scope: we could include all building societies and SDB providers that are not credit institutions, placing costs on around 65-80[28] additional businesses. However, this would ensure that the tool is more effective and delivers greater benefit, while also minimising the risk of unintended market distortions.

  - **Option 3:** implement it with comprehensive coverage: we could apply this to all types of account, including e-money, credit card, prepaid card and all credit union accounts. This would increase the number of institutions bearing additional costs by an unknown number and would require a greater level of technological complexity. This might increase the benefits of the tool but would be less likely to influence market distortion, since the additional businesses are less likely to be substitutable competitors.
- We will proceed with **2**

Rationale:

89. 5MLD suggests that "Member States may consider requiring other information deemed essential for FIUs and competent authorities for fulfilling their obligations under this Directive to be accessible and searchable through the centralised mechanisms." We will proceed with **2** on the grounds that it would offer information that is necessary to effectively fulfil authorities' obligations. It would help to tackle illicit finance in the SDB market, and would also minimise the displacement of risk within the building society and SDB sectors. Although **2** brings around 65-80 additional businesses, including some small and medium-sized businesses, into scope, it will also cause the least distortion to the market, in terms of regulatory requirements and compliance costs.

90. Law enforcement agencies consider that there will be clear benefits to their investigations. Firstly, it will improve efficiency and reduce costs. It will improve the efficiency of the current process for data gathering and pre-enquiry checks by allowing financial investigators to request the information they require immediately through the portal. It will: (i) reduce the time taken for investigators to request this information; (ii) reduce the time taken for firms to process and respond to these requests; and iii) provide investigators with quicker results from the searches they are running, significantly aiding the speed of their investigations.

91. The mechanism will provide investigators with a richer, and more complete dataset. This will enable investigators to submit more targeted applications to court. This will reduce the likelihood that investigators will need to submit subsequent applications, reducing the overall number of applications submitted. This will save investigators, courts and firms

[28] Based on estimates from trade associations, the FCA and NCA.

significantly time and effort currently taken to produce and process a large number of requests.

92. Secondly, this tool will improve the effectiveness of law enforcement by providing a richer, and more complete source of data that investigators (financial and others) can use to build a profile of a suspect they are investigating – including bank account and safety deposit box (SDB) information.

93. The mechanism will enable investigators to more clearly and accurately scope applications to court. This will improve the quality of court applications, making it easier for courts to approve applications. The mechanism also has the possible benefit of reducing follow-on applications made to courts to obtain additional information (as per the previous example) which may reduce time delays in investigations.

94. Thirdly, the mechanism could capture credit union account and safety deposit box information that is not currently available to investigators as neither are captured within credit reference agency checks. This will significantly aid investigations into a wide array of criminal activities by providing additional data that investigators can use. The law enforcement officers that the NCA have heard from were confident based on their experience that SDBs continue to be used for criminal purposes ranging from money laundering and organised crime, to child sexual exploitation or supply of false IDs. They said that access to information on SDB holders would be of benefit to policing; some said the deterrent effect alone could be game-changing in cleaning up the SDB market. The specific uses articulated to us include the following:

95. The European Commission's Action Plan for combatting terrorist financing of February 2016 sets out the policy rationale for this requirement, noting that "The existence of centralised registers at national level, which provide all national bank accounts listed to one person…is often cited by law enforcement authorities as facilitating financial investigations, including of possible terrorism financing".

Monetised and non-monetised costs

96. **Costs**: Approximately 500 businesses will be in scope[29], including banks, building societies, credit unions and SDB providers that are not credit institutions.

97. The cost of providing required account data in a timely fashion and suitable form will vary between institutions according to their size, number of accounts, data accessibility and technological infrastructure.

98. While not fully analogous to the introduction of this mechanism, the introduction of the FSCS Single Customer View (SCV) mechanism was an IT project that gathered data on a significant number of accounts, though fewer than this mechanism would affect. One very large firm has estimated its costs in providing data to the mechanism to be £3-4m plus ongoing maintenance costs. For a much smaller business, the implementation costs are estimated at £0.2m – £0.4m plus maintenance costs. Given that the mechanism, scope and delivery timetables will differ from SCV, this should not be interpreted as a reflection of the upper and lower costs; a business' costs could be below £0.2m or above £4m. Annual maintenance costs of SCV were estimated by the smaller business to be between £23,360 and £166,218, but a larger business would have significantly higher costs.

99. One state has estimated the build costs of their mechanism to be between £40,000 and £0.9m per business. Two other member states have estimated build costs to be £0.6m and £1m per business, although in the latter case, this still excludes operations, staff and other non-IT costs.

100. One business provided estimates of the ongoing annual costs of compliance with national registers of bank accounts in two different member states. In a state where it has a relatively small book of approximately 100 customers and reports manually, its costs are €18,000 (approx. £15,500) per year. In a state where it deals with a larger (though still comparatively small) book of customers, it's annual costs total €65,000 (approx. £56,300) for around 20,000 new customers and 50,000 updates to existing customers.

[29] Based on estimates from trade associations, the FCA and NCA.

