

<p>Title: Post-implementation review of the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017</p> <p>PIR No: RPC-HMT-5199(1)</p> <p>Original IA/RPC No: RPC17-HMT-3972(2)</p> <p>Lead department or agency: HM Treasury</p> <p>Other departments or agencies: Click here to enter text.</p> <p>Contact for enquiries: anti-moneylaunderingbranch@hmtreasury.gov.uk</p>	Post Implementation Review
	Date: 24/06/2022
	Type of regulation: Domestic
	Type of review: Statutory
	Date measure came into force: 26/06/2017
	Recommendation: Amend
	RPC Opinion: Fit for purpose

1. What were the policy objectives of the measure?

The objective of the Money Laundering Regulations 2017 ('the MLRs') was to, through transposition of the fourth, and later fifth, European Union Anti-Money Laundering Directives (AMLDs), make the UK financial system a hostile environment for illicit finance (i.e. funds deriving from illegal activity) whilst minimising the burden on legitimate businesses. The intended effect of introducing the MLRs was that relevant businesses would update their anti-money laundering and countering the financing of terrorism (AML/CFT) controls in line with the latest international standards set by the Financial Action Task Force (FATF), improving their ability to detect and prevent illicit funds flowing through the financial system.

2. What evidence has informed the PIR?

The PIR has drawn on a range of existing evidence (set out fully in section 2), including system-wide assessments conducted by international organisations, data on compliance, supervision and enforcement under the MLRs from the HM Treasury Annual Supervision reports, and assessments of supervisory effectiveness such as reports by the Office for Professional Body AML Supervision or supervisors' own reports. The Treasury also conducted a Call for Evidence to inform this review, which ran from July-October 2021 and received 94 responses, ranging across industry, AML/CFT supervisors, non-governmental organisations (NGOs), law enforcement and government departments. The Treasury conducted engagement sessions with industry groups, public sectors bodies and NGOs both in advance of the Call for Evidence to inform the scope and after it was published to support engagement and feedback in responses.

3. To what extent have the policy objectives been achieved?

The analysis of the PIR suggests three key findings:

1. There are continuing deficiencies in money laundering and terrorist financing (ML/TF) risk assessment and understanding across the regulated sector.
2. Specific deficiencies remain in the application of risk mitigating measures by the private sector, with supervisors noting inadequate customer due diligence or policies, controls and procedures as a common failing identified through their supervision.
3. There have been some improvements in the supervision regime, with the FCA and HMRC both responding to recommendations from the MER to strengthen their risk-based approach. However, the latest OPBAS report suggests continuing issues with inconsistent and supervision by professional body supervisors with varying levels of effectiveness, despite improvements in their technical compliance with the MLRs.

The UK clearly met its objective of fully transposing both the fourth and fifth European AML Directives. However, though improvements in the UK's AML/CFT regime have been made against the recommendations of the Financial Action Task Force to further prevent illicit finance from entering the economy, the PIR suggests further work is needed. The government remains committed to ensuring the UK has a robust AML/CFT regime, and the Review of the UK's AML/CFT regulatory and supervisory regime published alongside the PIR sets out specific proposals and next steps.

Sign-off for Post Implementation Review: Economic Secretary to the Treasury

I have read the PIR and I am satisfied that it represents a fair and proportionate assessment of the impact of the measure.

Signed: ***Richard Fuller***

Date: 21/07/2022

Further information sheet

Please provide additional evidence in subsequent sheets, as required.

4. What were the original assumptions?

The impact assessment assumed the cost of undertaking customer due diligence ranged from £3-£15 per customer, and the cost of undertaking enhanced due diligence ranged from £6-£30 per customer. It also assumed that relevant businesses covered by the regulations would have the same level of employee turnover as the national average of 15%.

5. Were there any unintended consequences?

A primary unintended consequence from AML/CFT regulation worldwide is for financial institutions to reduce their tolerance for risk, due to the cost of complying with regulations and the regulatory and reputational risk if controls fail. Some financial institutions may choose to withdraw services from any sectors they deem risky, for example if they provide a particular service or engage in business with high-risk countries. These decisions are not made on the basis of the risks posed by individual businesses or any mitigations implemented, so can risk businesses losing access to the formal financial sector. This is a global issue known as de-risking. The Call for Evidence sought views on de-risking behaviour

6. Has the evidence identified any opportunities for reducing the burden on business?

The UK is committed to meeting international AML/CFT standards set by the FATF. Within this commitment, the review has suggested several areas in which businesses regulated by the MLRs are currently required to undertake specific checks which may be unnecessary or disproportionate to the risks posed. There are also areas in which greater clarity on regulatory requirements should allow businesses to take a more risk-based approach. These potential changes could include:

- Allowing greater flexibility on the enhanced due diligence measures required for high risk third countries;
- Additional guidance on political exposed persons and deemed beneficial owners;
- Add additional 'low risk' criteria for the provision of pooled client accounts, which are currently limited to businesses within scope of the MLRs.
- Amend the requirements for the use of 'reliance' by businesses.

The government will consult further to understand the risk and impact of any changes to the MLRs.

7. How does the UK approach compare with the implementation of similar measures internationally, including how EU member states implemented EU requirements that are comparable or now form part of retained EU law, or how other countries have implemented international agreements?

The Financial Action Task Force sets international standards for anti money laundering, counter terrorist financing and counter proliferation financing, and assesses countries against these standards. The FATF conducts mutual evaluations of countries' AML/CFT regimes, and in December 2018 the UK received the best result out of over 40 countries assessed to that point, and currently over 100 countries assessed.

The UK is committed to continuing to meet the FATF standards and deliver an effective AML/CFT regime. While the majority of the requirements in the MLRs ultimately derive from the FATF, some were strengthened ('gold-plated') by the European Union as part of its Money Laundering Directives. These are areas where the Review suggests future amendments (see opportunities for reducing the burden on business, above).

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Introduction and background

1. The Economic Crime Plan 2019-22, published in 2019, set out the collective public-private response to economic crime¹. It set out seven priority areas which reflected the most significant barriers to combatting economic crime and offered the greatest scope for collaborative work between the public and private sectors.
2. Action 33 of the Economic Crime Plan committed HM Treasury to a comprehensive review of both the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 ('the MLRs')² and the Oversight of Professional Body Anti-Money Laundering and Counter Terrorist Financing Supervision Regulations 2017 ('the OPBAS regulations')³.
3. This commitment aligns with an extant legal duty in both these sets of regulations to conduct a post-implementation review their regulatory provision, which must set out the objectives intended to be achieved, assess the extent to which the objectives are achieved, assess whether the objectives remain appropriate, and assess the extent to which they could be achieved in another way which involves less onerous regulatory provision.
4. The Economic Crime Plan commits the review to considering the effectiveness and scope of the regulations, the proportionality of the duties and powers they contain, the effectiveness of enforcement actions taken under the MLRs, and the interaction of the MLRs with other pieces of legislation. There is considerable complementarity with the work within the private sector on how to improve the effectiveness of AML/CTF regimes, including the Wolfsberg Group's paper on demonstrating effectiveness, and this review will look to work in partnership with initiatives in the private sector to improve the effectiveness of their AML/CTF systems.
5. Following the UK's exit from the European Union, the UK has greater autonomy in setting AML/CFT regulations. This review offers the opportunity to ensure the AML regime responds to the UK's particular circumstances and risks, is as effective as possible in preventing and detecting illicit finance, and supports UK competitiveness by ensuring the UK is a clean and safe place to do business.

