

<b>Title:</b> The Money Laundering and Terrorist Financing (Amendment) (No. 3)(High-Risk Countries) Regulations <b>SI No:</b> 2021/1218  <b>Other departments or agencies:</b> N/A  <b>Contact for enquiries:</b> Medha Debashis (Medha.Debashis@hmtreasury.gov.uk) Stephanie Ukpelukpe (Stephanie.Ukpelukpe@hmtreasury.gov.uk)	<b>De minimis assessment</b>
	<b>Date:</b> 21/10/2021
	<b>Type of regulation:</b> Domestic
	<b>Date measure comes into force:</b> 02/11/2021
<b>Cost of Preferred (or more likely) Option</b>  £480,000	<b>Equivalent Annual Net Direct Cost to Business per year</b> £96,000

### 1. What is the problem under consideration? Why is government intervention necessary?

The UK's anti-money laundering (AML) regime is set out in the Money Laundering Regulations (MLRs). The scope of the MLRs covers both money laundering and terrorist financing. 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 security and is a key enabler of serious and organised crime, which costs the UK at least £37 billion every year.

Terrorist financing involves dealing with money or property that you know or have 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 money laundering and terrorist financing (ML/TF) risks.

The MLRs include a number of requirements that businesses that fall under its scope must take to combat ML/TF. These requirements include the need for firms to implement measures to identify and verify the people and organisations, with whom they have a business relationship or for whom they facilitate transactions. This includes measures relating to customer due diligence and enhanced due diligence.

Enhanced due diligence (EDD) is defined by regulation 33 of the MLRs as requiring measures such as obtaining additional information on the customer and customer's beneficial owner; and on the intended nature of the business relationship in order to establish with more care if money laundering or terrorist financing is likely to be an issue.

In addition, the regulations also require financial institutions and other AML regulated firms to carry out EDD in respect of business relationships and transactions involving 'high-risk third countries'. These are countries that have been identified as having strategic deficiencies in their anti-money laundering and counter terrorism financing (AML/CTF) regimes and that pose a significant threat to the UK's financial system.

The current definition of a 'High-Risk Third Country' in the MLRs is set out in Regulation 33A which states that a 'high-risk third country' is a country which is specified in Schedule 3ZA of the MLRs.

Schedule 3ZA is a list of countries and mirrors the lists of countries identified by the Financial Action Task Force (FATF), the global AML/CTF standard setter, as having strategic deficiencies in their AML/CTF regimes. The FATF meet periodically (3 times a year) to discuss global AML/CTF risk profiles and amend its public lists of jurisdictions under increased monitoring and high-risk jurisdictions.

When the UK's new autonomous high-risk third countries list was introduced, the UK committed to updating the list to mirror the periodic changes made by the FATF to their lists of countries identified as having strategic deficiencies in their AML/CTF regimes. If the current high-risk third country list in legislation is not amended, it will become outdated and non-reflective of global AML/CTF risk identified by the FATF, leaving the UK financial system at risk of threats from those who have strategic deficiencies in their AML/CTF regimes. Furthermore, the UK may become at risk of the FATF finding UK legislation non-compliant with international standards on AML/CTF as a result of not reflecting those countries identified as high-risk in legislation.

## **2. What are the policy objectives and the intended effects?**

This legislation will update the list of high-risk third countries that AML regulated firms need to apply EDD to in order to continue to be in line with international standards on combatting money laundering and reflective of global AML/CTF risks. The FATF meet periodically (3 times a year) to discuss global AML/CTF risk profiles and amend its public lists of jurisdictions under increased monitoring and high-risk jurisdictions which subsequently form the basis of the UK's high-risk third countries list.

Furthermore, 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.

## **3. What policy options have been considered, including any alternatives to regulation?**

### **Please justify preferred option**

**Option 1, Do nothing.** Under this option, the Government would not amend the current list of High-Risk Third Countries in the MLRs. This would result in the UK High-Risk Third Country list being at risk of becoming outdated and non-reflective of global AML/CTF risk identified by the FATF, leaving the UK financial system at risk of threats from those who have strategic deficiencies in their AML/CTF regimes. Furthermore, the UK may become at risk of the FATF finding UK legislation non-compliant with international standards on AML/CTF as a result of not reflecting those countries identified as high-risk in legislation.

