

<b>Title:</b> The Money Laundering and Terrorist Financing (High-Risk Countries) (Amendment) (No.2) Regulations 2023 <b>IA No:</b> <b>RPC Reference No:</b> RPC-HMT-5295(1) <b>Lead department or agency:</b> His Majesty's Treasury, Sanctions and Illicit Finance Team. <b>Other departments or agencies:</b> N/A.	<b>Impact Assessment (IA)</b>
	<b>Date:</b> 06/09/2023
	<b>Stage:</b> Final Stage IA.
	<b>Source of intervention:</b> Domestic
	<b>Type of measure:</b> Secondary legislation.
	<b>Contact for enquiries:</b> AntiMoneyLaunderingBranch@hmtreasury.gov.uk
<b>Summary: Intervention and Options</b>	<b>RPC Opinion: GREEN</b>

**Cost of Preferred (or more likely) Option** (in 2019 prices)

Total Net Present Social Value	Business Net Present Value	Net cost to business per year	Business Impact Target Status
£-429.7m	£-429.7m	£49.9m	Qualifying provision

**What is the problem under consideration? Why is government action or intervention necessary?**

The NCA assesses it is a realistic possibility that over £100 billion pounds is laundered every year through the UK or through UK corporate structures. To help mitigate this threat the UK's current Money Laundering, Terrorist Financing, and Transfer of Funds (Information on the Payer) Regulations 2017 ('the MLRs' require regulated sectors to apply Enhanced Due Diligence<sup>1</sup> for customer relationships and transactions with links to High Risk Third Countries (HRTC). The UK's policy is to align our HRTC list with that of the global anti money laundering and counter terrorist financing (AML/CFT) standard setter, the Financial Action Task Force (FATF). This legislation will update the UK's HRTC list to reflect the latest country additions and removals made by the FATF in 2023. These changes are important as the countries identified by FATF have significant AML/CFT deficiencies and updating UK's list will ensure that regulated sectors have appropriate controls in place to identify and prevent money laundering (ML) and terrorist financing (TF).

**What are the policy objectives of the action or intervention and the intended effects?**

This legislation will update the HRTC list to remove Albania, Cayman Islands, Jordan and Panama and to add Bulgaria, Cameroon, Croatia, Nigeria, South Africa and Vietnam<sup>2</sup>. The regulated sector will be obliged to conduct Enhanced Due Diligence for (i) business relationships when customers are established in a HRTC, and (ii) any occasional transactions where either of the parties to the transaction are established in a HRTC, as per Regulation 33 of the MLRs. The policy objective is to prevent the UK's regulated sectors from being misused by criminals by ensuring firms are applying Enhanced Due Diligence checks in line with the latest information on country risk. This brings economic benefits to the UK by ensuring that the UK is a trusted place to do business.

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

Option 1) Update the UK's High Risk Third Countries list now to reflect FATF changes (preferred): the UK's list will be updated and brought into line with the FATF's lists, ensuring the UK's response is proportionate to identified international threats and Government commitments<sup>3</sup>. Acting now is important to ensure there are no further delays in the UK aligning with internationally identified risks to protect the UK's financial system. Aligning the UK's list with the FATF's list is the preferred option and supported by the regulated sector.

Option 2) Do nothing – i.e., do not update UK's High Risk Third Countries list: the UK's list has already become outdated and out of step with the FATF's assessment of high-risk jurisdictions. Further delays will undermine the UK's risk-based approach to economic crime threats as the response would no longer be proportionate to the country threats. For example, firms would have to continue undertaking EDD on Albania, Cayman Islands, Jordan, and Panama who have rectified their systemic AML/CFT deficiencies identified by the FATF – leading to unnecessary costs for UK firms.

<sup>1</sup> Enhanced due diligence measures refers to actions to gather more information about a customer or transaction e.g., on the intended nature of the client relationship or transaction, or the source of funds (see further examples in the detailed analysis section below).

<sup>2</sup> The final list of countries is subject to FATF's final decision on country listing and de-listing in October 2023.

<sup>3</sup> <https://hansard.parliament.uk/Commons/2021-04-26/debates/3694E1EE-2CFE-41A7-8F2E-7FFE083861F4/FinancialServices>

Reasons why non-regulatory options are not feasible: The MLRs are the legislative framework underpinning the UK's response to money laundering and terrorist financing. They set out in respect of which countries firms need to conduct enhanced checks. The current regulations are necessary to ensure the UK remains in line with the Global AML/CFT Standards, and to help mitigate different risk appetites across the private sector, creating an even playing field across firms. The Government has committed to aligning the list of countries in the ML regulations with those on the FATF's list. The MLRs can only be updated through legislative change. Though the FATF lists are publicly available, firms are not legally obliged to update their approach in respect of certain jurisdictions, so long as the list set out in legislation differs.

**Will the policy be reviewed?** It will be reviewed. **If applicable, set review date:** By 26 June 2027

Is this measure likely to impact on international trade and investment?		Yes (indirect impact).		
Are any of these organisations in scope?	<b>Micro</b> Yes	<b>Small</b> Yes	<b>Medium</b> Yes	<b>Large</b> Yes
What is the CO <sub>2</sub> equivalent change in greenhouse gas emissions? (Million tonnes CO <sub>2</sub> equivalent)		<b>Traded:</b> N/A	<b>Non-traded:</b> N/A	

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

Signed by the responsible: Minister

Veronica Norbiton Date: 27/11/2023

# Summary: Analysis & Evidence

# Policy Option 1

**Description:** Update the UK's list of High Risk Third Countries to reflect FATF's changes

## FULL ECONOMIC ASSESSMENT

Price Base Year 2022	PV Base Year 2023	Time Period 10 Years <sup>1</sup>	Net Benefit (Present Value (PV)) (£m)		
			Low: -1,362.7	High: -61.0	Best Estimate: -429.7
COSTS (£m)		Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)	
Low		20.1	13.6	137.2	
High		237.7	131.3	1,366.4	
Best Estimate		80.2	43.7	456.2	
<b>Description and scale of key monetised costs by 'main affected groups'</b> The main <u>direct monetised cost</u> for regulated firms will be: <ol style="list-style-type: none"> <li>1) the familiarisation costs for compliance officers to read the UK's updated HRTC list and related public advisory notice.</li> <li>2) the transitional cost of conducting enhanced due diligence on existing customers established in the six new HRTCs being added to the list; and</li> <li>3) the annual costs of conducting enhanced due diligence on: (a) any new customers established in the six HRTCs being added or (b) any occasional transactions where either of the parties to the transaction is established in one of six HRTCs being added.</li> </ol>					
<b>Other key non-monetised costs by 'main affected groups'</b> Non-monetised costs may arise for customers, should regulated firms decide to transfer some of the increased costs of conducting EDD to customers or decide to avoid or change the nature or extent of their business relationships with HRTC customers due to the added cost of conducting EDD. Nevertheless, given that countries are on the UK and FATF's list on average for only 2 to 3 years <sup>2</sup> , such cases are not expected to be widespread. In addition, the government is taking steps to strengthen requirements in any instances of account closures to give customers more opportunities to challenge any closures (see additional detail below).					
BENEFITS (£m)		Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)	
Low		0.0	0.4	3.7	
High		0.0	8.9	76.2	
Best Estimate		0.0	3.1	26.6	
<b>Description and scale of key monetised benefits by 'main affected groups'</b> The key <u>direct monetised benefit</u> for regulated sectors will be the savings from no longer needing to conduct enhanced due diligence for new customers or occasional transactions relating to the four countries being removed from UK's HRTC list.					
<b>Other key non-monetised benefits by 'main affected groups'</b> The key <u>non-monetised benefit</u> for the regulated sector and for UK's economy more broadly will be that by aligning with the global AML/CFT Standard setter, this change will provide greater certainty to the regulated sector regarding the Government's commitment to align with FATF findings and will re-affirm UK's reputation as a safe and stable place to do business.					
<b>Key assumptions/sensitivities/risks</b>				<b>Discount rate (%)</b>	3.5%

<sup>1</sup> In line with regular Impact Assessments, a 10-year appraisal period is used for analysis purposes. Nevertheless, it should be noted that countries are on average listed by the FATF for only 2-3 years. Given de-listing a country requires further legislation the impact assessment does not assume a country will be de-listed after that period, but this means figures for total costs over the appraisal period are likely to be an overestimate for the true net cost to business.

<sup>2</sup> Based on information provided by FATF on country listings.

**Data challenges** – We faced various challenges for this IA due to a lack of available data on the volume of HRTC customers or occasional transactions with HRTCs. We engaged with both private sector firms, focusing on multinational banks which are most likely to be affected by the policy, and the UK’s AML/CFT supervisors to gather data, but most firms do not collect granular data on costs or customers which are aligned with the requirements of the MLRs. To mitigate this, we collected new data from a sample of the largest banks to help quantify the impact of these changes for South Africa and Nigeria (the most material changes made by the SI given the size of their economies and links to the UK), and beyond that relied on available proxy data, which required making several assumptions (see section on risks and assumptions below and Annex A for a full list). To the extent possible, all assumptions have been tested with supervisors and private sector, drawing on informal consultations and evidence provided from affected parties as part of previous MLRs reviews. Over the longer-term the government is taking proactive steps to improve the available data on the cost of compliance with the MLRs, which should help to inform IAs in future years.

**Sectoral differences** – We know that different sectors and types of firms face very different costs from HRTC requirements (e.g., those providing international services to HRTCs are likely to face higher costs). While we have tried to reflect these sector differences to the extent possible in our calculations, we faced several limitations in conducting a more thorough sectoral breakdown due to the lack of data.