I. Number of businesses in scope EU requirement : 420- 435

II. Number of additional businesses in scope: 65-85

Transitional costs :

As outlined in the text above, we have three alternative proxies available below on which we can base our estimates of the transitional costs of the measure per businesses. Proxy (a) is based on a different IT project and (b) and (c) on other state's estimates of the build costs of their own mechanisms.

a. SVC proxy of costs inputing data per business: £0. 2m –£ 4m

b. Other state A estimate of build cost per business: £ 40,000-0.9m

c. Other states B & C estimates of build cost per business: £ 0.6m-1m

We based our estimates on an average of the lower bound and upper bound estimates and we adjusted ranges to reflect optimism bias according to the guidelines of the Greenbook for capital expenditure on equipment and development projects (200% optimism bias on the upper bound and 10% on the lower bound)[30].

Option 1 (cost of implementing with the minimum scope)

Low estimate: (£0.2m + £0.04m + £0.6m)/3 = £0.28m average lower bound estimate based on proxies a,b and c. £0.28m + (£0.28m x 0,1) =£0.308m per businesses to account for optimism bias x 420 businesses = £129.36m for businesses in scope under option 1.

High estimate: (£4m +0.9m= 1m)/3 = £1.97 average lower bound estimate based on proxies a,b and c. £1.97m + (£1.97m x 2) =£3.93m per business to account for optimism bias x 435 businesses = 1731m for businesses in scope under option 1.

Option 2 (cost of extending the scope to 65-80 additional businesses)

Low estimate: (£0.2m + £0.04m + £0.6m)/3 = £0.28m average lower bound estimate based on proxies a,b and c. £0.28m + (£0.28m x 0,1) =£0.308m per businesses to account for optimism bias x 65 businesses = £20.02m for additional businesses in scope under option 2.

High estimate: (£4m +0.9m= 1m)/3 = £1.97 average lower bound estimate based on proxies a,b and c. £1.97m + (£1.97m x 2) =£3.93m per business to account for optimism bias x 80 businesses = £314.67m for additional businesses in scope under option 2.

Annual costs

As outlined in the text above, we have two alternative proxies available (a) and (b) set out below on which we can base our estimates of the measure of annual costs to businesses. Proxy (a) is based on a different IT project and proxy (b) is based on estimates provided in answers to our consultation .

a. maintenance costs of SCV (proxy): £23,360 - £166,218

b. estimates from consultation answers : £15,000 - £56,300

We based our estimates on an average of the lower bound and upper bound estimates of proxy a and b and adjusted the range to account for optimism bias.

Option 1 (cost of implementing with the minimum scope)

Low estimate: (£15,000 + £23,000 / 2) = £19,000 average lower bound estimate based on proxies a and b. £19,000 + (£19,000x0,1) to account for optimism bias = £20,900 per business x 420 businesses = £8.778m annual costs for businesses in scope under option 1.

High estimate: (£166,216 + £56,300/2) = £111,258 average lower bound estimate based on proxies a and b. £111,258 + (111,258 x 2) to account for optimism bias = £222,516 per

[30] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/191507/Optimism_bias.pdf

business x435 businesses = £96.794m annual costs for businesses in scope under option 1.

Option 2 (cost of extending the scope to 65-80 additional businesses)

Low estimate: (£15,000 + £23,000 / 2) = £19,000 average lower bound estimate based on proxies a and b. £19,000 + (£19,000x0,1) to account for optimism bias = £20,900 per business x 65 businesses = £1.358 m annual costs for additional businesses in scope under option 2.

High estimate: (£166,216 + £56,300/2) = £111,258 average lower bound estimate based on proxies a and b. £111,258 + (111,258 x 2) to account for optimism bias = £222,516 per business x 80 businesses = £17.801 m annual costs for additional businesses in scope under option 2.

Non-Monetised benefits

101. By improving the investigation of economic crime, this mechanism will help to make the UK a safer place to do business. A healthier, cleaner financial system has indirect benefits to UK businesses.

7. Requirement to publish an annual report

102. 5MLD requires self-regulatory bodies to publish an annual report containing information on their supervisory activity, including number of supervisory visits and enforcement action undertaken. Most of this information is already collected by supervisors and submitted to the Treasury in an annual return which informs the Treasury's annual AML/CTF supervision report which the Treasury is legally obliged to publish annually under the MLRs.

Monetised and non-monetised costs and benefits

103. The cost of publishing an annual report will incur to the 22 self-regulatory bodies listed in Schedule 1 of the MLRs. Given that self-regulated bodies already collect the information that should inform their annual report to inform the Treasury's annual supervision report, it is unlikely that the change would incur significant transition costs such as creating new data collection systems. Assuming self-regulated bodies have sufficient human resources to draft and publish of an annual report, that the data required for the report is already collected, that 70-105 work hours are required to draft and publish the report and based on an average compliance analysts salary (£35,000 p.annum) the cost of publishing an annual report would be between £1346 - £2019 per professional body supervisor (a total cost to the economy of approximately £29,612 – £44,423).

104. The publication of an annual report will benefit self-regulated bodies and their supervised population by providing accountability on how self-regulated bodies use their AML/CTF supervision fees. The reports will benefit society by improving the transparency of the supervision regime and providing contextualised data on the supervisory activities of self-regulated bodies. This may in turn contribute to strengthening the UK's supervision regime by encouraging self-regulated bodies to reflect on how they conduct their supervisory activities and promoting the sharing of best practice on AML/CTF supervision.