**Option 2 (preferred option).** Legislate to amend the MLRs to update the list of High-Risk Countries to mirror the countries identified by the FATF as having strategic deficiencies in their AML/CTF regime. This will ensure that the UK's list remains up to date and reflective of global AML/CTF risks as identified by the FATF and global standards to combat money laundering and terrorist financing. This will also fulfil the commitment the UK has made to updating the High-Risk Third Country list to mirror the periodic changes made by the FATF to their lists of countries identified as having strategic deficiencies in their AML/CTF regimes.

## **4. Please justify why the net impacts (i.e. net costs or benefits) to business will be less than £5 million a year.**

- **What will businesses have to do differently?**

Under Regulation 33 of the MLRs, AML regulated firms are required to undertake EDD "*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*". 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.

### **High-Risk Third Countries:**

The definition of a High-Risk Third Country in the MLRs is set out in Schedule 3ZA. Schedule 3ZA lists currently the following countries: Albania, Barbados, Botswana, Burkina Faso, Cambodia, Cayman Islands, Democratic People's Republic of Korea, Haiti, Iran, Jamaica, Malta, Mauritius, Morocco, Myanmar, Nicaragua, Pakistan, Panama, Philippines, Senegal, South Sudan, Syria, Uganda, Yemen and Zimbabwe. It is with respect to these countries that mandatory EDD is required to be performed by AML regulated firms under Regulation 33.

This measure would amend the list of countries defined as a High-Risk Third Country in Schedule 3ZA in order to mirror the changes made by the FATF to its lists of countries identified as having strategic deficiencies in their AML/CTF controls following its Plenary. Specifically, Jordan, Mali, and Turkey would each be newly defined as a 'high-risk third country' as a result of this measure and added to the list alongside the existing countries. This measure would also result in Botswana and Mauritius no longer falling within the definition of a 'high-risk third country' and would remove them from the Schedule 3ZA. Therefore the new list of countries would be as follows: Albania, Barbados, Burkina Faso, Cambodia, Cayman Islands, Democratic People's Republic of Korea, Haiti, Iran, Jamaica, Jordan, Mali, Malta, Morocco, Myanmar, Nicaragua, Pakistan, Panama, Philippines, Senegal, South Sudan, Syria, Turkey, Uganda, Yemen and Zimbabwe.

This measure would therefore require AML regulated firms to perform EDD when a business relationship is established with a person established in Jordan, Mali, and Turkey. This measure would also require EDD to be performed by AML regulated firms in relation to any relevant transaction where either of the parties to the transaction is established in Jordan, Mali and Turkey.

- **How many businesses will this impact per year?**

Based on data collected from AML supervisors in the latest Treasury annual returns, covering the period between 6 April 2019 and 5 April 2020, we estimate that around 97,400 entities are within scope of the MLRs and will thus be in scope of the mandatory EDD requirements relating to high-risk third countries.

- **What is the direct cost/benefit per business per year?**

Under the MLRs, AML regulated firms are also required to apply EDD under "in any other case which by its nature can present a higher risk of money laundering or terrorist financing". Regulation 33.6 states that "when assessing whether there is a higher risk of money laundering or terrorist financing in a particular situation, and the extent of the measures which should be taken to manage and mitigate that risk" a relevant person should consider "geographical risk factors". These geographic risk factors include countries identified by the FATF in their assessments. As such it is difficult to determine the full monetised costs of this measure as there

is already an analogous, but less prescriptive, obligation in the MLRs to take into account geographical risk factors when assessing the level of customer due diligence to apply.

Estimating the cost of EDD measures is difficult as this can be highly variable and depend on a business's risk appetite, business model and software solutions which 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 measure (as part of considering geographic risk factors under Regulation 33.6). As a result, the extent to which the changes will influence EDD cost it is unclear.

Various informal estimates regarding the cost of customer due diligence (CDD) have been given as part of the 4<sup>th</sup> Money Laundering Directive and 5<sup>th</sup> Money Laundering Directive consultations with estimates of £3-£15 as the average cost of initial CDD measures<sup>1</sup>. However, this estimate should be treated with caution as different institutions 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 and therefore estimate £4.5-£30 as the average cost of EDD.