**BUSINESS ASSESSMENT (Option 1)**

<b>Direct impact on business (Equivalent Annual) £m:</b>			<b>Score for Business Impact Target (qualifying provisions only) £m:</b>
<b>Costs: 53.0</b>	<b>Benefits: 3.1</b>	<b>Net: 49.9</b>	
			249.6

# Summary: Analysis & Evidence

# Policy Option 2

Description: Do not update the UK's list of High Risk Third Countries to reflect FATF changes

## FULL ECONOMIC ASSESSMENT

Price Base Year N/A	PV Base Year N/A	Time Period N/A	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	High: Optional	Best Estimate: N/A (all non-monetised)
<b>COSTS (£m)</b>	<b>Total Transition</b> (Constant Price) Years		<b>Average Annual</b> (excl. Transition) (Constant Price)	<b>Total Cost</b> (Present Value)	
Low	Optional		Optional	Optional	
High	Optional		Optional	Optional	
Best Estimate	N/A		N/A	N/A	
<b>Description and scale of key monetised costs by 'main affected groups'</b>					
There would be no direct monetised costs from not updating the UK's HRTC list to reflect that of the FATF.					
<b>Other key non-monetised costs by 'main affected groups'</b>					
The main non-monetised cost would be the political impact for UK from not removing the four countries who have been removed from the FATF's list due to significant improvements in their AML/CFT controls, particularly the Cayman Islands as a British Overseas Territory. There would also be reputational costs from UK not aligning with the latest information on country risk from the global standard setter.					
<b>BENEFITS (£m)</b>	<b>Total Transition</b> (Constant Price) Years		<b>Average Annual</b> (excl. Transition) (Constant Price)	<b>Total Benefit</b> (Present Value)	
Low	Optional		Optional	Optional	
High	Optional		Optional	Optional	
Best Estimate	N/A		N/A	N/A	
<b>Description and scale of key monetised benefits by 'main affected groups'</b>					
There would be no direct monetised benefits from not updating the UK's HRTC list to reflect that of the FATF.					
<b>Other key non-monetised benefits by 'main affected groups'</b>					
There are no major in-direct benefits from not updating the UK's HRTC list.					
<b>Key assumptions/sensitivities/risks</b>				<b>Discount rate (%)</b>	N/A
N/A.					

## BUSINESS ASSESSMENT (Option 2)

<b>Direct impact on business (Equivalent Annual) £m:</b>			<b>Score for Business Impact Target (qualifying provisions only) £m:</b>
Costs: N/A	Benefits: N/A	Net: N/A	

# Evidence Base

## Problem under Consideration and Rationale for Intervention

1. The NCA assesses it is a realistic possibility that over £100 billion is laundered every year through the UK or through UK corporate structures. In particular, the size of the UK's financial and professional services sector, the openness of our economy and the attractiveness of London for investors makes the UK particularly exposed to international money laundering risks.
2. The UK's Money Laundering, Terrorist Financing, and Transfer of Funds (Information on the Payer) Regulations 2017 ('the MLRs') help mitigate these risks by ensuring UK's financial and services sectors<sup>1</sup> have controls in place to detect illicit financial flows, in line with international standards. Under the existing MLRs, regulated sectors are required to apply enhanced due diligence (EDD)<sup>2</sup> for any business relationship with a person established in a high risk third country (HRTC) or in relation to any relevant transaction outside an established business relationship where either of the parties to the transaction is established in a HRTC<sup>3</sup>. The UK's HRTC list was last updated in early 2023 and includes 24 countries<sup>4</sup>.
3. The UK's policy position is to align the HRTC list with that of the global anti money laundering and counter terrorist financing (AML/CFT) standard setter, the Financial Action Task Force (FATF). The FATF updates its list three times per year to identify countries with significant AML/CFT deficiencies. Aligning the UK's list with that of the FATF ensures that regulated sectors have proportionate controls in place when conducting business relationships or transactions involving countries which present a heightened money laundering (ML) or Terrorist Financing (TF) risk.
4. The FATF lists countries based on a thorough, robust, and technical methodology which over 200 countries worldwide have signed up to. Assessment and monitoring is a multi-year process that is conducted by highly specialised expert assessors and reviewers from a range of countries who are afforded in-depth access to comprehensive data, written submissions and privileged information to inform their conclusions. All assessments and ongoing monitoring reports are then peer reviewed through extensive multilateral discussions of national expert representatives, including the UK, to ensure quality and consistency across countries.
5. This new statutory instrument would update UK's list to bring it up to date with that of the FATF, by reflecting FATF's changes from February, June, and October 2023. Specifically, these changes would add six countries that have been assessed to present a threat to the global financial system through their continued non-compliance with the FATF standards (Bulgaria, Cameroon, Croatia, Nigeria, South Africa, and Vietnam), and remove four countries that have been assessed to have addressed the deficiencies identified in their FATF assessments (Albania, Cayman Islands, Jordan, and Panama)<sup>5</sup>.

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<sup>1</sup> The MLRs apply to approximately 101,098 entities across the following sectors: (a) credit institutions; (b) financial institutions; (c) auditors, insolvency practitioners, external accountants, and tax advisers; (d) independent legal professionals; (e) trust or company service providers; (f) estate agents and letting agents; (g) high value dealers; (h) casinos; (i) art market participants; (j) cryptoasset exchange providers; (k) custodian wallet providers.

<sup>2</sup> Enhanced due diligence refers to gathering additional information on the customer or transactions, including additional information on the beneficial owner, nature of business, source of funds, and reason for the transaction, as well as enhanced ongoing monitoring, and obtaining approval of senior management for establishing or continuing the business relationship.

<sup>3</sup> A relevant transaction for the purposes of this section is defined as any transaction where the relevant person is required to conduct customer due diligence under Regulation 27. This could include carrying out a transfer of funds exceeding the equivalent of €1,000 or entering into a transaction (or series of linked transaction) above a certain threshold with a customer.

<sup>4</sup> Albania, Barbados, Burkina Faso, Cayman Islands, Democratic Republic of the Congo, DPRK, Gibraltar, Haiti, Iran, Jamaica, Jordan, Mali, Mozambique, Myanmar, Panama, Philippines, Senegal, South Sudan, Syria, Tanzania, Turkey, Uganda, United Arab Emirates, Yemen.

<sup>5</sup> As mentioned above, the final list is pending FATF's decision on country listing and de-listing at its October 2023 meeting.

The policy intent behind these changes is to protect UK's regulated sectors from illicit finance threats and to ensure that current controls in place are proportionate to the latest country risks identified.

6. It is important that the UK makes these changes now, as further delays would mean UK requirements are outdated and not in line with the latest information on country risk. The only way to update UK's list is through legislative changes, and the government has committed to aligning the UK's HRTC list with that of the FATF<sup>6</sup>. As we have been updating the UK's list three times per year since 2021, any attempt to introduce an industry-led alternative would be a drastic policy shift, and risk bringing UK out of line with key international partners and government commitments.

## **Rationale and Evidence to Justify the Level of Analysis Used in the IA (proportionality approach)**

7. This IA is assessed to be of medium impact based on:
  - a) The sizeable number of firms who will be impacted by these changes (101,098 entities in total subject to the MLRs as of 2021-22), but also;
  - b) The narrow and targeted nature of the updates being made to the existing HRTC requirements (i.e., to update the list of countries to align with that of the global AML/CFT standard setter, rather than change the underlying requirements themselves);
  - c) The fact that the changes are neither novel nor contentious, given that the government has routinely been updating the HRTC list for the last two years to reflect that of the FATF, and that HMT's informal engagement with regulated sectors has highlighted their preference for continued alignment with the international standard setter;
  - d) The high probability that the changes will meet their intended policy objective of ensuring UK AML/CFT regulations are proportionate to the latest information on country risk, to reduce the risk of overseas illicit financial flows being laundered through the UK's financial and services sectors; and
  - e) The fact that informal feedback from banks shows that some international firms are already applying some enhanced due diligence measures to the six countries being added to UK's list.
8. Prior to this SI, Impact Assessments for changes to the UK's HRTC list were informed exclusively by proxy data on the number of HRTC nationals living in the UK and the number of UK companies operating in HRTCs. Since then, we have taken proactive steps in Q2-Q3 of 2023 to address the lack of data by gathering information from the only sub-sector which holds some information on the volume of HRTC customers and transactions - the largest banks. Specifically, we collected data from a sample of eleven major multinational banks on the number of customers and occasional transactions with Nigeria and South Africa (which are the two most material countries due to be added to UK's list in terms of their economic size and ties to the UK)<sup>7</sup>. We have also held outreach sessions and calls with the main financial and non-financial supervisors and regulated sector representatives to test our assumptions and conclusions from this Impact Assessment. Thirdly, to strengthen our impact assessment we also collected new data from the Bank of England on CHAPs or (Clearing House Automated

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<sup>6</sup><https://hansard.parliament.uk/Commons/2021-04-26/debates/3694E1EE-2CFE-41A7-8F2E-7FFE083861F4/FinancialServices>

<sup>7</sup> This data was provided following a call through UK Finance, the trade association for the UK banking and financial services sector, to all their members. Feedback from the banks suggests this information took a long time to compile, and was not easily accessible, which is why we limited the request to the two most material countries.

Payments) transactions by HRTCs to give more context on the likely volume of transactions with different countries.

9. To reflect the medium impact of these changes, this impact assessment is also informed by data and estimates from the Foreign, Commonwealth and Development Office (FCDO)<sup>8</sup>, as well as publicly available data on business, trade, and immigration links with HRTCs.
10. On the cost of enhanced due diligence, we have relied on informal estimates offered during the 4MLD consultation in 2017 and updated these to account for inflation. While we have confirmed this assumption of compliance costs rising generally in line with inflation with recent industry research<sup>9</sup>, we recognise the need for updated data in this area. On this basis, HMT is engaging with regulated sectors to better quantify the cost of customer due diligence and other AML/CFT requirements, which will help inform future impact assessments in this area
11. To address other data gaps where supervisors and private sector actors do not collect information (e.g., on the number of HRTC customers or occasional transactions at a firm or sector level other than for Nigeria and South Africa), the government has drawn on proxies – including data on the numbers of HRTC nationals/ and companies operating in the UK, the number of UK nationals living in HRTCs, as well as CHAPS bank-to-bank transactions data per country. Over the longer-term, the government will continue working to improve data in this area, to help inform future impact assessments.

## Policy Objective & Options Considered

12. The policy objective is to ensure AML/CFT controls across regulated sectors are reflective of the latest information on country ML/TF risks, to reduce the risk of overseas illicit financial flows being laundered through the UK's financial and services sectors. This will help protect the UK's reputation as a safe place to conduct business and maintain confidence in the financial system, thereby generating more opportunities for inward investment and growth.
13. The secondary policy objective is to align the UK's list of HRTCs with those countries identified by the FATF, the global AML/CFT standard setter for strategic shortcomings in their AML/CTF controls, given the FATF's robust and consistent methodology in identifying these jurisdictions.
14. The UK's list of HRTCs is currently set out in Schedule 3ZA of the MLRs and contains 24 countries. Schedule 3ZA, and therefore the list of HRTCs, can only be amended by bringing forward secondary legislation. Though the FATF lists are publicly available, firms are not legally obliged to update their approach in respect of certain jurisdictions, so long as the list set out in legislation differs.
15. **Option 1** – Legislate to meet the above policy objectives, by updating the UK's HRTCs list in line with that of the FATF. These changes would only update the list to reflect country additions and removals agreed by FATF throughout 2023. This is a continuation of an existing policy of alignment with the FATF, which the UK has followed since leaving the European Union. Updating the list ensures that the UK's regulated sectors are applying enhanced scrutiny and due diligence to customer relationships and transactions with the latest HRTCs, given the increased ML/TF threat that these countries face.
16. **Option 2 (the 'do nothing option')** – The do-nothing option would be to leave the UK's HRTC list as is, rather than reflect changes agreed by the FATF. This would be a shift

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<sup>8</sup> The Foreign Commonwealth & Development Office does not routinely ask British nationals overseas to register their presence in any of these countries. Therefore, the FCDO inputs are low confidence figures from the best available data sources.