¹ Economic Crime Plan 2019-22

² Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017

³ Oversight of Professional Body Anti-Money Laundering and Counter Terrorist Financing Supervision Regulations 2017

6. This document sets out the approach and methodology taken during the post-implementation review, the range of evidence and data sources drawn on, and the findings and initial conclusions. A broader report, the Review of the UK's AML/CFT regulatory and supervisory regime, builds upon these findings and sets out options for future reform. This full report will be published alongside the PIR.

The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017

7. The UK has had regulations intended to prevent money laundering in place for nearly thirty years. Over time, these have evolved in line with international standards set by the FATF, an intergovernmental body which promotes effective implementation of measures for combatting money laundering and terrorist financing along with other threats to the integrity of the international financial system, and multiple EU Money Laundering Directives. The most substantial recent revision was in June 2017, transposing the European Fourth Money Laundering Directive and the Funds Transfer Regulation, which were themselves heavily informed by a substantial rewrite of FATF international standards in 2012. Since 2017, the MLRs have been amended, most significantly through the transposition of the Fifth Money Laundering Directive in January 2020.
8. Through these revisions, the MLRs have expanded in scope, bringing in new sectors outside of the original financial industry focus, and extending the requirements falling on those in scope to ensure an understanding of the beneficial ownership structure of those involved in transactions. The MLRs are designed to detect and prevent money laundering and terrorist financing before it occurs, both directly through the UK's financial institutions and through enablers who may be involved in transactions such as lawyers, accountants and estate agents. They seek to do this while minimising the burden on legitimate customers and businesses.
9. The scope of this legislation, and the international standards that inform it, covers both money laundering, and terrorist financing. As drawn out in detail in recent National Risk Assessments⁴, money laundering includes how criminals change money and other assets into clean money or assets that have no obvious link to their criminal origins. Money laundering can undermine the integrity and stability of our financial markets and institutions. It is a global problem and represents a significant threat to the UK's national

⁴ National Risk Assessment 2020

security. Money laundering is a key enabler of serious and organised crime, which costs the UK at least £37 billion every year. The NCA assesses that is highly likely that over £12 billion of criminal cash is generated annually in the UK and a realistic possibility that the scale of money laundering impacting on the UK (including through UK corporate structures or financial institutions) is in the hundreds of billions of pounds annually.

10. Terrorist financing involves dealing with money or property that a person knows or has reasonable cause to suspect may be used for terrorism. There is an overlap between money laundering and terrorist financing, as both criminals and terrorists use similar methods to store and move funds, but the motive for generating and moving funds differs. The UK has a comprehensive anti-money laundering and counter-terrorist financing (AML/CTF) regime, and the government is committed to ensuring that the UK's financial system is effectively able to combat ML/TF.

UK's AML Supervision Regime

11. HM Treasury appoints AML/CFT supervisors to ensure compliance with the requirements of the MLRs. The UK has 25 supervisors: three statutory supervisors (the FCA, HMRC and the Gambling Commission) and 22 legal and accountancy Professional Body Supervisors (PBSs). The list of PBSs is defined by Schedule 1 of the MLRs, and copied in Annex A of this report.
12. Supervisors are required to effectively monitor their supervised populations and take necessary measures to secure their compliance with the MLRs, as well as being responsible for a number of gatekeeping tests that prevent unfit or criminal persons from operating in the regulated sector.
13. HM Treasury is responsible for ensuring the effectiveness of the supervisory regime, and engages regularly with the supervisors, either bilaterally, or through a number of fora which exist to support supervisory cooperation and engagement. These include the AML Supervisors' Forum, the Public Sector Affinity Group, the Legal Sector Affinity Group, and the Accountancy Sector Affinity Group.
14. The Treasury also works with the Office for Professional Body AML Supervision (OPBAS) which oversees the 22 PBSs. OPBAS was established in 2018 to ensure a robust and consistently high standard of supervision by the PBSs, and to facilitate collaboration and information and intelligence sharing between PBSs, statutory supervisors and law enforcement agencies.

OPBAS Post-Implementation Review

15. The Treasury is required to undertake a post-implementation review of the Oversight of Professional Body Anti-Money Laundering and Counter Terrorist Financing Supervision Regulations 2017 ('the OPBAS Regulations'). This PIR is being published alongside this document, and the findings from both have informed the broader review of the UK's AML/CFT landscape.

Statutory Instrument 2022

16. As set out in the Call for Evidence published in July 2021, the Treasury has conducted this review whilst also progressing a Statutory Instrument which will make some time-sensitive or relatively minor amendments to the MLRs. A consultation was published alongside the Call for Evidence to inform the SI.

17. While the limited nature of amendments made through the SI mean they have limited relation to the findings of this review, where amendments have the potential to have a future impact or have been implemented to address known issues with the MLRs, this has been noted in the review.

Treasury Select Committee

18. In February 2022, the Treasury Select Committee published the report of its inquiry into Economic Crime. This inquiry reviewed the progress made by the government in combatting economic crime since the Committee's previous inquiry in 2020.

19. While the full report covered a range of economic crime-related topics, including the Economic Crime Plan 2019-22, fraud and Companies House reform, it made several recommendations on future reform of the UK's AML regime and supervisory approach. The Review of the UK's AML/CFT regulatory and supervisory regime addresses the points raised by the Committee's inquiry.

Approach to the PIR

Scope of this review

20. The UK's AML regime is comprehensive, incorporating not only the preventative activity undertaken by regulated businesses and supervisors to ensure illicit finance does not enter the financial system, but also the all-crime approach taken by the Proceeds of Crime Act 2002 (POCA), investigations by law enforcement, prosecutions by the UK's prosecutorial authorities and information and intelligence gathering and dissemination undertaken by several authorities, including the UK Financial Intelligence Unit.
21. The scope of this PIR is to assess the implementation and effectiveness of the MLRs and the activity they require. This includes the compliance of firms within the regulated sector with the requirements of the MLRs and their understanding of ML/TF risks. The effectiveness of the UK's supervision regime set out by the MLRs is also in scope, including supervisory, education and engagement and enforcement activity undertaken by supervisors.
22. As discussed below, the Treasury has followed the established methodology used by the Financial Action Task Force (FATF) for mutual evaluations of its member countries. This approach was proposed in the CfE and informed by respondents' views.
23. The scope includes some overlap with other legislation, for example POCA places a legal duty on all businesses within the regulated sector to report suspicious activity that drives substantial activity (and is informed by activity stipulated by the MLRs). However, the focus on the MLRs means broader AML activity, for example investigations and prosecutions under POCA, is out of scope of this review.
24. In assessing the effectiveness of the supervisory regime, this report considers all 25 supervisors including the 22 PBSs. The assessment of PBS effectiveness draws upon the reports published by OPBAS, most recently in September 2021. While developments in the PBS regime are intertwined with the work of OPBAS under its remit set out above, this review does not explicitly assess the extent to which OPBAS has achieved its objectives. This analysis is contained within the separate PIR of the OPBAS Regulations.

Methodology

25. As set out in the impact assessment for the MLRs, the policy objective was (through the transposition of the fourth, and later fifth, European Union anti money laundering

directives) to make the financial system a hostile environment for illicit finance whilst minimising the burden on legitimate businesses. The intended effect was that relevant businesses would update their money laundering controls in line with the latest international standards, improving their ability to detect and prevent illicit funds flowing through the financial system.