In terms of calculating overall EDD costs for AML regulated firms, it is difficult to establish the number of business relationships and transactions which would require EDD annually. As such, an estimate for the potential cost to the sector from performing EDD on customers who are established in a 'high-risk third country' which will be defined as a result of this measure, has been calculated based on the number of individuals in the UK were born in these countries included in this measure. It is important to note that national origin is not itself a basis for applying EDD under the MLRs and that ongoing costs will depend on what proportion of the total of high-risk customers businesses 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.

By using the number of individuals whose country of birth is defined as a 'high-risk third country' as a proxy for potential customers, this gives an estimated range of the increase in EDD costs as between £292,500 (65,000x4.5) and £1,950,000 (65,000x30)<sup>2</sup>. The estimated range of reduced EDD costs as a result of the removal of Mauritius and Botswana from the definition of a High-Risk Third Country is estimated between £220,500 (49,000x4.5) and £1,470,000 (49,000x30). As such the range in increase of net costs as a result of this measure are estimated to be between £72,000 and £480,000.

Furthermore, as there is already an existing analogous, but less prescriptive, obligation to take into account geographical risk factors when assessing the level of customer due diligence to apply, this may also influence the estimate of new costs associated with this measure as regulated businesses may already be performing EDD checks required by this measure. As such, we expect that the impact of this additional check will be limited as it forms part of a wider EDD framework already required by the MLRs.

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<sup>1</sup> Businesses conduct customer due diligence to identify their customer and confirm they are who they say they are. In practice, this means obtaining a customer's: name, photograph on an official document which confirms their identity, and residential address, and date of birth.

<sup>2</sup> Estimates on the number of individuals in the UK who are nationals of Jordan, Turkey, Mauritius, and Botswana have been sourced from the ONS's [Population of the UK by country of birth and nationality: 2020](#) – taken from tables A and B in the January 2020-December 2020 dataset. Mali has not been accounted for because ONS have been unable to supply an estimate due to disclosure control.

**5. Please confirm whether your measure could be subject to call-in by BRE under the following criteria. If yes, please provide a justification of why a full impact assessment is not appropriate:**

**a) Significant distributional impacts (such as significant transfers between different businesses or sectors)**

No.

**b) Disproportionate burdens on small businesses**

No. This measure applies to activities that are regulated under the MLRs regardless of the size of the business, so businesses regulated by MLRs can be of varied sizes. We do not anticipate that the requirements of the Instrument will have a significant impact on small businesses as the additional EDD checks form part of a wider EDD framework already required of these businesses under the MLRs.

**c) Significant gross effects despite small net impacts**

No.

**d) Significant wider social, environmental, financial or economic impacts**

No. It is possible that persons with connections to FATF listed countries, including potentially UK customers who are nationals of those countries, will be subject to increased scrutiny when establishing a business relationship with relevant persons for example banks.

National origin or nationality is not itself a basis for a customer to be treated as “established in” a particular country. The most obvious potential impact of listing is on *residents* of a listed country who do business in the UK with a regulated business. Such customers may well also be nationals of that country. Another potential impact might be on customers living in the UK who have certain family or other ties to a listed country that are associated with their race or nationality, a protected characteristic under the Equality Act 2010. For example, these customers may carry out more transactions involving residents of that country than other UK customers, or have more interests in companies based in that country which do business in the UK. EDD requirements could therefore indirectly have a greater effect on this group than on other persons.

However, there is no expected significant negative disproportionate equalities impact as a result of this measure compared to the current status quo as relevant businesses should already be factoring in FATF assessments (which the proposed measure is based on) into their risk-based approach when considering whether to apply EDD. Furthermore, the requirements of this measure do not prohibit or limit relevant businesses from providing services to individuals established in high-risk third countries, rather it requires relevant persons to apply additional scrutiny in light of ML/TF risks.

**e) Significant novel or contentious elements**

No.

Sign-off for de minimis assessment: SCS

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

**SCS of Policy**

Signed: Emily Bayley

Date: 21/10/2021

**SCS of Better Regulation Unit**

Signed: *Linda Timson*

Date: 21/10/2021

Sign-off for de minimis assessment: Minister

***I have read the de minimis assessment and I am satisfied that it represents a fair and***

Signed: ***John Glen, Economic Secretary***

Date: 28/10/2021

**Further information sheet**

Please provide additional evidence in subsequent sheets, as required.