<sup>9</sup> Lexus Nexus recent cost of compliance report suggests that in the past three years, firms reported that financial crime compliance costs have increased broadly in line with business inflation (up by 5.4%).



in UK's alignment policy, given we have routinely brought forward changes in recent years to reflect FATF updates (7 pieces of secondary legislation since March 2021). This would not meet the above policy objective of ensuring the UK's HRTC requirements are reflective of identified risks. Instead, it would mean the regulated sector would need to continue applying enhanced due diligence for four countries that FATF has recognised as making significant improvements in their AML/CFT regime. Similarly, regulated sectors would not need to apply enhanced due diligence for six countries that FATF has identified as having major deficiencies in their AML/CFT regimes.

17. Option 1 is the government and the private sector's preferred option.

## **Description of Implementation Plan for Preferred Option**

18. The changes would be given effect through secondary legislation to update Schedule 3ZA (the HRTC list) in the MLRs. As with all previous updates to the list, the changes would come into effect the day after the SI is laid via the made affirmative procedure. This urgency reflects the increased ML/TF risk associated with delaying the addition of new countries to the list, and use of the affirmative procedure is required by the relevant primary legislation (the Sanctions and Anti-Money Laundering Act 2017). This is particularly important given there have already been delays in reflecting the FATF changes from February and June 2023. These delays have arisen due to the need for the government to collect additional data to inform a full impact assessment for the first time, given the significant materiality of two of the countries being added to the list.

19. To ensure that regulated sectors have sufficient time to prepare for these changes, the government will update regulated sectors on the upcoming changes in advance via an advisory notice. We have also engaged informally with financial and non-financial supervisors and UK Finance - the largest industry representative for the banking and financial services sector – on the timeframe for the upcoming changes. Notably, as regulated sectors are already applying enhanced due diligence for the 24 countries currently on UK's list, this change would just require firms to update the relevant countries rather than wider changes. Similarly, it is likely that some of the larger regulated firms, for example multinational banks, are already applying enhanced due diligence for some of the countries yet to be added to the list, given that the MLRs already include a general, but less prescriptive, requirement for firms to consider geographical risk factors when assessing the level of customer due diligence to apply.

20. The changes will be monitored by supervisors as part of wider and existing enforcement of HRTCs and MLRs requirements. The UK has 25 AML/CFT supervisors: three statutory supervisors (the FCA, HMRC and the Gambling Commission) and 22 legal and accountancy Professional Body Supervisors (PBSs). HM Treasury is responsible for ensuring the effectiveness of the AML/CFT supervisory regime, and engages regularly with the supervisors, either bilaterally, or through several fora which exist to support supervisory cooperation and engagement. As such supervision and enforcement is already done at a general level, rather than based on the specific countries on the list, these changes would not create any additional supervision or enforcement activity. Indicators of success will be that regulated sectors are generally applying HRTC requirements as they should, and that this is in turn leading to an increase in identification of potential criminal activity<sup>10</sup>.

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<sup>10</sup> While it is possible to measure general compliance with HRTC compliance, it would be more challenging to measure the extent to which such requirements are directly leading to increased detection of suspected criminal activity (given that detection of suspected criminal activity may be due to many factors, which are often not reported to the public sector).

## Monetised and Non-monetised Costs and Benefits of Each Option (including administrative burden)

21. This section discusses the two options and their estimated costs and benefits to businesses, the public sector and society. Based on data collected from AML supervisors in the latest Treasury annual returns covering the period 2021-22, we estimate that at least 101,098 businesses were within the scope of the regulations<sup>11</sup>. This includes: 33,911 accountants, 8,462 legal professionals, 21,500 financial firms (regulated by the Financial Conduct Authority [FCA]), 265 gambling institutions, and 36,960 firms regulated by HMRC (which includes High Value Dealers, Trust and Company Service Providers, and Money Service Businesses not already regulated by FCA).

### Monetised and non-monetised costs

#### Option 1 (updating UK's HRTC list to align with FATF) –

22. Under the current regulations, regulated firms need to carry out enhanced customer due diligence '*in any business relationship with a person established in a high risk-third country or in relation to any relevant transaction<sup>12</sup> where either of the parties to the transaction is established in a high risk third country*'. This covers business relationships and relevant transactions involving:

- a) a legal person incorporated, having its principal place of business or in the case of a financial institution its principal regulatory authority in a listed high-risk third country.
- b) an individual resident in that country, but not merely having been born in that country.

23. Based on the above, the country additions to the UK's HRTC list would exclusively impact those firms with customers established in HRTC or transacting with individuals or companies established in HRTC. This may include UK firms with branches and subsidiaries in HRTCs and therefore their local customers, or UK firms offering services domestically or overseas to HRTC companies and residents.

24. The EDD should include<sup>13</sup>:

- a) 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 occasional transactions; and
- b) obtaining the approval of senior management to establish or continue a business relationship involving a high-risk third country; and
- c) 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.

25. When countries are added or removed from the HRTC list, these requirements apply to new and existing customers within the regulated sector. In addition, branches and subsidiaries of UK regulated firms based in HRTCs need to apply equivalent EDD measures to their customers and transactions. To help ensure the proportionality of

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<sup>11</sup> Notably, while these totals are from 2021-2022, we do not expect a large increase for 2022-2023, given that the totals only increased by 0.2% between 2020-2021 to 2021-2022.

<sup>12</sup> A relevant transaction for the purposes of this requirement is defined as any transaction where the regulated sector is required to conduct customer due diligence under Regulation 27. This could include carrying out a transfer of funds exceeding the equivalent of €1,000 or entering into a transaction (or series of linked transaction) above a certain threshold with a customer.

<sup>13</sup> Notably, under the current MLRs provisions, outside of enhanced due diligence, regulated firms must conduct a minimum level of customer due diligence on all customers and transactions (whether or not they are on the UK's HRTC list). This includes identifying the customer, verifying their identity, and assessing where appropriate the purpose of the intended business relationship or occasional transaction.

these measures, the government has published various advisory notices to clarify that regulated firms can take a risk-based approach when applying EDD to HRTC customers within the constraints of the MLRs requirements. In practice this means firms can prioritise higher-risk customer groups and should consider gathering less or more information, depending on the risk attributed to specific customers or transactions.

26. **Assumptions and proxies:** As noted above, engagement with the private sector, including multinational banks and UK Finance, and the UK's AML/CFT supervisors confirmed that data on customers that will fall in scope of the new HRTCs obligations is not available, and it would be burdensome and disproportionate to produce. Where needed, the impact assessment therefore makes use of assumptions and proxies, informed by engagement with the stakeholders noted above. A list of the assumptions used is given for reference in Annex A, and this was shared with expert stakeholders in the private sector and supervision regime to confirm the assumptions used are reasonable and proportionate for the purposes of this assessment.

27. **Sensitivity analysis:** Given the necessity of using multiple assumptions and proxies to inform this assessment, sensitivity analysis has been conducted using upper and lower figures around our central estimates for each input. Where data sources used provide upper and lower ranges, these have been used, and where not possible, as in the case for the majority of assumptions and proxies, a standard range of +/-25% of the central estimate has been used. The methodology for estimating costs and benefits has been replicated using these upper and lower figures to give final low and high estimates around the central transition and average annual costs, and average annual benefit. It should be noted that the range around the central estimate suggested by this analysis is large, indicating the degree of uncertainty around the figures presented in this assessment. As noted above, HMT is working to improve data availability in this area through further work to analyse the cost of compliance with the MLRs.

28. As result of obligations, the following three direct monetised costs are considered:

- i. the **costs of regulated sectors needing to familiarise themselves with the new HRTC list and related advisory notice.** Notably, the assessment assumes no extra costs from additional training or IT costs, given that firms are already applying and are very familiar with the HRTC requirements.

*Calculations: Familiarisation costs are usually calculated by multiplying the word count with the reading speed, wages, and number of affected parties. For the below calculation, we use the fact that the average reading time is 238 words per minute (wpm) /14280 words per hour<sup>14</sup>, and the median wage for a financial institution managerial compliance officer role is £ 31.93 per hour<sup>15</sup>. On the number of affected parties, we reflect below that at least one individual in each sole practitioner firm will need to read the requirements to familiarise themselves with the new HRTC list, and at least 1-2 compliance officers for other medium and larger firms.*

*Word count = SI (568 words) + average length of updated text in the HRTC public advisory notice (831 words) = 1,399.*

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<sup>14</sup> This estimate is based on research in the Journal of Memory and Language (2019):

<https://www.sciencedirect.com/science/article/abs/pii/S0749596X19300786#:~:text=Abstract,and%20260%20wpm%20for%20fiction>

<sup>15</sup> Based on FCA data on median wage figure for financial institution managers and directors Standard Occupational Classification (SOC) code 1131-

<https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/datasets/occupation4digitsoc2010ashetable14>

Average time to read 1,399 words =  $1,399/14280 = 0.096708683$  hrs (5.8 minutes).

Total familiarisation costs =  $0.096708683 \times 31.93 \times (101,098 \text{ [total number of regulated firms]}^{16} + 74,803^{17} \text{ [number of non-sole practitioner firms]}) = \text{£}543,006.387$

**BEST ESTIMATE FOR TOTAL FAMILIARISATION COSTS FOR ALL CHANGES = £0.54 million.**

*High/low estimates:* the above calculations are replicated, using the 75<sup>th</sup> and 25<sup>th</sup> percentile figures for the average hourly pay for a financial institution managerial compliance officer role (£47.69 and £21.12 per hour respectively), +/-25% on the central assumption of 175,901 compliance officers across both regulated companies and sole traders (219,876 and 131,926), and the lower and upper ranges for reading speed given in the Journal of Memory and Language article (10,500 and 18,000 words per hour)<sup>18</sup>.