8. Additional technical amendments to the MLRs

8.1 Changes to the requirement to be registered

105. Under Regulation 56 of the MLRs, High Values Dealers, Money Service Businesses (MSBs), Trust or Company Service Providers (TCSPs), bill payment service providers and telecommunication, digital and IT payment service providers who have applied to register to trade can do so legally until their application has been determined. This is problematic in the case of MSBs and TCSPs.

106. The NRA 2017 found that MSBs are at high risk of being abused for both money laundering and terrorist financing[31]. MSBs provide a range of services relating to the transmission or conversion of funds including money transmission services, foreign exchange and cheque cashing. Some MSBs are used for money laundering on a significant scale to move large sums of criminal cash overseas and significant poor practice has been identified in the sector.

107. The NRA 2017 also highlights that criminals continue to make use of TCSPs to establish trust and corporate structures to conceal the origin of criminal funds or move criminal proceeds oversee. Negligent or complicit TCSPs pose the greatest risk of money laundering and the mixed standard of implementation of the MLRs in the sector remains a key factor of risk.

Options

- **Option 0 - 'do nothing':** Under this option MSBs and TCSPs would continue to be legally allowed to practice until their application has been determined. Given the identified risks of money laundering and the mixed standards of implementation of the MLRs in the MSB and TCSP sectors, this option makes the AML supervision regime vulnerable to abuse.
- **Option 1:** Amend Regulation 56 of the MLRs so that MSBs and TCSPs can only practice legally once their application has been determined. This is the preferred option.

Rationale:

108. Amending the regulations, so that MSBs and TCSPs can no longer practice until their application is determined would help minimise the risk of corrupt complicit MSBs and TCSPs operating in the UK financial system. The 2017 NRA assessed MSBs as high risk for terrorist financing. There is no reason to conclude that this risk has decreased since 2015, and the sector in general continues to be exposed to risks arising from links to high-risk jurisdictions and generally poor compliance outside the largest firms. As such, the MSB sector continues to be assessed as high risk for terrorist financing. Closing the trading period whilst the application is being determined would minimise the risk of illicit MSB from trading whilst unregistered and reduce vulnerable funds at risk for TF / ML purposes. This will also reduce registered individuals or businesses who deliberately omit, conceal or misrepresent information and trade whilst their application is being determined.

109. Similarly, the NRA 2017 identified some of the greatest risk around the TCSP sector to be negligent or complicit TCSPs facilitating money laundering and the mixed standards of implementation across the sector. This risk can be mitigated if TCSPs are not allowed to trade whilst their application is pending.

Monetised and non-monetised costs

110. **Costs** We anticipate that the main cost to businesses of this amendment would be the opportunity cost of waiting for their application to be processed which may take up to 45 days. However, we anticipate that HMRC will process most applications from MSBs and TCSPs in less than 45 days and that applications will be processed between 20 and 45 days.

111. In the last 12 months, 318 MSBs have registered with HMRC. Based on data collected by HMRC at registration, the average throughput for these 318 MSBs in their first year of practice is between £63,994- £394,182. HMRC does not collect data on the profit of MSBs. However, they estimate that MSB's profit represents only a small proportion of the throughput (commissions– running costs) between 1-5% depending on the type of commission and services offered. Over 45 days, this equates to £640-£19,710. However, we appreciate that businesses may not receive as much in their first 45 days of operation and profits may fall between £0-19,710.

[31] HMT, HO (2017) National risk assessment of money laundering and terrorist financing 2017. https://www.gov.uk/government/publications/national-risk-assessment-of-money-laundering-and-terrorist-financing-2017

112. In addition, there is an opportunity cost for employees of MSBs. Employees are likely to be paid at the minimum wage (on average £6.06 across age categories). Assuming that all employees work full time (35h, 5h/day) the opportunity cost for employees of not working for up to 45 days would be (£6.06x (5hours a day x 45days)) £1,363.5 per employee.

113. The 318 MSBs who registered in the past 12 months have on average 72 employees. However, the average number of employees per MSB above was skewed by one of the businesses with 12,000 employees. According to data submitted to the Treasury in their last annual return for the period 2017-2018, approximately 17% of MSBs supervised by HMRC were sole practitioners. If we exclude the outlier, the three businesses with the next highest numbers of employees has respectively 8,404 ,700 ,300 employees and the average number of employees 34 across 317 MSBs.

114. In the last 12 months, 303 TCSPs have registered with HMRC. Based on information collected by HMRC on 98 of 303 of these businesses, the average net profit was between £188,265-£498,214. Over 45 days this equates to £23,210-£61,423. However, we appreciate that businesses may not be as profitable in their first 45 days of operation and as a result the anticipated profit for the first 45 days ranges from £0-£61,423.