26. The measurement of these policy objectives is difficult. The immediate *outputs* – i.e., relevant persons maintaining compliance with the updated MLRs – can be inferred through AML supervisors’ assessments of their sectors’ compliance, though this is based on small sample sizes and dependent on supervisory effectiveness. The intended *outcome* – i.e., the prevention of illicit finance from entering the financial system – is even more difficult to measure.
27. The Financial Action Task Force (FATF) sets international standards for AML/CFT and conducts mutual evaluations of its members’ regimes to ensure these standards are being met. The FATF methodology sets out the approach assessors follow when evaluating countries; the current methodology was introduced in 2012 and has been continually updated to reflect the latest requirements to combat ML/TF, most recently in October 2021⁵.
28. The FATF methodology evaluates countries against the FATF’s 40 Recommendations, which assess technical compliance (i.e., does a country have the correct laws and policies in place), and 11 Immediate Outcomes which assess the effectiveness of a countries’ regime.
29. Assessing AML/CFT effectiveness is a complex, much-debated topic and the FATF methodology is considered best practice worldwide for conducting such an assessment. The CfE therefore proposed three primary objectives to judge the effectiveness through which the MLRs had met their policy goal, based on the FATF’s Immediate Outcomes 3-5, as well as a secondary objective. These are set out below.
 - I. The regulated sector acts to identify, prevent and report suspicious activity⁶.
 - II. Supervisors take a risk-based approach to monitoring compliance and make proportionate and dissuasive use of their powers and enforcement tools.

⁵ FATF methodology

⁶ The original call for evidence used ‘suspicious transactions’ in wording the first objective, but responses have noted that this suggests a focus on financial transactions over other suspicious activity, so has been amended.

- III. Accurate and up-to-date Beneficial Ownership information is collected, maintained and made available to competent authorities so as to prevent the exploitation of UK corporate vehicles and other forms of legal personality.

Secondary objective:

- I. The regulated sector work in partnership with supervisors and the government to improve collective understanding of the ML/TF threat, which in turn ensures compliance activity is focussed on the highest risks and the regulated sector provides valuable information to law enforcement.

30. Respondents to the CfE were broadly in agreement with the proposed approach to base the assessment on the FATF methodology. Support was most pronounced for the first two objectives, while responses on the third objective were split. Some respondents agree that the collection and provision of beneficial ownership should be a key aim of the MLRs, while some disagreed, arguing that this should primarily be a function of Companies House which sits outside of the MLRs. Given these responses and the range of existing proposals to improve beneficial ownership information and enhance Companies House which would make any assessment quickly obsolete, this assessment focuses on the extent to which the first two objectives have been achieved⁷.

31. The FATF's last mutual evaluation of the UK's regime was published in December 2018. The comprehensive assessment of Immediate Outcomes 3 and 4 in the MER have therefore served as a baseline for the effectiveness assessed in this report. The MER made several recommendations for improving the UK's effectiveness, and the extent to which these have been completed has been drawn from various other publications (see *Evidence* section below).

Alternative definitions of effectiveness

32. Several respondents in the financial services sector proposed a focus on the Wolfsberg Group's Principles for Demonstrating Effectiveness⁸. The Wolfsberg Group is an

⁷ The UK places a significant focus on ensuring beneficial ownership transparency and is the only G7/G20 country with a free, fully public and easily accessible beneficial ownership register, while the recent Economic Crime (Transparency and Enforcement) Act 2022 introduced a new Register of Overseas Entities Beneficial Ownership. However much of this activity derives from other legislation and is therefore beyond the scope of this review. The MLRs do provide for BO transparency of trusts, through the creation of the Trust Registration Service (TRS). This is currently undergoing a significant expansion in scope following the Money Laundering and Terrorist Financing (Amendment) Regulations 2019 so has not been assessed here, however its implementation will continued to be monitored as part of the government's broader work to prevent the abuse of trusts and TCSPs.

⁸ https://www.wolfsberg-principles.com/sites/default/files/wb/Wolfsberg%20Group_Demonstrating_%20Effectiveness_JUN21.pdf

association of global banks focused on the management of financial crime risk. The Principles for Demonstrating Effectiveness set out the Group's suggestion for the key elements of an effective AML/CFT programme.

- I. Complying with AML/CTF laws and regulations.
- II. Providing highly useful information to relevant government agencies in defined priority areas.
- III. Establishing a reasonable and risk-based set of controls to mitigate the risks of an FI being used to facilitate illicit activity.

33. In September 2020, the US Financial Crimes Enforcement Network (FinCEN) published an Advance Notice of Proposed Rule Making (ANPRM) seeking comment on clearly defining a requirement for 'effective and reasonably designed' AML programs in the Bank Secrecy Act regulations (BSA)⁹. The proposed amendments set out in the ANPRM would explicitly define an effective and reasonably designed program as one which:

- I. Identifies, assesses, and reasonably mitigates the risks resulting from illicit financial activity—including terrorist financing, money laundering, and other related financial crimes—consistent with both the institution's risk profile and the risks communicated by relevant government authorities as national AML priorities;
- II. Assures and monitors compliance with the recordkeeping and reporting requirements of the BSA; and
- III. Provides information with a high degree of usefulness to government authorities consistent with both the institution's risk assessment and the risks communicated by relevant government authorities as national AML priorities.

34. Both the Wolfsberg Group and FinCEN definitions are focused on the effectiveness of preventative measures, i.e., on the extent to which the first proposed objective above has been met. They have informed the consideration, set out in the broader review of the UK's regime, of how the UK should measure effectiveness in the future.

Review of the UK's AML/CFT regulatory and supervisory regime

35. The Treasury bears a statutory duty to publish this assessment of the effectiveness and implementation of the MLRs. However, as set out in the CfE, the full Review is more

⁹ <https://www.federalregister.gov/documents/2020/09/17/2020-20527/anti-money-laundering-program-effectiveness>

comprehensive and seeks to inform the future direction of the UK's AML regime. This PIR, though a standalone review of the implementation of the MLRs, should be seen as part of the broader Review, which has been informed both by the conclusions of the PIR and the responses to the CfE.

36. As well as this PIR, the Review consists of three broad chapters, which assess different aspects of the regime and consider options for future reform. These chapters are:

- a) Defining effectiveness: As set out above the definition and evaluation of AML/CFT is complex and is approached through different methodologies. The Review considers the potential for the UK to adopt a clearer definition of what effectiveness in the UK's AML/CFT regime looks like, and how it can be measured. This section of the report also considers the UK's future approach to amending the extent of the regulated sector (i.e., adding or removing sectors), now the UK is no longer bound to follow EU AMLDs.
- b) Driving effectiveness: This section of the report considers the specific drivers of AML/CFT effectiveness, either through specific regulations in the MLRs, guidance provided by the public sector to enhance understanding of the MLRs, or engagement between bodies to improve effectiveness.
- c) Supervisory reform: Building on the findings of the PIR, this section considers options for reform of the UK's supervision regime, addressing concerns that the structure of the regime impedes effectiveness.

37. The Review considers evidence of effectiveness to date and sets out options or recommendations for future reform. These changes will inform future policy development and will be taken forward through a number of workstreams, including the second Economic Crime Plan. Potential amendments to the MLRs will be made through secondary legislation following any necessary public consultation.