High estimate for total familiarisation cost =  $(1,399/10,500) \times 47.69 \times 219,876 = \text{£}1,379,145$

Low estimate for total familiarisation cost =  $(1,399/18,000) \times 21.12 \times 131,926 = \text{£}213,769$

ii. **the cost of firms needing to apply enhanced due diligence to existing HRTC customers established in a HRTC.**

Once the changes come into effect, firms will need to conduct EDD on any existing natural or corporate customers established/resident in HRTCs (who have not already been subject to the full range of EDD checks for other reasons<sup>19</sup>). As mentioned above, these costs would most significantly impact firms with branches and subsidiaries in HRTCs, followed by those facilitating frequent transactions with individuals/companies established in HRTC, and where services are offered to such HRTC customers based anywhere in the world.

**Cost of Enhanced Due Diligence:** Calculating the cost of EDD is based on the average cost of conducting CDD measures, which is estimated to be between £3-£15, based on informal estimates offered during consultations in 2017 on transposition of the 4<sup>th</sup> EU AML Directive into UK law. Based on general feedback from supervisors and the expanded requirements for EDD, it is assumed that EDD measures are between 1.5-2 times as expensive as CDD, giving a range of £5.25-£26. Given the passage of time since these 2017 estimates were offered, we have updated the figures below to account for Consumer Price Index Inflation (using ONS and BoE figures)<sup>20</sup>. Further work on the cost of CDD and EDD is taking place as part of the ongoing MLRs consultation which should allow these estimates to be further tested and updated, if appropriate.

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<sup>16</sup>This figure is from the Annual Supervisory Returns for 2022.

<sup>17</sup> This figure is from the Annual Supervisory Returns for 2022.

<sup>18</sup> The upper bound for reading speed was used to calculate the lower bound for familiarisation costs, and the lower bound for reading speed used to calculate the upper bound for familiarisation costs.

<sup>19</sup> See section on estimating counterfactual costs below.

<sup>20</sup>This assumption that financial crime compliance costs have increased broadly in line with business inflation is supported by a recent industry studies.

CPI adjusted	EDD lower	EDD upper	EDD mid-point
2017	£5.25	£26	£15.63
2022	£6.38	£31.61	£19

Table 1 - Estimates for cost of EDD

For the below calculations, the mid-point estimate for EDD cost is used to calculate a central estimate, with upper and lower estimates used for sensitivity analysis.

*Calculations:* To estimate the cost for existing HRTC customers, the average number of existing HRTC customers for South Africa and Nigeria (based on data provided by a sample of banks) is multiplied by the average cost of EDD and the number of impacted firms. Despite engaging with the private sector it was not possible to confirm the number of regulated firms with HRTC customers, so the number of financial firms with overseas operations is used as a suitable proxy. The calculation for South Africa is shown below as an example.

Transition cost for conducting EDD on existing customers relating to South Africa (£) = 7,400.77 (per firm average number of customers established in South Africa) X 19 (average EDD cost per customer) X 425 (FCA-regulated firms which reported overseas operations) = 44,602,262.50

A sample of banks provided data for South Africa and Nigeria as the two most material countries to be added to UK's HRTC list. Given it would have been disproportionate and burdensome for them to collect data for other countries being listed, proxies were used to calculate transition and annual costs<sup>21</sup>. This gives an assumption for the total number of customers relating to each jurisdictions, and a multiplier of 3 has been used to reflect the possibility each customer may use multiple regulated entities. This reflect informal engagement with industry/supervisors shows that it would be only a small minority of non-financial firms that would have regular HRTC customers<sup>22</sup>. An example for Bulgaria is given below and total transition costs for all 6 jurisdictions are given in table 2 below.

Transition cost for conducting EDD on existing customers relating to Bulgaria (£) = 96,700 (total estimated existing customers resident or established in Bulgaria) X 19 (average EDD cost per customer) X 3 (multiplier to reflect customers using multiple regulated firms in the UK) = 5,511,900.00

- iii. **Thirdly, there would also be direct monetised annual costs for firms from enhanced due diligence from onboarding potential new HRTC customers and/or relevant transactions for the six countries being added.** Relevant

<sup>21</sup> Specifically using: (i) The number of UK nationals living in the HRTCs (as estimated by the FCDO) as regulated firms have confirmed these individuals would be most likely to access UK banking services from HRTCs; and (ii) The number of UK companies operating in HRTCs and HRTC nationals resident in the UK (in the absence of better or alternative data) as proxies for calculating how many entities and individuals established in HRTC are likely to access UK regulated services or to transact with persons established HRTC. Importantly, the HRTC requirements do not apply to HRTC nationals living in the UK, nor to UK businesses operating in HRTCs, but we have used these data points as proxies as we do not have data on the number of HRTC companies operating in the UK or the number of HRTC residents accessing UK financial or non-financial services.

<sup>22</sup> Based on informal estimates provided by one of the largest Professional Body Supervisors, across approximately 6,400 regulated firms, there are only a handful of branches in HRTCs (approx. 5). Furthermore, we have accounted for this gap, by using figures from the largest banks including those with branches and subsidiaries in HRTCs, which is likely to be an overestimate for the sector given many of the 425 firms offering services overseas won't have subsidiaries and branches in HRTCs.

transactions are those above certain thresholds conducted outside of an established business relationship<sup>23</sup>. Most sectors focus on establishing longer term business relationships and feedback from the banks noted that the majority do not conduct transaction outside of business relationships<sup>24</sup>, however there may be some occasions where financial and non-financial sectors apply such transactions (e.g., an art dealer or High Value Dealers (HVDs) in UK selling something as a one-off to someone in a HRTC, or an Money Service Businesses (MSBs) or foreign currency exchange provider facilitating a one-off transaction).

***Calculations:** To calculate the annual EDD cost of **new business relationships with HRTC customers** for South Africa and Nigeria, the data provided by the sample of major/large international banks on their estimated new customers per year with those countries is multiplied by the average cost of EDD and by the number of impacted firms. As for transition costs the number of financial firms offering overseas services is used as a suitable proxy for the number of firms affected by HRTC requirements.*

*As for transition costs, it would have proved burdensome for banks to provide firm-level data for the other countries being listed, so instead it is assumed that new customers per year typically represent around 2% of existing customer figures as in the data provided by banks for Nigeria and South Africa. As for transition costs, this is an estimate for total customers linked to each of the 4 jurisdictions, not a per firm average, so rather than using the total of expected affected firms, a multiplier of 3 is used, reflecting that customers may use more than one regulated firm's services.*

*Examples for ongoing EDD costs for new business relationships are given below for South Africa and Bulgaria, and totals for all countries are presented in the table below.*

*Annual ongoing EDD costs for new South Africa business relationships (£) = 73.4 (per firm average number of new customers per year) X 19 (average cost of EDD per customer) X 425 (number of FCA-regulated firms with overseas operations) = 592,411.36*

*Annual ongoing EDD costs for new Bulgaria business relationships (£) = 1,934 (total number of new Bulgaria-linked customer per year) X 19 (average cost of EDD per customer) X 3 (multiplier to reflect customers using multiple regulated firms in the UK) = 110,238.00*

*In the absence of better data, it is assumed that customer growth remains at 2% over the 10-year appraisal period, since that level of customer growth already more than accounts for population growth (roughly 0.4% in recent years). This assumption has been tested with experts in the private sector and supervision regime.*

*To calculate the cost of EDD for **occasional transactions with customers where either of the parties to the transaction is established in a HRTC**, data provided by banks on the average number of transactions with South*

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<sup>23</sup> A relevant transaction for the purposes of this requirement is defined as any transaction where the regulated sector is required to conduct customer due diligence under Regulation 27. This could include carrying out a transfer of funds exceeding the equivalent of €1,000 or entering into a transaction (or series of linked transaction) above a certain threshold with a customer (ranging from €2,000 to 15,000 euros depending on the sector).

<sup>24</sup> Only 30% of the eleven responses from the major banks noted that they conduct occasional transactions.

Africa/Nigeria is multiplied by the average cost for EDD, and the number of affected firms. For the four other countries, CHAPS<sup>25</sup> data is used to determine the likely volume of occasional transactions (by comparing the figures to the South Africa/Nigeria data).

On the number of affected firms for occasional transactions, feedback provided by the banks and supervisors suggests that only 30% of major multinational banks conduct occasional transactions with HRTCs, and around 50% of MSBs, while the percentage of high value dealers and art dealers are likely to be much smaller (>5%). Informal dialogue with supervisors suggests that casinos, accountants, lawyers generally do not conduct transactions outside of established business relationships. The analysis therefore uses the total of 769.5 firms (which is 30% of the 425 financial firms operating overseas, added to 50% of all HMRC regulated MSBs).

Examples for South Africa and Bulgaria are given below, and totals for all countries are given in table 2 below.

Annual ongoing EDD costs for occasional transactions with South Africa (£) = 1,391 (average number of occasional transactions with South Africa) X 19 (average EDD cost per customer) X 769.5 (estimate for number of firms conducting occasional transactions) = 20,347,748.59

Annual ongoing EDD costs for occasional transactions with Bulgaria (£) = 1,391 (average number of occasional transactions with Bulgaria based on proportion of CHAPS data) X 19 (average EDD cost per customer) X 769.5 (estimate for number of firms conducting occasional transactions) = 773,214.45

	Total EDD Transition Cost for Existing Customers (£m)	Total EDD cost for New Customers (£m)	Total EDD cost for Occasional Transactions (£m)
<b>South Africa</b>	44.62	0.59	20.35
<b>Nigeria</b>	59.76	11.08	28.91
<b>Bulgaria</b>	5.51	0.11	0.77
<b>Vietnam</b>	1.56	0.031	0.87
<b>Croatia</b>	0.50	0.010	0.16
<b>Cameroon</b>	0.94	0.018	0.020
<b>Totals</b>	<b>112.88</b>	<b>11.84</b>	<b>51.09</b>

Table 2 - Best estimates for transition and annual EDD costs

**BEST ESTIMATE FOR TOTAL TRANSITIONAL COST (NOT INCLUDING FAMILIRISATION) FOR ALL SIX COUNTRIES = £112.88 million.**

**BEST ESTIMATE FOR TOTAL ANNUAL EDD COST FOR ALL SIX COUNTRIES = £62.93 million.**

Commentary on above figures – It is expected that the total costs for South Africa and Nigeria are generally larger than that of the other four countries given the significant emigration and business ties with these countries. Informal engagement

<sup>25</sup> The Clearing House Automated Payment System (CHAPS) is a sterling same-day system operated by the Bank of England that is used to settle high-value wholesale payments. While the transactions would be much wider than occasional transactions, and other payments systems may be used for relevant transactions (e.g. the Faster Payments System) the data is a suitable proxy of the extent to which UK regulated sectors are transacting with specific countries.

with regulated firms suggests they are aware of the likely additional costs of adding these two countries, particularly for firms that have local branches and subsidiaries.