115. The 98 TCSPs have on average 10 employees. Based on an average minimum wage of £6.06 and the same calculations as above, the opportunity cost for employees would be £1363.50 per employee

I. number of MSBs registering with HMRC annually: 318

II. Average number of employees per MSB: 34

III. Estimated MSB profit per day(range): £0 - (19,710/45days) = £438

IV. Estimated hourly wage of MSB/TCSP employees: £6.06

V. number of TCSP registering with HMRC annually: 98

VI. Average number of employees per TCSP: 10

VII. Estimated TCSP profit per day (range): £0 – (£61,423/45days) = £1364.95

Opportunity cost for MSBs

Low estimate: £0 x 20 days = £0

High estimate: £438 x 45 days = £19,710 x 318 MSBs = £6.267million

Opportunity cost for employees of MSBs

Low estimate: £ 6.06 x 5hours a day x 20 days = £606 per employee x 34 employees x 318 MSBs = £6.552 million

High estimate: (£6.06x 5hours a day x 45 days=)) £1,363.5 per employee x 72 employees x 318 MSBs = £31.207 million

Opportunity cost for TCSPs

Low estimate: £0 x 20 days = £0

High estimate: £1364.95 x 45 days per TCSP x 98 TCSPs = £6.019 million

Opportunity cost for employees of TCSPs:

Low estimate: £ 6.06 x 5hours a day x 20 days = £606 per employee x 10 employees x 98 TCSPs = £593,990

High estimate: £ 6.06 x 5hours a day x 45 days = £1,363.5 per employee x 10 employees x 98 TCSPs= £1.335 million

Total = opportunity cost for MSB + opportunity cost for MSB employees+ opportunity cost for TCSP+ opportunity cost for TCSP employees

Low estimate: £0+ £6.552 million+ £0 + £593,990 = 7.145 million

High estimate: £6.267 million + £31.207million + 2.675 million + £6.019 million = 46.148 million

8.2 Complex network structures

116. Regulation 24 of the MLRs transposes Article 46 of 4MLD which requires all obliged entities to conduct ongoing training of their employees. There are a small number of large operators in the MSB sector who cover a large share of the market. There are range of complex network structures where agents are engaged to provide services. This sometimes includes agents that are large high street names who then engage their own agents to supply their own services and those of the principal MSB. The policy intention behind article 46 of 4MLD and regulation 24 which transposes it is that all staff providing services of the principal should be trained. Multi-layer arrangements with subagents who deal with frontline customers can result in those employees delivering the service not receiving the relevant training. We propose to amend the regulations to require principals to ensure that the employees of their agents are trained appropriately. As noted in the consultation, this requirement would apply across all obliged entities.

Options

- **Option 0 - 'do nothing':** Employees of agents delivering the service of MSBs and other obliged entities will continue not to receive the relevant training. This makes businesses in regulated sector more vulnerable to ML/TF and increases the risk in the sector and does not fulfil the policy intent of 4MLD.
- **Option 1:** Amend Regulation 24 of the MLRs to require agents to be made aware of their obligation to train employees.

Monetised and non-monetised costs and benefits

117. Obliged entities will need to ensure that the agents they hire to deliver regulated activities are trained. It's not possible to obtain a monetised estimate of the costs as it has not been possible to estimate the number of agents providing regulated who are currently untrained. We anticipate that most agents hired to carry out regulated activities would already fall within the scope of regulated entities and as a result it is unlikely that sectors outside the MSB sector will be affected.

118. In our consultation, we asked stakeholders who operate as part of a network of agents whether they already provide training to employees. Several major MSBs said they already provide training to employees. Similarly, other obliged entities employing agents to carry out their businesses such as representatives of the accounting sector said employees of their agents would already be trained as they would also be directly supervised for AML purposes. As a result, we anticipate that the cost to businesses of this change will be minimal.

8.3 Criminality checks

119. Regulation 26 transposes Article 47 of 4MLD which requires member states to take measures necessary to ensure that competent authorities take the necessary measures to prevent criminals convicted of relevant offences to hold management functions in relevant sector. Some supervisors have considered self-declaration of criminal conviction by those holding management functions or beneficial owners in relevant sectors as sufficient to comply with regulation 26 as currently drafted. This has led to an inconsistent compliance

with the regulation and is problematic in that it may allow criminals to hold key roles in regulated firms.

Options

- **Option 0: 'Do nothing'** We could choose to keep existing legislation unchanged. However, this may allow criminals to exploit the vulnerabilities of the supervision regime to hold key positions in regulated firms.
- **Option 1:** Amend regulation 26 to clarify that self-regulated bodies should conduct criminality checks or have sufficient information in their possession to determine whether beneficial owner or manager applying for approval in a relevant sector has had a criminal conviction.

Rationale:

120. The National Risk Assessment 2017, found that accountancy and legal services were at a high risk to be exploited by criminals to launder money due to their ability to create an appearance of legitimacy, create corporate structures and transfer values. The change to regulation 26 will contribute to preventing criminals from operating in the accountancy and legal sector and help safeguard the integrity of the UK's professional services. The change will also ensure that the requirements of 4MLS are applied consistently across the UK's AML supervision regime.