Evidence

38. The PIR has been prepared using the Magenta Book supplementary guidance for conducting post implementation reviews¹⁰. The level of evidence required has been developed based on the proportionality guidelines set out in Figure 1 of that guidance. The MLRs are a wide-ranging set of Regulations, with over 100,000 businesses in scope so it is important to conduct a comprehensive review with a broad evidence base.
39. However, the government is still committed to adhering to the FATF standards, as well as meeting the terms of the UK-EU Trade and Cooperation Agreement, which commits the UK to continuing to meet international standards (Article 186) and continuing to prevent and combat money laundering and terrorist financing (Title X). There is therefore limited scope, for the government to change its approach, particularly on the extent of regulation currently in place.
40. The Treasury has therefore developed a detailed evidence base to inform the analysis of the impact of the MLRs, but acknowledges that there are remaining difficulties in evidence gathering. This is most evident in available data on the costs imposed on businesses by the MLRs (see '*What have the costs to business been?*', below).
41. As set out above, this PIR focuses on Immediate Outcomes 3 and 4 of the FATF methodology. The FATF MER, published in December 2018, serves as a baseline, and several other publications and data sources have been used to evaluate the extent to which the regime has responded to the recommendations set out in the MER and the improvements that have resulted from these improvements. The sources that have informed the PIR are set out below.

FATF Mutual Evaluation Report (MER)

42. The FATF conducts mutual evaluations of its member countries' AML/CFT regimes to assess compliance and effectiveness against the FATF Recommendations. While technical compliance against the 40 Recommendations is rated as either Compliant (C), Largely Compliant (LC), Partially Compliant (PC) or Non-Compliant (NC); effectiveness against the 11 Immediate Outcomes is rated as either High (HE), Substantial (SE), Moderate (ME) or Low (LE).

¹⁰

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/879444/Magenta_Book_supplementary_guide._Guidance_for_Conducting_Regulatory_Post_Implementation_Reviews.pdf

43. The UK obtained the best FATF MER out of 40 countries assessed at the time of the MER, and over 100 countries since, with the assessment team noting the UK's well-developed and robust regime to effectively combat money laundering and terrorist financing¹¹.
44. The UK received a rating of ME in both Immediate Outcomes 3 and 4. The MER made a number of recommendations for improvements under both IOs, and improvements against these recommendations are considered in this report.

IMF Financial Sector Assessment Program (FSAP)

45. The IMF's Financial Sector Assessment Program conducts evaluations of countries' financial sectors in order to understand their financial stability policy framework and the source, probability, and potential impact of the main risks to macro-financial stability. All FSAP evaluations are required to be associated with an AML/CFT assessment, conducted either by the IMF or by the FATF mutual evaluation process.
46. The IMF conducted an FSAP of the UK and published a technical note on the AML/CFT regime in March 2022¹². The report focused on key aspects of the regime: risk-based AML/CFT supervision, entity transparency and international cooperation.
47. The FSAP's recommendations under the first of these aspects – risk-based supervision – are most relevant for this PIR, and include the breadth and depth of risk-based supervision of credit and financial sector supervision, the implementation of FATF's 'travel rule' for cryptoassets (which is being implemented by the SI 2022), improving the consistency of supervision for the legal, accountancy and TCSP sectors, improving risk and threat understanding, and increasing available resources.

National Risk Assessment of Money Laundering and Terrorist Financing

48. The MLRs require the Treasury and the Home Office to conduct regular assessments to identify, assess, understand and mitigate the risks of money laundering and terrorist financing affecting the United Kingdom. These National Risk Assessments (NRAs) provide a stocktake of collective understanding of ML/TF risks, and provide supervisors and regulated businesses with information to inform their own risk assessments.

¹¹ FATF Mutual Evaluation Report of the UK

¹² United Kingdom: Financial Sector Assessment Program-Some Forward Looking Cross-Sectoral Issues

49. The latest NRA was published in December 2020, and provided updates to risk assessment across the regulated sector¹³. Sectors are rated high, medium, or low risk for both money laundering and terrorist financing, based on vulnerabilities, likelihood of abuse, and mitigations.

HM Treasury AML/CFT Supervision reports

50. The Treasury is required by the MLRs to collect and publish data on supervisory and enforcement activity undertaken by the 25 AML/CFT supervisors. Nine reports have been published to date, with the most recent report (for 2019-20) being published in November 2021.

51. The supervision reports are informed by annual questionnaires completed by the supervisors. As well as quantitative data on activities undertaken these also include detailed explanations of the approach taken by the supervisors to ensuring they provide effective supervision to their populations.

OPBAS reports

52. OPBAS conducts detailed evaluations of the 22 PBSs' AML supervision and uses the findings from these evaluations to inform reports on the progress and themes identified.

53. OPBAS assesses PBSs against the requirements of the MLRs and its Sourcebook, which provides guidance for PBSs on how they can meet their obligations¹⁴.

54. OPBAS has to-date published three reports, most recently in September 2021. After focusing on the technical compliance of PBSs with the requirements of the MLRs in its first 2 reports, the third OPBAS report moved to a greater focus on how effectively PBS conducted their AML supervision¹⁵.

Supervisors' reports

55. As well as system-wide assessments and oversight reports, there are a number of reports published by individual supervisors which detail their approach to supervision, activity undertaken to meet their obligations as supervisors, and assessments of the effectiveness of this activity.

¹³ National Risk Assessment of Money Laundering and Terrorist Financing 2020, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/945411/NRA_2020_v1.2_FOR_PUBLICATION.pdf

¹⁴ Sourcebook for professional body anti-money laundering supervisors

¹⁵ OPBAS Progress and themes from our 2020/21 supervisory assessments

56. These include the HMRC Self-Assessment, which HMRC committed to undertaking against the standards set out in the OPBAS Sourcebook in the Economic Crime Plan 2019-22. These self-assessments are undertaken by staff independent of the core Economic Crime Supervision team within HMRC.
57. The first self-assessment was published in March 2021 and made several recommendations based on the findings of the assessment team¹⁶. Progress against these recommendations will be assessed in the second self-assessment, due to be published in Summer 2022.
58. As well as the HMRC self-assessment, Regulation 46A of the MLRs also requires PBSs to publish annual reports setting out their activity undertaken as supervisors. PBSs published their first reports under R.46A in November 2021. HM Treasury and OPBAS jointly provided guidance to support PBSs in the drafting of these reports.

Call for evidence

59. HM Treasury published a Call for Evidence (CfE) in July 2021, seeking views on the methodology for this PIR, the evidence which could be used to inform it, and views on the broader questions contemplated by the Review¹⁷.
60. The CfE was split into three broad sections:
- a) The systemic review, which sought views on the overall effectiveness of the regime, and their scope;
 - b) The regulatory review, which sought views on whether key elements of the MLRs were operating as intended; and
 - c) The supervisory review, which considered the structure of the supervisory regime and the work of OPBAS to improve the effectiveness and consistency of PBS supervision.

¹⁶ HMRC Anti-Money Laundering Supervision annual assessment

¹⁷ Call for Evidence: Review of the UK's AML/CFT regulatory and supervisory regime

Findings and recommendations

61. The analysis of the PIR suggests three key findings:

- a) There are continuing deficiencies in ML/TF risk assessment and understanding across the regulated sector. While it is difficult to judge progression against the findings set out in the MER, it seems likely that many businesses fail to properly understand the risk they are exposed to. Respondents to the call for evidence called for increased guidance and granular risk information from the public sector.
- b) Specific deficiencies remain in the application of risk mitigating measures by the private sector, with supervisors noting inadequate customer due diligence or policies, controls and procedures as a common failing identified through their supervision.
- c) There have been some improvements in the supervision regime, with the FCA and HMRC both responding to recommendations from the MER to strengthen their risk-based approach. However, the latest OPBAS report suggests continuing issues with inconsistent and ineffective supervision by professional body supervisors.

The extent to which the policy objectives of the MLRs have been met

Immediate Outcome 4: The regulated sector acts to identify, prevent and report suspicious activity

62. The FATF MER in 2018 set out the key findings for the effectiveness of the UK's preventative measures. It noted that the UK imposed comprehensive and consistent requirements for preventative measures across all entities performing activities covered by the FATF Standards. It highlighted thematic reviews by regulators as helpful guides to industry on best and poor practice, and that these indicated that compliance was inconsistent across different categories of FI.