High/low estimates: the above calculations are replicated, using the upper and lower estimates for the cost of EDD from the 2017 transposition of the EU's 4<sup>th</sup> MLD, adjusted for inflation (£31.61 and £6.38 per customer). There was no range on the available data used for the total number of firms in scope, the total number of existing customers, the total number of new customers, or the average number of occasional transactions so a standard range of +/-25% is used around the central estimate.

	EDD Cost for Existing Customers (£m)		Total EDD cost for New Customers (£m)		Total EDD cost for Occasional Transactions (£m)	
	High	Low	High	Low	High	Low
<b>South Africa</b>	115.93	8.42	1.54	0.11	52.89	3.84
<b>Nigeria</b>	155.35	11.29	28.80	2.09	75.16	5.46
<b>Bulgaria</b>	15.28	0.93	0.31	0.019	2.01	0.15
<b>Vietnam</b>	4.32	0.26	0.086	0.0052	2.27	0.17
<b>Croatia</b>	1.40	0.084	0.028	0.0017	0.42	0.031
<b>Cameroon</b>	2.61	0.16	0.052	0.0032	0.053	0.0038
<b>Totals</b>	<b>294.91</b>	<b>21.14</b>	<b>30.81</b>	<b>2.23</b>	<b>132.81</b>	<b>9.65</b>

Table 3 - High and low estimates for transition and annual EDD costs

**HIGH ESTIMATE FOR TOTAL TRANSITIONAL COST (NOT INCLUDING FAMILIRISATION) FOR ALL SIX COUNTRIES = £294.91 million**

**LOW ESTIMATE FOR TOTAL TRANSITIONAL COST (NOT INCLUDING FAMILIRISATION) FOR ALL SIX COUNTRIES = £21.14 million**

**HIGH ESTIMATE FOR TOTAL ANNUAL EDD COST FOR ALL SIX COUNTRIES = £163.62 million**

**LOW ESTIMATE FOR TOTAL ANNUAL EDD COST FOR ALL SIX COUNTRIES = £11.88 million**

29. **Counterfactual**: As noted above, it is likely that some firms will already be applying EDD to business relationships or occasional transactions with the jurisdictions being added to the HRTC list, as they have already been publicly identified by the FATF as being high risk. The MLRs require regulated firms to consider if any customer relationship or transaction is high risk, and specifically cite assessments by the FATF as credible sources to inform geographic risk assessments in Regulation 33(6)(c). It is not mandatory to apply EDD on business relationships and occasional transactions with any particular country unless it is included on Schedule 3ZA, but if a regulated firm does conclude a customer relationship is high risk, it must apply EDD. This pre-existing application of EDD by regulated firms decreases the impact of listing countries, so should be netted off against the total costs of conducting EDD on existing customers and new customers. It is assumed that compliance officers in firms that are already applying EDD to the relevant countries will still need to read the SI and advisory notice, so there is no saving in familiarisation costs.
30. Multinational banks were asked to provide data on the proportion of customers in the affected countries to which they already applied EDD, but the small sample size and the



range given (2-100% of customers) made the data unsuitable for use in calculating the counterfactual. Instead the analysis uses data collected by the FCA in its REP-CRIM questionnaire. REP-CRIM questionnaires are issued to a subset of the FCA's supervised population, and collect data on firms' intrinsic financial crime risks, including the jurisdictions which each firm considers to be high risk.<sup>26</sup>

31. The analysis uses the proportion of the 1,900 firms that responded to REP-CRIM identifying each of the jurisdictions in question as high risk as a suitable proxy for the proportion of customers that are already subject to EDD. The accuracy of this is uncertain, as it is possible that even if only a small proportion of firms view a jurisdiction as high risk, they may be responsible for a large proportion of customers linked to that jurisdiction. However, it is deemed to be a reasonable assumption for this assessment, and as with other key assumptions has been tested with experts in the private sector and supervision regime. The proportion of respondents identifying each jurisdiction being listed is shown in table 4 below.

<b>Jurisdiction</b>	<b>Proportion of 1,900 respondents to REP-CRIM identified jurisdiction at high risk (%)</b>
South Africa	5.8
Nigeria	18.7
Bulgaria	2.2
Vietnam	13.9
Croatia	1.9
Cameroon	11.2

*Table 4 - Proportion of respondents to FCA's REP-CRIM questionnaire identifying jurisdictions as high-risk*

Calculations: To calculate the counterfactual the calculations for EDD cost for existing customers, EDD cost for existing customers, and EDD cost for occasional transactions are repeated using the assumed proportion of customers and occasional transactions which are already subject to EDD. An example for South Africa is shown below, and totals for all countries in table 5 below.

Transition cost avoided for South Africa where EDD is already applied to a proportion of customers (£) = 0.058 (proportion of customers assumed to already be subject to EDD) X 7,400.77 (per firm average number of customers established in South Africa) X 19 (average EDD cost per customer) X 425 (FCA-regulated firms which reported overseas operations) = 2,582,236.25

Existing EDD costs for South Africa business relationships (£) = 0.058 (proportion of customers assumed to already be subject to EDD) X 73.4 (per firm average number of new customers per year) X 19 (average cost of EDD per customer) X 425 (number of FCA-regulated firms with overseas operations) = 34,359.86

Existing EDD costs for South Africa occasional transactions (£) = 0.058 (proportion of customers assumed to already be subject to EDD) X 1,391 (average number of occasional transactions with South Africa) X 19 (average EDD cost per customer)

<sup>26</sup> <https://www.fca.org.uk/data/financial-crime-analysis-firms-2017-2020#f-chapter-id-key-observations-firms-views-on-jurisdiction-risk>

X 769.5 (estimate for number of firms conducting occasional transactions) = 1,180,169.42

	<b>EDD Cost avoided for Existing Customers (£m)</b>	<b>Existing EDD cost for new customers <u>and</u> occasional transactions (£m)</b>
<b>South Africa</b>	2.58	1.21
<b>Nigeria</b>	11.17	7.67
<b>Bulgaria</b>	0.12	0.019
<b>Vietnam</b>	0.21	0.13
<b>Croatia</b>	0.010	0.0033
<b>Cameroon</b>	0.11	0.0044
<b>Totals</b>	<b>14.10</b>	<b>8.84</b>

Table 5 - Best estimates for transition cost avoided and existing annual EDD costs

**BEST ESTIMATE FOR TOTAL TRANSITIONAL COST (NOT INCLUDING FAMILIRAIASATION) FOR ALL SIX COUNTRIES, NETTING OFF COUNTERFACTUAL = £98.78 million.**

**BEST ESTIMATE FOR TOTAL ANNUAL EDD COST FOR ALL SIX COUNTRIES, NETTING OFF COUNTERFACTUAL = £54.09 million.**

*High/low estimates:* the above calculations for counterfactuals are replicated, using a +/- 25% range around the assumed proportions of customers already subject to EDD in table 5, and the high and low estimates for EDD cost for existing customers, EDD cost for existing customers, and EDD cost for occasional transactions shown in table 3. The resulting high and low estimates for EDD cost avoided for existing customers, and the existing cost for new customers and occasional transactions in shown in table 6 below.

	<b>EDD Cost avoided for Existing Customers (£m)</b>		<b>Existing EDD cost for new customers <u>and</u> occasional transactions (£m)</b>	
	<b>High</b>	<b>Low</b>	<b>High</b>	<b>Low</b>
<b>South Africa</b>	8.39	0.37	3.94	0.17
<b>Nigeria</b>	36.28	1.58	24.28	1.10
<b>Bulgaria</b>	0.42	0.015	0.063	0.0027
<b>Vietnam</b>	0.75	0.027	0.41	0.018
<b>Croatia</b>	0.034	0.0012	0.011	0.00047
<b>Cameroon</b>	0.37	0.013	0.015	0.00059
<b>Totals</b>	<b>45.88</b>	<b>1.99</b>	<b>28.72</b>	<b>1.25</b>

Table 6 - High and low estimates for transition cost avoided and existing annual EDD costs

To give the best estimate of the range around central estimates for total transitional cost and total annual EDD cost, the high estimate for the counterfactual is netted off against the low estimate for total cost, and the low estimate for the counterfactual is netted off against the high estimate for total cost.

**HIGH ESTIMATE FOR TOTAL TRANSITIONAL COST (NOT INCLUDING FAMILIRAIASATION) FOR ALL SIX COUNTRIES, NETTING OFF COUNTERFACTUAL = £292.92 million.**

***LOW ESTIMATE FOR TOTAL TRANSITIONAL COST (NOT INCLUDING FAMILIRAIISATION) FOR ALL SIX COUNTRIES, NETTING OFF COUNTERFACTUAL = £24.74 million.***

***HIGH ESTIMATE FOR TOTAL ANNUAL EDD COST FOR ALL SIX COUNTRIES, NETTING OFF COUNTERFACTUAL = £162.37 million.***

***LOW ESTIMATE FOR TOTAL ANNUAL EDD COST FOR ALL SIX COUNTRIES, NETTING OFF COUNTERFACTUAL = £16.84 million.***

32. **Enforcement or compliance costs from option 1:** as mentioned above there would be no monetised or non-monetised additional costs for supervisors or from non-compliance for industry, as supervisors are already enforcing HRTC requirements, and these are enforced on a general level rather than for specific countries.
33. **Non-monetised costs from option 1:** there may be some indirect non-monetised costs to HRTC customers if regulated sector firms decide to transfer some of the additional EDD costs over to clients or decide to change the nature or extent of business relationships with HRTC customers due to the added cost of doing enhanced due diligence. Nevertheless, given that countries are on the UK and FATF's list on average for only 2-3 years<sup>27</sup>, and any EDD costs for customers would be depending on individual commercial decisions by firms, we do not expect such costs to be widespread.
34. In addition, the government is taking steps to strengthen requirements around account closures to give customers more opportunities to challenge any closures. For example, on 21 July 2023 the government published a policy statement that set out its plans to strengthen requirements relating to payment account contract terminations. It is proposed that these changes will increase the minimum notice period in cases of contract termination to 90 days – giving customers more time to challenge a decision through the Financial Ombudsman Service or find a replacement bank. The government will publish further information on these changes in due course, and will publish the necessary impact assessments alongside any legislation required to implement changes. The analysis in the IA therefore does not take these possible future changes into consideration.