Monetised and non-monetised costs and benefits

121. Some self-regulatory supervisors already carry out criminality checks on their members, however we anticipate that there will be a small transition cost to other supervisors. This will include the cost of familiarising themselves with the new requirements including legal advice and understanding the gap between the compliance gap between their current policies and legal requirement. Self-regulatory supervisors may need to train their compliance teams to understand and implement new policies and procedures. The size of the 22 self-regulatory supervisors, their supervised population and corporate structures vary widely which makes it difficult to evaluate the overall transition cost of the amendment.

122. We anticipate that relevant businesses and individuals applying for approval by self-regulatory supervisory bodies will have to pay for the costs of criminality checks. The Treasury requires self-regulatory bodies to provide the number of applications received under regulation 26 through its annual return which informs its supervision report. However, we cannot provide the exact number of yearly applications due to inconsistencies in the way the returns were filled. Based on the incomplete data collected through the 2017-2018 returns, we estimate the number of individuals who will apply for approval every year will be between 4,000 – 8,000.

123. The cost of a standard DBS check is £25. We also anticipate that there will be an administrative cost to firms and sole practitioners for physically making the application. It takes approximately 30 minutes to complete a DBS application, but additional administrative time may be required for employers and professional body supervisors to process the application details. Based on information from statutory supervisors, we estimate that employers need between 1 and 3 hours and that self-regulatory supervisory bodies need an additional hour to process a DBS check. According to estimates for June 2018 of the ONS, the average weekly earnings is £517 in the UK (£14.7/ h for a 35h week).[32] The salary of a senior compliance officer is approximately £48/h. It usually takes up to 14 days to receive a DBS certificate, this is not expected to cause significant delays to employees starting a new job as the application is likely to form part of a firm's wider onboarding procedures.

<u>8.4 New technologies (changes to regulation 19)</u>

32 https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/datasets/averageweeklyearningsbysectorearn02

124. In December 2018, the FATF MER of the UK's AML/CTF regime recommended (Recommendation 15.2) that financial institution should be required to undertake risk assessments prior to the launch or use of new products, new business practices and delivery mechanisms. The MLRs currently require financial institutions to take appropriate measure to assess and mitigate any ML/TF risks arising from the adoption of new technology, but this does not extend to explicitly include all new products, business practices and delivery mechanisms. However, the Joint Money Laundering Steering Group (JMLSG) Guidance states that relevant persons should assess ML/TF risks prior to the launch of any new products, business practices and delivery mechanisms.

Options

- **Option 0; 'do nothing'**: The Government would not seek to amend the current regulation. This would represent a potential breach of the FATF standards and could undermine the UK's credibility as a leader in the field of AML/CTF.
- **Option 1: Clarify the MLRs to comply with FATF standards*:*** The Government would amend the MLRs to make it explicit that firms are required to undertake risk assessments prior to the launch or use of new products, new business practices and delivery mechanisms as already specified in the JMLSG guidance. The Government is committed to the FATF standards and implementing them as far as possible, the amendment would clarify the regulations. Therefore, option 1 is the preferred option.

Rationale: Amending the regulation would clarify the existing regulatory situation and ensure the UK meet FATF standards.

Monetised and non-monetised costs and benefits

125. **Costs** We consulted on the proposed change in June and representatives from the financial sector, e-money and payment sector answered that many firms already conduct such risk assessments before adopting new products and delivery mechanisms. In addition, the JMLSG guidance which clarifies legal obligation under the MLRs for financial institutions, already states that financial institutions are required to undertake such risk assessments. Therefore, we do not anticipate that the amendment will lead to additional costs to businesses.

8.5 Group Policies (change to regulation 20)

126. The last FATF MER of the UK's AML/CTF regime recommended (Recommendation 18.2(b)) that financial groups should be required to implement group-wide programmes against money laundering and terrorist financing, including, when necessary for AML/CTF purposes, the provision of customer, account and transaction information from branches and subsidiaries. The MLRs already require relevant persons to have policies, controls and procedures through their group for data protection and information sharing for AML/CTF purposes. However, they do not explicitly require relevant persons to have, controls and procedures relating to the provision of customer account and transaction information for branches and subsidiaries.

Options:

- **Option 0 - 'Do nothing':** This would not meet the FATF standards and could undermine the UK's credibility as a leader in the field of AML/CTF.
- **Option1**: Amend the MLRs to meet with FATF recommendation 18.2(b). This is the preferred option.

Rationale: Amending the regulation would clarify the existing regulatory situation and ensure the UK meets FATF standards.

Monetised and non-monetised costs and benefits

127. We propose to amend Reg 20(1)(b) of the MLRs to make it explicit that group level policies should include polices on the sharing of information about customer accounts and transactions.

128. We anticipate that the main cost to businesses will be the transition cost of updating and implementing their group policies. We anticipate that the regulation will mainly affect large financial services businesses with global operations. Other FATF members such as Hong King already explicitly require groups to have such policies in place. Therefore, it is difficult to estimate the cost of this change given some businesses may be widely compliant already and because law does not specify what the content of the policies should be to allow businesses flexibility on how to comply.

129. In our consultation, we asked stakeholders what costs and benefits this change would entail. Respondents to the consultation found it difficult to provide monetised estimates of the cost this would incur. However, informal consultation with a range of representatives of the financial sector suggests that developing a group level policy would involve a development stage including an assessment of the compliance gap, drafting an initial policy, an outreach exercise to understand the countries with potential information-sharing restrictions, two rounds of internal consultation on the draft policy, updating the draft policy to address the feedback from consultation, policy approval and reporting to FCA.