Understanding of ML/TF risks and AML/CFT obligations

63. The MER found that risk understanding across all sectors within the regulated sector had improved since the previous evaluation of the UK's regime but noted continuing deficiencies. Larger firms were found to have a better understanding of risks and their AML/CFT obligations and were able to better allocate adequate resources to tackling risks. Having a good understanding of the risks that apply to their sector, products and

customers is the central element of the risk-based approach that relevant entities under the MLRs should pursue. The CfE sought views on whether firms had sufficient risk understanding to effectively implement a risk-based approach – responses suggest there continue to be concerning deficiencies across the regulated sector.

64. **Financial and credit institutions:** The 2020 NRA noted that the scale and complexity of the UK's global financial centre makes it attractive for criminals and corrupt elites to use to launder illicit funds. It rated retail banking, wholesale banking and wealth management and private banking high risk for money laundering, and payment services and electronic money medium risk.

65. The NRA noted that understanding of risk in the sector has developed, particularly on the impact of diversification in the retail banking sector as challenger banks become more widespread. However, it noted that intelligence gaps remain due to complex criminal methodologies and the wide variety of business models used across the sector.

66. The FCA's response to the Call for Evidence agreed that the MER's findings on risk understanding continue to be relevant, highlighting specific failings within the financial services sector, and interventions such as the FCA's 'Dear CEO' letter in May 2021¹⁸. Among other failings this noted poor-quality business-wide risk assessments across the sector. Other FS respondents noted that smaller firms often lacked experienced and skilled financial crime risk professionals which hindered their ability to pursue a true risk-based approach. Some respondents reported a good risk understanding, though focused on MLROs, and pointed to other factors (such as fear of regulatory action) for a failure to adopt a risk-based approach.

67. **Cryptoassets:** The MER noted that the UK was developing its understanding of the use of 'virtual currencies' and planning to extend AML/CFT requirements and supervision to the sector. In January 2020, the Money Laundering and Terrorist Financing (Amendment) Regulations 2019 completed this expansion of the regulated sector to cover cryptoasset exchange providers and custodian wallet providers, supervised by the FCA.

68. The 2020 NRA noted the risk of money laundering through cryptoassets had increased from low to medium since 2017. It noted that although some firms had developed customer onboarding regimes, investigatory monitoring systems and customer databases, the quality of firms' control frameworks had proven varied.

¹⁸ <https://www.fca.org.uk/publication/correspondence/dear-ceo-letter-common-control-failings-identified-in-anti-money-laundering-frameworks.pdf>

69. The government is committed to continuing to develop a robust AML regime for cryptoassets to help prevent their use for illicit purposes, and help bolster confidence in the UK as a safe and reputable place to start and grow a business.
70. **Accountancy:** The 2020 NRA maintained a high ML risk rating for accountancy services while maintaining a low TF risk rating, and noted that accountancy service providers are at highest risk when they do not fully understand the money laundering risks and do not implement appropriate risk based controls. The MER noted that accountants' understanding of their risk was improving.
71. Responses from the accountancy sector, including accountancy sector PBSs, reported a reasonable level of risk understanding. The Institute of Chartered Accountants in England and Wales (ICAEW) reported that their monitoring activity demonstrates good risk understanding in the vast majority of firms. The 2020 monitoring report sets out that of the 1,725 monitoring reviews in 2019, 277 required follow-up action for the firm, with the most common finding being the lack of a firm-wide risk assessment or inadequate documentation of the client risk assessment.
72. **Legal services:** The 2020 NRA also maintained a high ML risk rating for legal services while maintaining a low risk for TF, noting that a failure to carry out obligations under the MLRs or take a tick box approach to compliance would increase this risk.
73. Responses to the Call for Evidence, including from legal sector PBSs, suggest risk understanding in the sector is improving. For example, the Solicitor Regulation Authority's most recent review of Firm Risk Assessments in 2019 found that 79% of firms had a compliant risk assessment.
74. **Trust and company service providers:** The NRA increased the risk of TCSPs from medium to high, and found that although the majority of TCSPs adequately risk assess their clients and seek to understand the nature of their customers business activity, it was almost certain that a relatively small number do not understand the risks involved. The risk of TF was maintained as low.
75. **Estate and lettings agents:** The NRA upgraded the ML risk of estate agents from low to medium while maintaining a low risk for TF. This was driven by increased understanding of the risks in the sector and observed ML cases including the use of overseas buyers and the use of complex structures.
76. Letting agents, where they undertake lettings with a value of more than €10,000 a month (approximately £8,300), were brought in scope of the MLRs by the Money Laundering and Terrorist Financing (Amendment) Regulations 2019. They were given a risk rating of

medium in the 2020 NRA due to the ability to conceal the beneficial owners and final destination of funds, and the regular flow of funds.

77. Letting agents were not assessed in the MER, but the assessment team noted that many estate agent businesses (EABs) thought letting agents were riskier since they handle client funds.
78. Only two respondents to the Call for Evidence from the estate and lettings agency sector provided a view on risk understanding, noting that risk understanding in SMEs was still poor and more should be done to improve their risk understanding and ability to pursue a risk-based approach.
79. **Money Service Businesses:** The NRA maintained its assessment of high risk for both ML and TF. It found the sector's compliance with the MLRs tended to be poor among small and medium size MSBs while large principals tended to make substantial investments in compliance activities.
80. **Casinos:** The NRA maintained the risk rating for gambling (both casinos and non-AML-regulated) as low for both ML and TF. It noted that some subsectors, including casinos had increased in risk since 2017, in part due to poor compliance with the MLRs. This followed similar findings in the MER that some casino operators had weaknesses in the risk assessments. The Gambling Commission's response to the Call for Evidence shows these deficiencies persist, with only 43% of risk assessments reviewed in the 12 months prior to their return demonstrated a good knowledge of the risk-based approach
81. **High value dealers:** The NRA increased the ML risk rating from low to medium, while maintaining a low risk rating for TF. This was driven by vulnerabilities created by anonymity of transactions, portability across borders, exposure to high-risk jurisdictions and level of cash used in the sector, which makes it attractive for trade-based money laundering.
82. **Art market participants:** Art market participants (AMPs) were also added to the regulated sector by the Money Laundering and Terrorist Financing (Amendment) Regulations 2019 and are supervised by HMRC. The NRA noted it was too early to fully assess the effectiveness of AMP mitigations, and rated the sector high-risk for ML.

Application of risk mitigating measures

83. The MER reported that regulated entities across a broad range of sectors had AML programs designed to mitigate ML/TF risks. While the assessment team found strong knowledge of AML/CFT requirements from firms, and a strong commitment to apply relevant measures to prevent financial crime, they noted that thematic reports suggested

that pertinent issues existed, particularly for smaller firms that committed less resources to combatting ML/TF risk.

84. More recent evidence suggests that specific deficiencies remain. The 2019-20 HMT AML Supervision report noted that inadequate customer due diligence and enhanced due diligence were frequent breaches noted by the FCA and Professional Body Supervisors, while HMRC and the Gambling Commission both cited a lack of appropriate AML policies controls and procedures. The FCA's 'Dear CEO' letter noted above also cited customer due diligence and enhanced due diligence as a common control failing identified in the retail banking sector.

85. As well as repeated concerns about the challenges to smaller firms in adequately understanding risk, another commonality across all sectors appears to be the desire for better support in understanding risk, both through guidance and granular risk assessments, and increased public-private partnership to build awareness and understanding.