Option 2 (do nothing – i.e., do not update UK's list to align with FATF) –

35. There **would not be any direct monetised costs of option 2** - not updating the UK's HRTC list to align with that of the FATF. The main **non-monetised cost** would be the political impact for UK from not removing the four countries who have been removed from the FATF's list due to significant improvements in their AML/CFT controls, particularly the Cayman Islands as a British Overseas Territory.

**Monetised and non-monetised benefits**

Option 1 (updating UK's HRTC list to align with FATF) –

36. There **would not be any transitional benefits** of updating the UK's list given that the transitional costs for the four countries being removed is a sunk cost.
37. However, **there would be direct monetised annual benefits from removing the four countries for the UK's list**, as regulated firms would no longer need to conduct ongoing

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<sup>27</sup> Based on data provided by the FATF Secretariat.

EDD on new HRTC customers from the four countries, nor would they need to do EDD on any occasional transactions where either of the parties is established in those countries.

*Calculations:* To calculate the annual benefits for the four countries due to be removed, the assessment uses the same formula as above for calculating annual costs. For example, to calculate the EDD saving for new HRTC customers, the average number of new HRTC customers (based on 2% of existing customer figures) is multiplied by the average EDD cost, and the number of affected firms (i.e., the total number of financial firms that reported to FCA to be operating overseas).

Similarly, to calculate the saving from EDD on occasional transactions, data provided by the banks on occasional transaction figures for Nigeria and South Africa along with CHAPS data for Cayman Islands, Panama, Albania, and Jordan is multiplied by the average EDD cost and number of affected firms (769.5 based on 30% of multinational financial firms, and 50% of all HMRC regulated money service business). This gives the totals for each country shown in table 7.

	<b>Total Savings from not applying EDD on New HRTC Customers (£m)</b>	<b>Total Savings from not applying EDD on HRTC Occasional Transactions (£m)</b>
<b>Cayman Islands</b>	0.060	2.65
<b>Panama</b>	0.0021	0.041
<b>Jordan</b>	0.021	1.00
<b>Albania</b>	0.17	0.28
<b>Totals</b>	<b>0.25</b>	<b>3.97</b>

*Table 7 - Best estimates for savings from no longer conducting EDD on customers and occasional transactions*

**BEST ESTIMATE FOR TOTAL ANNUAL EDD SAVING FOR ALL FOUR COUNTRIES = £4.22million**

*High/low estimates:* as for costs, analysis was repeated using upper and lower ranges to understand uncertainty around the central estimates, given the necessary use of assumptions and proxies. As with many of the data sources for costs, no range data was available so a standard range of +/-25% was used around the assumed number of customers linked to each country, the number of occasional transactions, and the number of relevant firms. The same upper and lower estimates for the cost of EDD per customer were used. High and low estimates for the total savings from not applying EDD on new HRTC customers and occasional transactions for each country is shown in table 8 below.

	<b>Total Savings from not applying EDD on New HRTC Customers or HRTC Occasional Transactions (£m)</b>	
	<b>High</b>	<b>Low</b>
<b>Cayman Islands</b>	7.04	0.51
<b>Panama</b>	0.11	0.008
<b>Jordan</b>	2.65	0.19
<b>Albania</b>	1.22	0.082
<b>Totals</b>	<b>11.10</b>	<b>0.79</b>

*Table 8 - High and low estimates for savings from not conducting EDD on customers and occasional transactions*

**HIGH ESTIMATE FOR TOTAL ANNUAL EDD SAVING FOR ALL FOUR COUNTRIES = £11.1 million.**

**LOW ESTIMATE FOR TOTAL ANNUAL EDD SAVING FOR ALL FOUR COUNTRIES  
= £0.79 million.**

38. **Counterfactual:** the estimates for costs assume a proportion of customers and occasional transactions for each jurisdiction (equivalent to the proportion of firms which identified each jurisdiction as high risk in FCA’s REP-CRIM survey – see table 9 below) will already be subject to EDD. To ensure the costs and benefits are balanced, this assumption is carried over for benefits, and it is assumed a proportion of customers and occasional transactions will still continue to be subject to EDD after countries have been de-listed. This is likely to be an over-estimate, since de-listing represents a statement from FATF that a country has addressed its strategic AML/CFT deficiencies, but is a reasonable assumptions for the purposes of this assessment. As with other key assumptions it has been tested with experts in the private sector and supervision regime.

	<b>Proportion of 1,900 respondents to REP-CRIM identified jurisdiction at high risk (%)</b>
<b>Cayman Islands</b>	10.4
<b>Panama</b>	19.7
<b>Jordan</b>	5.7
<b>Albania</b>	12.5

Table 9 - Proportion of respondents to FCA's REP-CRIM questionnaire identifying jurisdictions as high-risk

*Calculations:* The counterfactual for benefits represents savings not realised because firms choose to continue to apply EDD to a proportion of customers and occasional transactions. The calculations for benefits above are therefore replicated for the 4 countries being de-listed, using only a proportion of customers and occasional transactions equivalent to those in table 9. These benefits for realised are set out in table 10 below.

	<b>Total savings not realised due to continued EDD on new HRTC customers (£m)</b>	<b>Total savings not realised due to continued EDD on HRTC occasional transactions (£m)</b>
<b>Cayman Islands</b>	0.0062	0.28
<b>Panama</b>	0.00041	0.0081
<b>Jordan</b>	0.0097	0.057
<b>Albania</b>	0.021	0.035
<b>Totals</b>	<b>0.037</b>	<b>3.97</b>

Table 10 - Best estimate for savings not realised due to continued EDD on customers and occasional transactions

**BEST ESTIMATE FOR TOTAL ANNUAL EDD SAVING FOR ALL FOUR COUNTRIES, NETTING OFF COUNTERFACTUAL = £3.82million**

*High/low estimates:* the above calculations for counterfactuals are replicated for the high and low estimates for not applying EDD on new HRTC customers or occasional transactions. As with cost calculations, upper and lower ranges for the proportion of customers and occasional transactions already subject to EDD are estimated using a standard range of +/-25% around the central estimate. The resulting high and low estimates for total annual EDD savings not realised are shown in table 11 below.

	<b>Total Savings from not applying EDD on New HRTC Customers or HRTC Occasional Transactions (£m)</b>	
	<b>High</b>	<b>Low</b>
<b>Cayman Islands</b>	0.92	0.040
<b>Panama</b>	0.027	0.0012
<b>Jordan</b>	0.19	0.0082
<b>Albania</b>	0.19	0.0078
<b>Totals</b>	<b>1.32</b>	<b>0.057</b>

*Table 11 - High and low estimates for savings not realised due to continued EDD on customers and occasional transactions*

*As for costs, to give the best estimate of the range around central estimates for total savings not realised, the high estimate for the counterfactual is netted off against the low estimate for total savings, and the low estimate for the counterfactual is netted off against the high estimate for total savings.*

**HIGH ESTIMATE FOR TOTAL ANNUAL EDD SAVING FOR ALL FOUR COUNTRIES, NETTING OFF COUNTERFACTUAL = £10.96 million.**

**LOW ESTIMATE FOR TOTAL ANNUAL EDD SAVING FOR ALL FOUR COUNTRIES, NETTING OFF COUNTERFACTUAL = £0.52 million.**

Option 2 (do nothing – i.e., do not update UK’s list to align with FATF) -

39. Option 2 would not have any monetised or non-monetised benefits.

**Risks and assumptions**

40. Earlier reviews and Impact Assessments of the MLRs<sup>28</sup> have highlighted the difficulty for government to estimate the cost of due diligence. This is because regulated industries themselves have difficulties with identifying the costs of AML customer due diligence checks. This is partly because customer due diligence checks are integrated into businesses’ commercial activities rather than carried out separately. It is also difficult to isolate the costs to business incurred by changes to the HRTC list, which are intrinsically linked to other costs of compliance with the MLRs and broader economic crime legislation (such as suspicious activity reporting and sanctions compliance).

41. Despite these challenges this impact assessment has sought to take a thorough approach to data collection, and to test assumptions with supervisors and the private sector where possible. A full list of assumptions made is included in Annex A, which was shared with experts in the private sector and supervision regime to ensure the assumptions are reasonable and proportionate for the purposes of this analysis. The key assumptions made, and proxies used, for the above cost calculations include:

- a) **Number of affected parties** – As data on the number of regulated firms that have HRTC customers is not publicly available, a mixture of novel data collection and use of proxies has been pursued. Data on the number of HRTC customers with South Africa and Nigeria was collected from eleven major multinational banks, which allows for more robust calculation of the likely impact on the financial services sector, but these figures are not likely to be accurate or representative for other regulated sectors or firm types (e.g., smaller firms or lawyers or accountants etc). To account for this, the HRTC customer figures for South Africa and Nigeria are multiplied by the number of financial institutions

<sup>28</sup> [https://www.legislation.gov.uk/ukia/2019/172/pdfs/ukia\\_20190172\\_en.pdf](https://www.legislation.gov.uk/ukia/2019/172/pdfs/ukia_20190172_en.pdf)

which have reported to FCA they operate overseas, rather than by the total number of firms regulated by the MLRs. This should reflect a more accurate estimate, given that: (i) not all of the FCA regulated firms that operate overseas will have business in the six HRTCs being added to UK's list; (ii) a relatively smaller proportion of non-financial business (e.g., lawyers, accountants, art dealers etc) are likely to have regular business with HRTCs<sup>29</sup>.

- b) Secondly, given that informal consultations with supervisors confirmed that the vast majority of regulated sectors would only conduct occasional transactions very infrequently, and given that regulated sectors themselves do not collect information on the number or frequency of occasional transactions, we have extrapolated out our transaction data for the banking and MSB sectors only, rather than all regulated firms. Similarly, even within these sectors, banking sector data and informal consultations with supervisors showed that only 30% of large multinational banks typically conduct occasional transactions, and around 50% of MSBs.
- c) **Proxies for HRTC customers and occasional transactions** - Thirdly, as data is not available from the banks on customer numbers or occasional transactions with countries other than South Africa and Nigeria, this assessment relies on proxies instead to calculate the figures for Bulgaria, Vietnam, Cameroon, Croatia, Cayman Islands, Panama, Jordan, and Albania. For the volume of natural and legal customers, the number of UK nationals living in the six HRTCs is used (given that these individuals would be most likely to seek the service of a UK bank in that HRTC).<sup>30</sup> The number of UK companies operating in HRTCs is used as a proxy for the number of HRTCs companies accessing UK regulated services (given this data is not available). To account for the fact that HRTC residents may also access services from UK regulated sectors, the number of HRTC nationals living in the UK is used as a proxy (given that data on the exact number of overseas HRTC residents accessing UK regulated services is not available). For the number of occasional transactions, payment volumes for Nigeria and South Africa are extrapolated for other countries by drawing on the frequency of country-by-country CHAPS data.