130. The new policies will then need to be implemented across the group which would most notably involve carrying out a business impact assessment of the new requirement against current group and country level processes including technology control checks and reporting, training across all countries and impacted teams, an evaluation of human resources needs and depending on the results of the impact assessment developing plans to close the compliance gap.

131. **Who will be affected:** Based on data collected from supervised firms by the FCA for their financial crime survey, 167 of the UK headquartered financial institutions they supervise for AML purposes have 1 or more subsidiaries. The vast majority of these (126) have less than 5 subsidiaries and 18 firms have over 10 subsidiaries. The estimated transition costs outlined below are based on consultation with large firms with operations in several countries and it is likely that these costs would be much lower for smaller firms; responses to our consultation did not provide any evidence on the costs to smaller businesses. It is also likely that smaller groups with operations in the UK only will already have such policies in place. In the absence of more detailedevidence and to account for optimism bias, we applied these costs to the 167 businesses likely to be affected.

<u>Transition Cost</u>[33]

I. Estimated number of UK businesses affected: 167

II. Average salary per/h of an AML policy team member: £48

Policy development phase:

III. Cost of assessing compliance gap (20% of the time of 2 compliance AML policy team members over 8 weeks): (((37.5h x 8weeks)x 0.2) x £48) x 2) = £5,760

IV. Cost of drafting preliminary draft (30% of the time of 2 AML policy team members over 3 weeks): (((37.5h x3 weeks) x 0.3) x £48) x2 =£3,240

V. Cost of country-level outreach exercise based on 60 countries (40% of 1AML policy team member over 4 weeks): ((37.5hx 4 weeks) x 0.4) x £48 =£2,880

VI. Cost of processing feedback and update policy based on 2 rounds of consultation: (30% of combined time 2 AML policy team member's tome over 5 weeks): ((37.5h x 5 weeks) x 0.3) x £48)x =£2,700

VII. Cost of finalising group policy (40% of combined time of 2 policy officials over 1 week): (37.5h x 0.4) x £48 =£720

[33] The monetised estimates below are based on estimates provided by range of financial sector stakeholders and FCA's register of financial institutions

VIII. Cost Reporting to FCA (40% of time of 1 AML officer over 2 weeks): (37.5hx0.4)x£48 =£720

IX. Transition cost estimate : (£5,760+£3,240+£2,880+£2,700+£720+£720) = £16,020 per business x167 =£2.675m per sector

132. These estimates do not take into account the costs of implementation and therefore total transitional cost to businesses is likely to be higher. The calculations above are based on estimates provided by a range of stakeholders from the financial sector. Responses to our consultation did not provide any estimates of implementation costs. We followed up with a range of stakeholders from the financial sector but they were unable to provide us with an estimate of the implementation costs as they will depend on a variety of factors including the scale of the compliance gap, business model and scale of operations, risk appetite and we were therefore unable to provide a final estimate. The scale of the compliance gap and the actions needed to remedy it will be determined during the policy development phase which businesses have not yet conducted and branches and subsidiaries abroad may bear some of the implementation costs. Therefore, firms cannot provide an accurate estimate of implementation costs at this stage.

133. In the absence of an accurate estimate for the reason stated above or of a suitable proxy on the ratio costs between of policy development and implementation costs from similar policies we make the plausible assumption for the purpose of this analysis that the implementation costs could multiply transitional costs for UK based businesses by a coefficient between 5 and 20 (to account for the difference in the size and complexity of the financial groups) if all businesses had to implement changes to their policies This gives us an estimate range of between £2.675m x 5 =£13.375m and £2.675m x 20 = £53.5 million. However, as stated above, Other FATF members such as Hong King already explicitly require groups to have such policies in place. Therefore, it is difficult to estimate the cost of this change given some groups may be widely compliant already and because law does not specify what the content of the policies should be to allow businesses flexibility on how to comply.

VI. Impact on Small and Micro businesses

134. Data from our 2017-18 annual returns suggests that at least 30,211 of the approx. 91,696 obliged entities (33%) supervised under 4MLD were sole practitioners, the majority of which were legal and accountancy professionals.

135. The Government's March 2017 *Cutting Red Tape* review of the UK's AML regime found that the complexity of customer due diligence requirements hit small businesses particularly hard and creates a barrier to entry for small businesses in regulated sectors. While large firms have departments and specialist resources to manage regulatory requirements, SMEs are less able to do this.

136. The EU Directive and 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. The money laundering and terrorist financing risk is not proportional to the size of businesses, small businesses are often the target or accomplices of criminals seeking to launder the proceeds of crime or finance terrorist activities. Consequently, for the regulations to achieve their intended policy objective it is necessary that regulation should apply to all businesses within the scope of the regulations irrespective of their size.

137. The Treasury approved guidance containing detailed and accessible information on compliance requirements is published by JMLSG, FCA, HMRC, the Gambling Commission and the legal and accountancy sectors. The guidance will be updated to consider the changes introduced by 5MLD and new guidance will be published for previously unregulated sector. The guidance has legal status and notably aims to help small and micro-businesses understand and comply with their obligations.