Reporting obligations and tipping off

86. The MER noted that the firms met with during the evaluation understood and implemented their reporting obligations adequately. However, it noted concerns that SAR filing was low in some sectors, though showed a healthy trend in the largest sectors, as well as high volume of reporting from other sectors leading to poor quality SARs, or reporters filing SARs in response to unexplained/unusual transactions without additional analysis or investigation. However, the MER also noted the impending plans to reform the SARs regime, including replacing the IT system to improve operation.

87. These reforms were included in the Economic Crime Plan: 2019-2022¹⁹. Including to deliver the IT transformation, deliver greater feedback on SARs, and ensure the confidentiality of the SARs regime. The Statement of Progress, published in May 2021, noted that the IT reform was progressing and that tactical improvements to the Defence Against Money Laundering (DAMLs) system had enabled better prioritisation of risk and harm cases, halving the processing time to less than three days²⁰.

¹⁹ <https://www.gov.uk/government/publications/economic-crime-plan-2019-to-2022/economic-crime-plan-2019-to-2022-accessible-version>

²⁰ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/983251/Economic_Crime_Plan_Statement_of_Progress_May_2021.pdf

Immediate Outcome 3: Supervisors take a risk-based approach to monitoring compliance and make proportionate and dissuasive use of their powers and enforcement tools

88. The MER found that the UK's supervision regime was moderately effective. The report highlighted varying quality of supervision among the UK's 25 AML/CFT supervisors, in particular noting that the FCA, HMRC, the Gambling Commission and the SRA had a stronger understanding of the ML/TF risks than the other 21 PBSs. However, the assessment team identified significant weaknesses in the risk-based approach to supervision among all supervisors, with the exception of the Gambling Commission.
89. The report suggested several recommended actions to improve effectiveness in the supervision regime; ensuring supervisors adopted a greater focus on targeting their activity at the areas of highest risk, and addressing the significant deficiencies in PBS supervision, in particular monitoring the impact of the Office for Professional Body Supervision (OPBAS)²¹. The MER also recommended that all supervisors should continue to ensure that proportionate, dissuasive, and effective sanctions were applied for violations of AML/CFT obligations, and that the UK continued to progress the extension of the regulated sector to virtual currency exchange providers.

Financial Conduct Authority

90. The FCA is the AML supervisor for credit and financial institutions, and since 2020 the supervisor for cryptoasset service providers. The MER found that the FCA had a good understanding of inherent ML/TF risks faced by its population and built its understanding through a number of sources including supervisory activities, data returns and engagement with policy and law enforcement officials regarding emerging risks. It also found that the FCA's supervisory activity was driven by ML/TF risk, but that the FCA should consider the appropriateness of applying a four year cycle to higher risk firms under the Systematic AML Programme (SAML P – targeted at the 14 largest retail and investment banks) and the Proactive AML Programme (PAML P – targeted at 156 firms from high risk sectors smaller than firms in the SAML P). It recommended the FCA consider how to ensure appropriate intensity of supervision for all the different categories of its supervisory population from low to high risk.
91. The FCA continues to have a good understanding of the risks faced by its supervisory population, with financial crime and AML risk assessment integrated at corporate, sector

²¹ HMT bears a separate obligation to review the OPBAS Regulations 2017 and assess the effectiveness of OPBAS. This assessment is covered in a separate publication.

and portfolio (i.e. sub-sector) level, as well as a dedicated financial crime sector risk assessment. This is informed by the broader assessments, the FCA's financial crime supervisory and intelligence work, and the financial crime data returns to identify which sectors pose the greatest ML/TF risk.

92. In response to the MER's criticisms of its risk-based approach, the FCA has implemented a more flexible, risk-based and targeted approach to ensure its resources are directed towards firms where there is the greatest risk of money laundering. This supervisory strategy draws on a new Data Strategy that sets out the roadmap by which the FCA intends to become a more data enabled regulator²². The FCA has expanded its REP-CRIM annual financial crime data returns by approximately 4,500 additional firms, taking the total number of firms in scope of the survey to over 7,000. This was recommended by the FATF assessment team, and will ensure the FCA better understands intrinsic financial crime risks in its sector.

93. Where the MER raised concerns about the SAML, the FCA has introduced its new Modular Assessment Proactive Programme (MAPP). This new modular approach focuses on reviewing a firm's financial crime systems and controls in relation to specific risks over multiple firms at the same time. This enables the FCA to review the largest, most systemically important firms more frequently and enables it to compare the mitigation of the risk across the sample. These modules are quicker to complete and should result in the FCA assessing some of the larger banks more often than before. The PAML is now better informed by new FCA-developed tools which utilise REP-CRIM returns as well as other available data sources (e.g. SARs and whistle-blower intelligence).

94. The data for FCA desk-based reviews and on-site visits in the most recent published HMT supervision reports (see Table 1 below) show a trend to greater use of DBRs and fewer on-site visits. The period runs to March 2020, so very little of the data should be affected by the Covid-19 lockdowns.

Number of:	2017-18	2018-19	2019-20
Desk-based reviews (total)	38	47	147
Compliant	38	0	90
Partially compliant	0	20*	48
Non-compliant	0	0	9
On-site inspections (total)	98	64	30

²² <https://www.fca.org.uk/publications/corporate-documents/data-strategy>

Compliant	0	0	1
Partially compliant	84	50	14
Non-compliant	14	14	15

Table 1: FCA desk-based reviews and on-site inspections (Source: HMT AML/CFT supervision reports)
** 27 DBRs in 2018-19 were reactive case reviews which are not assigned a compliance rating*

95. The FCA targets its activities at areas of highest risk; for example in 2019-20, of the 147 DBRs 137 were high risk firms and 26 of the 30 on-site visits were high risk firms. The IMF FSAP questioned whether the total number of inspections were commensurate to the assessed risks of the FCA’s supervised population and expressed concern about the extent to which a substantial portion of the supervisory population are monitored for AML/CFT compliance.

96. As of 10 January 2020, the FCA has become the UK’s AML supervisor for cryptoasset businesses, such as exchanges and wallets, who are carrying out activity in the UK. The FCA’s approach to this sector is developing in line with the risk-based approach, targeting resource on firms that pose the highest risk. The FCA is applying a robust assessment process at the registration gateway, and has identified significant weaknesses in firms’ controls, resulting in a large number of firms (circa 90%) withdrawing their applications, or being rejected or refused by FCA.

97. The FCA also continues to take a strong approach to enforcement against breaches of the MLRs. Through the MLRs and the Financial Services and Markets Act 2000, it has a broad range of enforcement powers, including to cancel or suspend a relevant person’s authorisation; impose fines; publicly censure firms for breaches of the MLRs; the power to prohibit management; pursue an injunction through the courts; issue Directions; and launch a criminal prosecution. In recent years, enforcement actions have included a number of large fines imposed, including Standard Chartered Bank fined £102.2m in 2019, Commerzbank fined £37.8m in 2020, and HSBC fined £63.9m in 2021.

98. Table 2 below shows fines issued by FCA in the previous three HMT AML/CFT supervision reports.

	2017-18	2018-19	2019-20
Number of fines	0	3	0
Total sum of fines	0	£103.1m	0

Table 2: FCA fines for AML/CFT breaches (Source: HMT AML/CFT supervision reports)

99. The FCA also secured its first successful criminal prosecution under the Money Laundering Regulations 2007 in 2021, after NatWest Plc pleaded guilty to three breaches under the regulations. In December, a court awarded a fine of £264.8m against NatWest.