42. **Sensitivity analysis:** Given the necessary use of assumptions and proxies, a high/low range has been calculated using upper and lower estimates for inputs. In some cases, noted in the discussion on methodology above, these are drawn from the data inputs used, but in the majority of cases no range was available so a standard range around the central estimate of +/-25% is used. The final high/low estimates demonstrate the degree of uncertainty around the central estimates calculated through this assessment.

43. **Counterfactual:** As noted above, it is likely some customers and occasional transactions linked to countries being listed are already subject to EDD, given the countries have been publicly identified by the FATF as being high risk for ML/TF purposes. To estimate the proportion of customers and occasional transactions subject to EDD, it is assumed it is broadly equivalent to the proportion of firms which responded to the FCA's REP-CRIM questionnaire for 2019-20 (the latest year for which data is available) identifying each of the jurisdictions being listed as 'high-risk', since firms are required by the MLRs to apply EDD to high risk business relationships and transactions<sup>31</sup>.

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<sup>29</sup> In addition, it is likely that the transitional costs for the financial firms is an overestimate given that some banks are likely to have already conducted Enhanced due diligence on some existing HRTC customers, and therefore would not need to do the full suite of EDD again. Based on the bank data, banks confirmed that 2-100% of customers are likely to already be subject to some EDD measures.

<sup>30</sup> The Foreign Commonwealth & Development Office does not routinely ask British nationals overseas to register their presence in any of these countries. Therefore, the FCDO inputs are low confidence figures from the best available data sources.

<sup>31</sup> <https://www.fca.org.uk/data/financial-crime-analysis-firms-2017-2020#f-chapter-id-key-observations-firms-views-on-jurisdiction-risk>

44. Overall, while the figures presented in this assessment generally align with totals and country difference expected, given the reliance on proxies in the absence of better data, there is low to medium confidence in the accuracy of the overall quantitative conclusions. To strengthen such IAs going forward, HM Treasury is gathering updated information from regulated sectors on the costs of compliance, which should provide more detailed sector by sector figures.

## Impact on Small, Micro and Medium Sized Businesses

45. Small and Micro businesses and medium-sized enterprises fall within the scope of the Money Laundering Regulations and will therefore be obliged to enact the changes brought forward in this SI. HMT does not explicitly collect data from supervisors specifically on the number of obliged entities that are considered Small and Micro Businesses as defined by the number of employees. However, according to the latest annual returns data from supervisors for 2021 to 2022, 21,26295 of the 101,098 obliged entities (approximately 26%) under the Money Laundering Regulations are sole practitioners, of which the majority (at least 65%) are independent legal and accountancy professionals.

46. HMT has also started collecting data on the size of businesses based on annual revenue for the purposes of administering the Economic Crime Levy, where the annual fixed fee is based on UK revenue in the accounting period ending in the previous financial year, however this data will not be available until later this year and is focused mostly on medium and large businesses. The next available alternative to this data was collected from Professional Body Supervisors in the last few years when HMT was developing the Economic Crime Levy, which shows that most firms subject to MLRs are small and micro sized entities.

<b>All in-scope entities<sup>32</sup></b>	<b>Micro sized entities</b>	<b>Small sized entities</b>	<b>Medium/large sized entities</b>
87,870	65,245	18,701	3,936

47. The cost of introducing EDD for new HRTCs is likely to result in relative higher costs to Small and Micro Businesses, than it would for large firms, given such businesses are less likely to rely on automated screening and EDD checks, without specialist resource/departments to manage these requirements. However, based on informal consultations with supervisors and evidence received through the last MLRs review, we understand that independent lawyers and accountants (which make up most of the sole practitioners) are much less likely to conduct occasional transactions, or have subsidiaries or branches in HRTCs. This is due to the nature of their services, since they will almost always enter into a business relationship with a customer. We therefore assess that small and micro business will be most affected in respect of the costs of conducting EDD on existing or new customers.

48. The Money Laundering and Terrorist Financing risks associated with businesses are not necessarily proportionate to the size of the business. Small and Micro Businesses can still be abused for illicit purposes and may be specifically targeted if they are thought to have weaker due diligence procedures. This is why the MLRs, guided by the FATF standards, do not allow for any exemptions based on size of business. Any such exemptions would undermine the policy intent of the measure.

49. However, the MLRs do recognise the need for proportionality, and the legal requirement for businesses to have policies, controls, and procedures to mitigate and effectively

<sup>32</sup> The reason why the total number of entities is lower here than figures above for 2021-2022 is because this data is from an earlier year (estimated to be 2019-2020).



manage their risks of money laundering and terrorist financing (Regulation 19) stipulates that those controls must be “proportionate with regard to the size and nature of the relevant person's business”. This allows smaller firms, particularly those undertaking low risk activity, to tailor their due diligence procedures to some extent, lowering the costs imposed.

50. To help further mitigate some of the challenges for all firms, but particularly smaller and medium firms, HMT will publish an advisory notice prior to the changes coming into effect, which will re-iterate the flexibility for firms to apply a proportionate approach for EDD within the constraints of the HRTC requirements. Supervisors (The Joint Money Laundering Steering Group (JMLSG), FCA, HMRC, the Gambling Commission and the legal and accountancy sectors) have also published guidance containing detailed and accessible information on compliance requirements, including EDD in respect of HRTC customers and transactions.
51. There is limited scope to apply additional mitigation measures to reduce the impact on small, micro and medium sized businesses. It is important to note that small and micro businesses are already obliged to conduct Enhanced Due Diligence on countries on the UK's list of High Risk Third Countries. Any exemption brought in for these new six countries would be inappropriate, as it would create an inconsistent and imbalanced policy where small and micro businesses would continue to have obligations related to an outdated list and leave the UK open to enhanced risks from the sector. It would also make these firms considerably more attractive to individuals and organisations looking to abuse the UK's financial system to move illicit funds.

### **Wider impacts (consider the impacts of your proposals)**

52. A detailed equalities assessment will be made available alongside this impact assessment via [www.gov.co.uk](http://www.gov.co.uk). Overall, the expected equalities impact of this measure will be that natural and legal persons who are established in a high-risk third country, as well as transactions with them, will be subject to additional due diligence and scrutiny from UK regulated firms when compared to other UK customers. National origin or nationality is not itself a basis for a customer to be treated as “established in” a high risk third country, nevertheless, such individuals may face more impact from the changes, due to their increased likelihood of conducting business with high risk third countries.
53. Another potential impact might be on customers living in the UK who have certain family or other ties to a high risk third country, even if not nationals. For example, these customers may carry out more transactions involving residents of that country than other UK customers or have more interests in UK companies based in that country, which means they will be more impacted by the increased due diligence. The government has sought to mitigate these equalities impacts to some extent by issuing Guidance to regulated firms to clarify that “nationality” in itself is not a basis to be subject to enhanced due diligence, and that within the constraints of the HRTC requirements, firms should consider the intensity with which they undertake due diligence depending on the risk attributed to a customer. We do not expect this change to have any major direct impacts on innovation and competition for the UK domestic market.

### **A summary of the potential trade implications of measure**

54. The measure may have a positive impact on trade and investment by reinforcing the UK's reputation as a safe place to do business. It will mean that the UK's list of HRTCs remains up-to-date and in line with the FATF, the global AML/CFT standard setter. This will ensure that the UK remains responsive to international ML/TF risks by requiring UK regulated sectors to apply proportionate AML/CFT controls.
55. The measure may impose some indirect costs on trade and investment between the UK and those countries added to the HRTC list. Sectors regulated under the MLRs will be

required to apply EDD for customer relationships and transactions with links to countries added to the UK list of HRTCs, including those that relate to trade and investment, which will result in associated costs for conducting this EDD. As explained above, there may be some indirect costs to HRTC customers if regulated sector firms decide to transfer some of the additional EDD costs over to clients or decide to change the nature or extent of business relationships with HRTC customers due to the added cost of doing enhanced due diligence. This practice may be applied to customers involved in trade and investment between the UK and those countries added to the HRTC list, in which case the measure would impose an indirect cost on trade and investment between the UK and those countries added to the HRTC list. To give an example, a UK bank regulated under the MLRs that provides financial services to an export company with links to a HRTC would be required to undertake EDD when establishing a customer relationship with the export company. In this scenario, the UK bank could decide to transfer some of the additional EDD costs over to the export company, which would result in an indirect cost on trade and investment between the UK and those countries added to the HRTC list. The measure will not impose an indirect cost or benefits on trade and investment activity that rely solely on the services of entities that are outside the scope of the MLRs, such as freight forwarding companies or entities regulated under the AML/CFT laws of other countries.

56. The measure may result in some indirect benefits to trade and investment between the UK and those countries removed from the HRTC list. Sectors regulated under the MLRs will no longer be required to apply EDD for customer relationships and transactions with links to countries removed from the UK list of HRTCs, including those that relate to trade and investment, which will result in removing the associated costs of conducting EDD. The measure may result in an indirect benefit where trade and investment activity involves services regulated under the MLRs and regulated sector firms decide to transfer some of the additional EDD costs over to clients or decide to change the nature or extent of business relationships with HRTC customers due to the added cost of doing enhanced due diligence.
57. Entities regulated under the MLRs are responsible for applying EDD and would bear the immediate costs and benefits of the measure. Where regulated entities decide to transfer some of the additional EDD costs on to their customers, this would be dependent on individual commercial decisions by firms and, as explained above, we do not expect such costs to be widespread. This applies more widely to customer relationships and transactions with links to customers on the UK list of HRTCs and we do not expect the costs and benefits of the measure to disproportionately affect trade and investment activity.
58. The overall indirect costs and benefits of the measure on trade and investment would be larger in relation to countries added to the list of HRTCs that have larger trade and investment flows to and from the UK. This is based on the assumption that trade and investment activity requires financial and other regulated services, and that the provision of these services by entities regulated under the MLRs would be proportional to the level of trade and investment. The trade and investment flows to and from the Cayman Islands, South Africa and Nigeria are the greatest, meaning that the indirect costs and benefits on trade and investment of the measure would be greatest in relation to these countries.