138. Only some of the proposed changes going beyond EU requirements may have an impact on small and micro-businesses.

139. **Expanded Scope of cryptoasset businesses regulated:** Responses to our consultation suggest that most cryptoasset businesses are already partially compliant with the regulations and carry out some form of customer due diligence as banks would require them to do so in order to gain access to financial services. Therefore, it is likely that the main transition cost for these businesses will be familiarisation with the regulations. The Treasury will approve JMLSG guidance to help businesses understand their obligations under the regulations and how these apply to their own sectors.

140. The FCA estimates that the majority of firms who are likely to fall in scope of the MLRs will be small or micro-businesses, irrespective of where the scope is extended beyond 5MLD. However, given that these businesses are currently unregulated no formal data collection on staff numbers has taken place, and this assumption is based on estimated turnover, volumes of trade and the nascent nature of the industry. 5MLD came into force in June 2018 and the government only finalised the scope of our regime in the autumn of 2019, after a period of consultation. Consultation responses were not able to give an accurate figure of the make-up of the cryptoasset industry in the UK, given the rapidly evolving nature of the sector. The FCA's estimate of 80 UK applicant firms remains the most accurate figure to date, although the FCA estimate that the inclusion of larger peer-to-peer traders is likely to raise the estimated number of firms applying to 100. As outlined in the cryptoasset businesses section, we know that 15 of these businesses are likely be regulated under the minimum EU directive requirement and we therefore estimate that there may be an additional 65-85 small and micro-businesses falling in scope of the regulation as a result of the proposed expansion of the minimum EU requirements under option 2. The risk of money laundering through cryptoasset businesses does not depend on the size of the staff of cryptoasset businesses and it is possible that businesses falling within the RPC's definition of small and micro-businesses will turnover large volumes of funds which makes them vulnerable to being exploited for money laundering and terrorism financing.

141. As outlined above going beyond minimum EU requirements for the regulation of cryptoassets by expanding the scope of the legislation to crypto-to-crypto exchange facilities, cryptoasset ATMs, peer-to-peer exchange facilities and initial coin offerings will help ensure that illicit activity is not displace to other businesses distorting the markets and to fill the potential loopholes created by the minimum EU requirements. Exempting small and micro crypto-to-crypto exchange facilities, cryptoasset ATMs, peer-to-peer exchange facilities and initial coin offerings from the regulations or mitigation such as exempting them from parts of the regulation would prevent the policy from achieving its aim by allowing and encouraging illicit activity to take place through small and micro-businesses.

142. **Expanded Scope of the register of bank account ownership:** Some of the 65-85 additional businesses in scope will be small and medium-sized businesses. Although we currently are not able to provide precise number, these businesses would be supervised by the FCA which estimates that 90% of the firms it supervises would be in the range of 1-49 staff members. It is therefore highly likely that between 58-77 of the additional businesses in scope would be small and micro-businesses. Although these businesses are small in terms of workforce, the financial nature of their business means that they may facilitate a high volume of transactions which makes these businesses vulnerable to money laundering. Exempting small and micro-businesses from the measure would greatly limit the effectiveness of the register of bank account ownership as a law enforcement tool and as a result cannot be considered.

143. **EDD (FATF recommendation 10.13):** This change will apply to financial institutions only, which are already in scope of the regulations. It requires financial institutions to include the beneficiary of a life insurance policy as a relevant risk factor in determining the need for EDD. The addition of 'beneficiary of a life insurance policy' as a relevant factor to consider EDD would not require firms to conduct EDD automatically on beneficiaries of life insurance policies, but rather decide on a risk-based approach whether EDD is required. It is unlikely that this clarification of the legal requirements on EDD will lead to a substantial change in firms' risk-based approach regardless of whether they are small or micro-businesses as being the beneficiary of a life insurance policy will be one factor among other which will help a firm determine whether EDD is required. The FCA estimates that 90% of the financial

institutions it supervises (approx. 17,100) have a workforce of between 1-49 staff members. The additional number of EDD checks small and micro-businesses carry out as a direct result of this change is therefore likely to be minimal and it as many other factors will come contribute to rating the risk of a specific customer and deciding whether EDD is necessary and it would not be proportionate to estimate this cost. Regardless of the size of their staff, financial institutions are likely to have large turnovers and customers who are the beneficiaries of life insurance policies which the FATF identified as a potential money laundering risk. Exempting small and micro-businesses from this requirement or mitigations reducing requirements for small and micro businesses would create a loophole in the regulations and allow illicit activity to take place through small and medium businesses. The Treasury approves industry-led guidance drafted by JMLSG which clarifies the financial sector's obligations under the regulations. The Treasury will approve an updated guidance covering changes under 5MLD which will help businesses understand their new obligations.