HMRC

100. HMRC is the AML supervisor for money service businesses, high value dealers, estate agents, letting agents (since 2020), art market participants (since 2020), and supervises trust and company service providers (TCSPs) and accountancy service providers which are not supervised by a professional body supervisor. The MER reported that HMRC had a good understanding of the inherent ML/TF risks in the sectors it supervised, drawing on multiple sources to build its understanding of risk.

101. The MER confirmed that HMRC pursued a risk-based approach to its supervisory practices, developing tactical plans for each sector it supervised. However, the assessment team expressed concerns that some higher risk firms were never inspected and the level of resourcing was not sufficient over the medium- to long-term.

102. Table 3 (below) shows the total number of desk-based reviews and on-site visits undertaken by HMRC reported in the previous three HMT AML/CFT supervision reports.

Number of:	2017-18	2018-19	2019-20
Desk-based reviews (total)	38	107	1,012
On-site inspections (total)	1,314	1,265	817
Number of DBRs and on-site visits assessed as compliant	59	95	288
Number of DBRs and on-site visits assessed as partially compliant	125	227	517
Number of DBRs and on-site visits assessed as non-compliant	157	350	439

Table 3: HMRC desk-based reviews and on-site inspections (Source: HMT AML/CFT supervision reports)

103. HMRC responded to the MER’s findings by strengthening its risk-based approach, supported by an increase in charges to its supervised population from May 2019. The enhanced approach includes a tightened registration process, greater use of behavioural

science and educational material to support compliance among its supervised population, and an increase in interventions.

104. HMRC has also recently completed an in-depth self-assessment of its supervision regime, against the Office for Professional Body Anti-Money Laundering (OPBAS) sourcebook standards and the MLRs, with support from HMT and OPBAS. The self-assessment was conducted by individuals outside of the Economic Crime Supervision team. A summary of the report was published in March 2021. A second self-assessment will be published in 2022 to assess progress made.

105. HMRC also takes a robust approach to enforcement under the MLRs. In 2019-2020 HMRC carried out over 2,000 supervisory interventions, issued penalties totalling £9.1m and prevented 31 non-compliant businesses and individuals from trading by suspending or cancelling their AML registration. In January 2021, HMRC reported it had imposed a record £23.8m fine on a Money Service Business for breaching the MLRs. Also in 2019-2020, HMRC successfully prosecuted 2 individuals for anti-money laundering regulatory failings as well as a further 29 individuals for money laundering offences under the Proceeds of Crime Act. Criminals are now serving a combined 83.25 years as a result of the action taken. In 20-21, HMRC has had a further two successful prosecutions for AML regulatory failings, and 17 individuals convicted under the Proceeds of Crime Act.

Gambling Commission

106. The MER found the Gambling Commission had a good understanding of ML/TF risks and used a suitable variety of tools to assess inform its risk assessment. It also found the Gambling Commission to have an effective risk-based approach through its desk-based reviews and on-site visits.

107. The Gambling Commission continues to have a good understanding of risk and publishes its own ML and TF risk assessment which covers both casinos and other gambling businesses who do not fall within scope of the MLRs sector but have obligations under the GC licensing conditions²³.

108. Table 4 below shows the total numbers of desk-based reviews and on-site visits undertaken by the Gambling Commission over the past three years.

Number of:	2017-18	2018-19	2019-20
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²³ <https://www.gamblingcommission.gov.uk/licensees-and-businesses/notice/gambling-commission-risk-assessment-published>

Desk-based reviews (total)	27	38	66
Compliant	3	16	16
Partially compliant	13	9	15
Non-compliant	11	13	35
On-site inspections (total)	15	27	48
Compliant	4	5	15
Partially compliant	4	4	6
Non-compliant	16	118	27

Table 4: Gambling Commission desk-based reviews and on-site inspections (Source: HMT AML/CFT supervision reports)

Professional Body Supervisors (PBSs)

109. The 22 PBSs, which are listed in full in Schedule 1 of the MLRs, supervise the legal and accountancy service providers within scope of the MLRs in their membership populations. Most of the PBSs also supervise TCSP activity conducted by their supervised entities. The MER found a varying understanding of ML/TF risk across the legal and accountancy PBSs, with some having strong risk understanding and implementing risk models to consider inherent risk factors, while others had a limited understanding and focused purely on factors such as the size of the practice or types of services offered.

110. The MER found that the lack of risk understanding among smaller legal and accountancy supervisors had impacted their ability to apply a risk-based approach, but noted that generally PBSs did apply an RBA to their supervision. The assessment team did note concerns that some PBSs used simple metrics to allocate firms to supervisory cycles, with some firms being put into cycles with relatively few inspections due to having lower gross fee income.

111. The findings of inconsistent and ineffective supervision by PBSs had already been raised in the National Risk Assessment of Money Laundering and Terrorist Financing 2015. In response to this finding, the UK established OPBAS, with the dual objectives of improving effectiveness and consistency of PBS supervision and driving information and intelligence sharing across the regulated sector.

112. Since its foundation, OPBAS has published three reports setting out its supervisory assessments of all PBSs. The first two reports focused on the PBSs' compliance with against the requirements of the MLRs, based on assessments against the OPBAS Sourcebook. The first report found that the quality of AML supervision varied, and OPBAS required all PBSs to put strategic action plans in place to remedy failings.

The second report identified instances of strong improvement, but continuing inconsistency in supervision, with some PBSs lagging behind peers.

113. The third report, published in September 2021, moved to a greater focus on the effectiveness of PBS supervision, consistent with the FATF approach. OPBAS considered the extent to which PBSs' AML systems and controls mitigated the risks and threats of ML/TF, with the report identifying significant weaknesses in effectiveness in meeting the MLRs. Key deficiencies included:

- a) Just over 60% of PBSs allocated the responsibility for managing AML supervisory activity effectively through clear governance structures, with a third of PBSs not having effective separation of advocacy and regulatory functions. OPBAS noted this presented a clear risk of conflict of interest, though found that accountancy PBSs were more effective in handling conflicts of interest than those in the legal sector.
- b) Over 80% of PBSs had not implemented an effective risk-based approach. Identified deficiencies included a lack of effectiveness in writing adequate risk profiles, regularly reviewing and appraising risks and using risk understanding to determine the frequency and intensity of supervisory visits.
- c) Only half of PBSs were effective in using both proactive and reactive tools for the supervision of members. In particular, the accountancy sector failed to ensure that members took timely action to correct deficiencies.

114. As well as continuing deficiencies in PBSs supervision, the OPBAS report suggests that significant inconsistencies remain between supervisors, with some delivering effective supervision to their populations to a far greater degree than others.

Unintended consequences

115. While ensuring illicit finance is prevented from entering the financial system, the MLRs also seek to prevent unnecessary burdens to legitimate businesses. A common issue globally is the phenomenon of de-risking, whereby businesses choose not to enter business relationships with entire sectors or with links to specific countries, irrespective of the risks posed by individual businesses and any mitigations implemented.

116. The effects of de-risking can be damaging for legitimate businesses, as they can struggle to access required bank accounts or payment services, sometimes despite having effective AML controls in place.

117. The call for evidence sought views on the extent to which the MLRs had produced unintended consequences by contributing to the issues posed by de-risking (Q36).

Respondents articulated that de-risking occurs:

- a) as a result of a firm's risk appetite, and
- b) as a result of the cost of compliance with regulatory requirements exceeding the potential profit associated with the client relationship/transaction.

118. Respondents stressed that businesses must retain discretion to set a low-risk appetite and to make commercial decisions. While agreeing with the importance of businesses retaining discretion to make commercial decisions, one respondent noted that AML requirements must not be used as a justification for commercial decisions. Another respondent stressed the importance of communicating with a client about the reason(s) for ending a business relationship but noted that there is tension with requirements under the Proceeds of Crime Act (not the MLRs) not to "tip-off".

119. The majority of the 20 responses to this question expressed a view that no changes to the MLRs were necessary. Some respondents expressed a view that de-risking could be mitigated by reducing the overall costs associated with complying with the requirements in the MLRs. To this end a number of proposals were made. These can be summarised as:

- a) Additional guidance from supervisors on thematic issues to ensure that businesses truly understand the risks in specific circumstances. One respondent noted that FCA's guidance's on Politically Exposed Persons (PEPs) as an example of where communication from a regulator has supported a more targeted application of requirements by firms. Other areas identified for future guidance included risks in specific sectors, such as pawnbroking, and risks associated with new technologies. A number of respondents highlighted that additional guidance was particularly important to smaller businesses who they perceive to have less confidence to adequately identify and conduct the necessary checks, and therefore take a blanket approach of not conducting business with potential clients with certain characteristics.
- b) Additional guidance from supervisors on management of risk. A small number of respondents expressed a view that some firms were mistakenly ending client relationships due to a view that where risks were identified a relationship must be

ended, rather than putting in place to mitigate potential risks, such as ongoing monitoring, or restricting the type of services that may be provided.

- c) Changes to the MLRs designed to make requirements more risk based. While the majority of respondents expressed a view that no changes were necessary to the MLRs to mitigate de-risking, a small number of respondents expressed a view that changes to requirements on customer due diligence (CDD) and Enhanced Due Diligence (EDD) would reduce the overall compliance burden to firms by making checks more risk based, and this would in turn result in a reduction in de-risking.

What have the costs to business been?

Challenges of cost-benefit analysis

- 120. The impact assessment for the Money Laundering Regulations set out the challenges of conducted cost-benefit analysis for AML controls. The MLRs are underpinned by a risk-based approach, which means businesses must be satisfied they fully understand the risks presented to them by their products and customers and have taken adequate steps to mitigate them.
- 121. For example, the CDD obligations of the MLRs require regulated businesses to identify and verify their customers, but the resources and cost involved in doing so can vary significantly across sectors and across individual businesses. There are over 100,000 businesses within scope of the MLRs, ranging from sole-practitioner accountants to global banks, and they will vary in their approach to meeting the requirements of the MLRs.
- 122. The challenge of measurement is further compounded by the difficulties in isolating costs driven by the requirements of the MLRs. Larger firms in scope of the MLRs, such as the major banks, will have large financial crime teams, responsible for not only compliance with the MLRs but the full range of applicable financial crime legislation (e.g. obligations deriving from POCA and the Financial Services Markets Act 2000 (FSMA)). It is difficult to identify which costs within these result from the MLRs.
- 123. It is also difficult to estimate the counterfactual if the MLRs did not exist. Much of the activity that results is likely to be conducted by regulated entities even if it did not exist as a legal duty (i.e. firms would still wish to identify their customers), and it is

designed to ensure firms do not commit criminal offences under POCA or the Terrorism Act 2000, so contains many obligations businesses would wish to meet even without the requirement to do so set out in the MLRs. After nearly 30 years of some businesses being subject to the MLRs alongside other financial crime legislation, it may no longer be fully possible to disentangle their obligations (and the costs they drive) from wider business processes in order to produce reliable estimates. Reinforcing this point, responses to the Economic Crime Levy consultation (run from July to October 2020) emphasised that businesses in some sectors would struggle to even disentangle within their own accounts what work they undertook was within scope of the MLR, and which sat outside of it.

124. Acknowledging the difficulties set out above, there have been estimates made of the costs to business of complying with the MLRs. For example, a report published by LexisNexis in 2021, drawing on analysis by Oxford Economics, estimated the costs of AML compliance for financial institutions in the UK to be £28.7bn per annum²⁴. As noted above parts of the total cost presented are not driven by the MLRs, for example LexisNexis estimate that 8% of the total cost is driven by watchlist and sanctions screening, while a further 8% is driven by suspicious activity reporting. These are both critical aspects of an effective financial crime regime but are largely driven by non-MLR legislation.

125. Although this analysis is a useful contribution to the literature, Oxford Economics were commissioned directly by LexisNexis to undertake the research, and it is difficult to determine its accuracy without additional primary evidence.

126. The government will continue to seek to understand the costs to business of the MLRs, including those resulting from any changes made following the recommendations of this review.

²⁴ LexisNexis Risk Solutions: https://solutions.risk.lexisnexis.co.uk/cutting-the-costs-of-aml-compliance?trmid=BSUKIFC21.FCC.TCOC.PHGO-613506&gclid=Cj0KCQjwyMITBhDKARIsAAJ-9Vthq-YMyNQDdcNHn3Y_JQC-6dDKHYkJWWt61Nea1Hn7fkhcEpPnhk8aAvKVEALw_wcB

Conclusions

127. The scale of the problem that the regulated sector is facing is sizeable and it is complex in nature. Both firms and supervisors have made significant efforts to prevent illicit finance from entering the regulated sector. Stringent enforcement penalties in recent years have shown the robust response from supervisors is targeting those businesses that commit the most egregious breaches of the MLRs.
128. This PIR has demonstrated positive progress has been made, but there is clearly more that can be done. The government has committed to ensuring the MLRs are effective, improving regulation and supervision where it is not sufficiently robust and removing requirements which do not help the regime meet its objectives or place a disproportionate burden on businesses.
129. While the UK is no longer bound by the EU's Anti Money Laundering Directives, it remains committed to international standards as a leading member of the Financial Action Task Force. The scope to diverge significantly from the current regulations is therefore limited, as much of the UK's regulation ultimately derives from the FATF standards. However, the review has demonstrated that the government's focus must be on driving the effective implementation of the MLRs, working with businesses and supervisors to ensure understanding and compliance with the requirements of the regulations, and the implementation of an effective risk-based approach.
130. This work has already begun; the Review of the UK's AML/CFT regulatory and supervisory regime, published alongside this PIR, proposes an overarching framework for driving effectiveness, options for the most significant reform to the UK's supervision regime in its history, and a series of options for reforming the MLRs to ensure they best target ML/TF while reducing the burden on legitimate businesses and customers and minimising de-risking behaviour that results from the MLRs.
131. The recommendations resulting from the Review will be taken forward through future policy development and legislation, both by HMT and through cross-government leadership, including the upcoming second Economic Crime Plan.

Annex A – Professional Body Supervisors

1. Association of Accounting Technicians
2. Association of Chartered Certified Accountants
3. Association of International Accountants
4. Association of Taxation Technicians
5. Chartered Institute of Legal Executives/CILEx Regulation
6. Chartered Institute of Management Accountants
7. Chartered Institute of Taxation
8. Council for Licensed Conveyancers
9. Faculty of Advocates
10. Faculty Office of the Archbishop of Canterbury
11. General Council of the Bar/ Bar Standards Board
12. General Council of the Bar of Northern Ireland
13. Insolvency Practitioners Association
14. Institute of Certified Bookkeepers
15. Institute of Chartered Accountants in England and Wales
16. Institute of Chartered Accountants in Ireland
17. Institute of Chartered Accountants of Scotland
18. Institute of Financial Accountants
19. International Association of Bookkeepers
20. Law Society/ Solicitors Regulation Authority
21. Law Society of Northern Ireland
22. Law Society of Scotland