144. **Additional technical changes to the MLRS:**

- **change to the requirement to be registered:** This change applies to MSBs and TCSPs applying to register with HMRC and is likely to affect small and micro-businesses. In the last six months, HMRC received 24 applications from MSBs with 49 employees or less and 26 applications for TCSPs with 26 employees or less. Therefore we anticipate that the measure will affect approximately ((26+24)x2 =) 100 small and micro businesses annually. Amending the regulations, so that MSBs and TCSPs can no longer practice until their application is determined would help minimise the risk of corrupt complicit MSBs and TCSPs operating in the UK financial system. The 2017 NRA assessed MSBs as high risk for terrorist financing. Similarly, the NRA 2017 identified some of the greatest risk around the TCSP sector to be negligent or complicit TCSPs facilitating money laundering and the mixed standards of implementation across the sector. The change of the requirement to be registered would help mitigate this risk. Exempting small and micro-businesses from this change would potentially allow complicit small and micro-businesses in the MSB and TCSP sector practice while their application is determined and would not achieve the desired policy objective of mitigating the risk identified within the sector. HMRC will where possible seek to process the applications of MSBs and TCSPs faster than the 45 working days to mitigate the opportunity cost to businesses.

- **New technologies:** The change requires firms to undertake risk assessments prior to the launch or use of new products, new business practices and delivery mechanisms. This is already recommended by the JMLSG guidance for the financial sector and responses to our consultation from financial sector respondents suggest that most firms already carry out such assessments. Therefore, we do not anticipate that this change will incur significant additional costs to financial institutions in general including small and micro businesses. The FCA estimates that 90% of the financial institutions it supervises (approx. 17,100) have a workforce of between 1-49 staff members. Regardless of the size of their staff, financial institutions are likely to implement new technologies, policies and procedure which could make them more vulnerable to being exploited by criminals for money laundering and terrorism financing purposes. The risks of ML associated with new technologies affect all sizes of businesses and as such exempting or mitigating the regulations for small and micro-businesses from the regulation would not achieve the desired policy outcome.

- **Group Policies:** The last FATF MER of the UK's AML/CTF regime recommended (Recommendation 18.2(b)) that financial groups should be required to implement group-wide programmes against money laundering and terrorist financing, including, when necessary for AML/CTF purposes, the provision of customer, account and transaction information from branches and subsidiaries. Due to the size of these firms operations we do not anticipate that such financial groups would fall within the category of small and medium businesses.

VII. Conclusion

112. Money laundering and terrorism financing are serious threats to the security and prosperity of the UK. It impacts society as a whole, including citizens, businesses and the government. The government is committed to protect the integrity of our financial system and ensuring the UK remains and attractive country to carry out business and invest. This commitment to fight money laundering was recently restated in the Government's 2019 Economic Crime Plan.

113. Last year the FATF MER found that the UK had one of the most robust systems for combating money laundering and terrorism financing. However, criminals are continuously adapting their methods and exploiting new technological developments and there is more work to be done.

114. The amending Directive represents an important step in updating the EU member states' legislation to combat these emerging threats. Furthermore, the Government is committed to meeting the international standards set by FATF and ensuring AML/CTF supervisors have all the necessary power to carry out their supervisory functions.

115. The Government's approach to transposition intends to implement the Directive in a proportionate and effective way to clamp down on illicit flows while minimising burdens on legitimate businesses. The Government will seek additional evidence to understand the impact of the Money Laundering Regulations as part of its review of the 4MLD in 2022.

Monitoring and Evaluation:

116. Our monitoring and evaluation plan and for post-implementation review of 5MLD is under development and will be reviewed based on lessons learnt from the upcoming review of 4MLD in 2022. We envisage that the following elements may form the basis of the evaluation:

- **Policy objectives:** The objective of this regulation is to make it more difficult for criminals to launder the proceeds of their crime through the UK's financial system. The government will continue to assess risks of money laundering and terrorism financing as part of the National Risk Assessment and should assess whether further intervention is required based on it's evaluation of risk and whether exemptions of low risk sectors should be considered. This evaluation should also take into account FATF recommendations and assessments.
- **Compliance and enforcement:** Effectiveness of the 5MLD amendments to the regulations depend on the extent to which businesses understand and implement their obligations. The government should consider seeking evidence in future years on the levels of compliance from all regulated sectors but in particular newly regulated sectors under 5MLD.
- **Impact on UK businesses:** Given current gaps in data on newly regulated businesses, the government may consider reviewing the estimates made in this impact assessment in light of data supervisors will collect upon registration to re-evaluate the impact on newly regulated industries. This impact assessment identified a lack of data on the costs of CDD/EDD in particular for non-financial institutions. The government may consider improving its evidence base on the costs of CDD/ EDD across different sectors and the types of measures businesses have adopted to comply with this requirement. This impact assessment has identified that the measure may have indirect benefits on businesses, the government should consider seeking further evidence on whether this benefits have actualised and whether there have been any direct benefits.
- **Small and micro businesses:** Based on the data gaps identified in this impact assessment, the government should consider collecting further evidence on the impact of the regulations on small and micro businesses, including the total number of small and medium businesses in scope of the regulations. Based on this evidence the government may consider mitigations if appropriate.

- **Market structure and impact:** For newly regulated sector, the government should consider whether the implementation of 5MLD affected the market structure of newly regulated sectors, for example whether the measure has affected the number of firms in the market or create obstacles to entry.