<b>Countries Added to the List of HRTCs</b>	<b>Trade in Goods and Services, £bn (Q1 2022-Q1 2023)</b>	<b>Outward Stock of FDI, £bn (2021)</b>	<b>Inward Stock of FDI, £bn (2021)</b>
Bulgaria	3.7	0.3	0.05
Cameroon	0.9	N/A	N/A
Croatia	1.9	0.4	0.1

Nigeria	7.6	3.4	0.8
South Africa	10.3	21.5	7.9

Table 12 - Trade and investment flows between UK and countries being listed

Countries Removed from the List of HRTCs	Trade in Goods and Services, £bn (Q1 2022-Q1 2023)	Outward Stock of FDI, £bn (2021)	Inward Stock of FDI, £bn (2021)
Albania	0.5	N/A	N/A
Cayman Islands	5.2	24.2	2.2
Jordan	1.0	6.6	N/A
Panama	1.3	0.4	1.0

Table 13 - Trade and investment flows between UK and countries being de-listed

Source: <https://www.gov.uk/government/collections/trade-and-investment-factsheets>

59. Some entities regulated under the MLRs may decide to exit relationships with customers involved in trade and investment due to the added cost of EDD. As explained above, we expect such cases to be very rare and therefore not to have a material impact on trade and investment.

## Monitoring and Evaluation

60. The UK has 25 AML/CFT supervisors responsible for ensuring firms in their supervised population are compliant with the requirements of the MLRs<sup>33</sup>. This includes ensuring regulated firms understand the ML/TF risks they are exposed to and that they have suitable processes, controls and procedures to mitigate those risks, including through the application of CDD and EDD in line with the MLRs. This will therefore include the application of EDD with respect to HRTCs and jurisdictions listed in Schedule 3ZA. Supervisors have a range of enforcement powers which can be used where non-compliance is identified, and these powers have been used multiple times regarding the application of suitable controls for high risk jurisdictions<sup>34</sup>.

61. HM Treasury is required to conduct a review of the MLRs at intervals of no less than 5 years, to ensure the requirements set out (beyond just HRTC measures) remain appropriate, proportionate, and effective, and publish a report setting out the review's findings. The most recent report, published in June 2022, represented a comprehensive assessment of the MLRs and the UK's AML/CFT supervision regime<sup>35</sup>. As part of its scope, it looked in detail at the EDD requirements for regulated businesses when entering into business relationships or conducting occasional transactions with HRTCs, and recommended further consultation on specific amendments to the MLRs to ensure burdens on businesses are proportionate to the risk of HRTCs. A dedicated consultation on these changes will be published by HMT, so the impact of potential changes has not been estimated in this assessment.

62. The next review will take place no later than 2027, and while its scope is not yet confirmed it is anticipated that it will follow a similar approach, including looking at the effectiveness of specific requirements relating to HRTCs. To ensure a more robust body of evidence is available for this review, HMT has also committed to undertaking dedicated research on the cost of the regulated sector's compliance with the MLRs. Once complete, this will represent a significant improvement on the current issues with data availability discussed in this document.

<sup>33</sup> The AML/CFT supervisors include the FCA, HMRC, the Gambling Commission, and the Professional Body Supervisors listed in Schedule 1 of the MLRs.

<sup>34</sup> For examples, see the FCA's final notices for enforcement action against Guaranty Trust Bank (UK) Limited (<https://www.fca.org.uk/publication/final-notices/guaranty-trust-bank-uk-limited-2023.pdf>) and Al Rayan Bank PLC (<https://www.fca.org.uk/publication/final-notices/al-ryan-bank-plc-2023.pdf>)

<sup>35</sup> <https://www.gov.uk/government/publications/review-of-the-uks-amlcft-regulatory-and-supervisory-regime>



## **ANNEX A – Full list of assumptions shared with experts in the private sector and supervision regime to ensure they are reasonable and proportionate for the purposes of this assessment.**

### **Familiarisation costs:**

1. Approximately **2 compliance officers** per large and medium firm will need to fully read the SI and latest government notice on HRTCs, and **one compliance officer** for sole practitioners.
2. No additional training or IT costs would arise from additions/removals to the UK's list, given that firms are already applying and are very familiar with the HRTC requirements.

### **Transitional costs:**

3. The majority of firms will only do the full list of prescriptive EDD in regulation 33(3A) once a country is listed. Therefore only a proportion of customers will have been subject to the full suite of EDD measures outlined in regulation 33(3A) prior to the UK adding such countries to its list. It is assumed this proportion is similar to the proportion of firms which identified the jurisdictions being listed as high-risk in their return to the FCA's REP-CRIM questionnaire (i.e. 2% for Bulgaria, 11% for Cameroon, 37% for Croatia, 20% for Nigeria, 6% for South Africa, 14% for Vietnam).
4. Only a small number of non-financial firms are likely to have regular HRTC customers. Estimates from large multinational banks for the number of existing HRTC customers are likely to be an overestimate for most other financial and non-financial sectors.

### **Annual costs:**

5. On average (and excluding changes in business location or strategy) the number of HRTC customers for firms increases at a yearly rate of 2%.
6. In the absence of data from the regulated sector on the number of occasional HRTC transactions with countries being added to UK's list, data on the frequency of CHAPS transactions with specific countries is a good proxy to show the relative volume of likely occasional transactions with those countries.
7. Around 30% of major multinational banks would conduct occasional transactions with HRTCs (e.g., transactions outside of normal business relations), and around 50% of MSBs, while the percentage of high value dealers and art dealers are likely to be much smaller (>5%).
8. The vast majority of firms stop doing the full list of prescriptive EDD in regulation 33(3A) for HRTC customer as soon as a country is de-listed from UK's list. It is assumed proportions equivalent to those set out in Q3 will continue to apply EDD.
9. Given that we do not have data on the number of existing and new HRTC customers for firms for four countries being added to UK's list (Bulgaria, Cameroon, Croatia, Vietnam), we are relying on the following proxies to give an indication of the volume of HRTC customers – e.g. the number of UK nationals living in HRTCs (given these individuals would be most likely to seek the service of a UK bank/regulated firm in that HRTC); the number of UK companies operating in HRTCs (as the best proxy to show the materiality of commercial ties and the likely volume of HRTCs companies accessing services from UK regulated firms); and the number of HRTC nationals living in the UK (as the best proxy to estimate the number of HRTC residents potentially accessing UK regulated services).

## ANNEX B – Supporting Country Specific Data Calculations (not for publication given sensitivity)

### 1. Country specific transitional cost of applying enhanced due diligence to existing HRTC customers.

Average number of existing customers for **South Africa** based on bank data = 5523.5 X £19 (average expected EDD cost) X 425 (number of FCA regulated firms which have reported having overseas operations based on 2022 supervisory return) = £44,602,262.50.

Average number of existing customers for **Nigeria** per firm based on bank data = 7400.77 X £19 (average expected EDD cost) X 425 (number of FCA regulated firms which have reported having overseas operations based on 2022 supervisory return) = £59,761,239.77.

Total estimated number of existing **Bulgarian** customers = 17,500 (Number of UK nationals living in Bulgaria) + 200 (number of UK firms operating in Bulgaria as a proxy for Bulgarian companies operating in UK) + 79000 (number of HRTC nationals living in UK as a proxy for residents in HRTC who may have accessed regulated services in UK) X £19 (average estimated EDD cost) X 3 (to equate for the fact that customers are likely to access more than one regulated service) = £5,511,900.00

Total estimated number of existing **Vietnamese** customers = 5000 (Number of UK nationals living in Vietnam) + 350 (number of UK firms operating in Vietnam as a proxy for Vietnamese companies operating in UK) + 22000 (number of HRTC nationals living in UK as a proxy for residents in HRTC who may have accessed regulated services in UK) X £19 (average estimated EDD cost) X 3 (to equate for the fact that customers are likely to access more than one regulated service) = £1,558,950.00.

Total estimated number of existing **Croatia** customers = 800 (Number of UK nationals living in Croatia) + 40 (number of UK firms operating in Croatia as a proxy for Croatian companies operating in UK) + 8000 (number of HRTC nationals living in UK as a proxy for residents in HRTC who may want to access services in UK) X £19 (average estimated EDD cost) X 3 (to equate for the fact that customers are likely to access more than one regulated service) = £503,880.00.

Total estimated number of **Cameroon** customers = 500 (Number of UK nationals living in Cameroon) + 12 (number of UK firms operating in Cameroon as a proxy for Cameroon companies operating in UK) + 16000 (number of HRTC nationals living in UK as a proxy for residents in HRTC who may want to access services in UK) X £19 (average estimated EDD cost) X 3 (to equate for the fact that customers are likely to access more than one regulated service) = £941,184.00.

**TOTAL TRANSITIONAL EDD COST FOR ALL SIX COUNTRIES = £ 112.88 million.**

### 2. Country specific annual costs of applying EDD to new HRTC customers.

Annual ongoing costs for adding **South Africa** = 73.36 (Average new customers per year resident or established in South Africa based on data provided by major international banks) X £19 (average estimated EDD cost) X 425 (number of FCA regulated firms which have overseas operations according to FCA data) = £592,411.36.

Annual ongoing costs for adding **Nigeria** = 1371.81 (Average new customers per year resident or established in Nigeria based on data provided by major international banks) X £19 (average estimated EDD cost) X 425 (number of FCA regulated firms which have overseas operations according to FCA data) = £11,077,431.82.

Annual ongoing cost for adding **Bulgaria** = 1934 (average number of new customers per year based on 2% of existing customers) X £19 (average estimated EDD cost) X 3 (to equate for the fact that customers are likely to access more than one regulated service) = £110,238.00.

Annual ongoing cost for adding **Vietnam** = 547 (average number of new customers per year based on 2% of existing customers) X 19 (average estimated EDD cost) X 3 (to equate for the fact that customers are likely to access more than one regulated service) = £ 31,179.00.

Annual ongoing cost for adding **Croatia** = 176.8 (average number of new customers per year based on 2% of existing customers) X 19 (average estimated EDD cost) X 3 (to equate for the fact that customers are likely to access more than one regulated service) = £ 10,077.60.

Annual ongoing cost for adding **Cameroon** = 330 (average number of new customers per year based on 2% of existing customers) X 19 (average estimated EDD cost) X 3 (to equate for the fact that customers are likely to access more than one regulated service) = £ 18,823.68.

### 3. Country specific annual costs of applying EDD to occasional transactions.

Average number of occasional transactions with **South Africa** based on bank data (1391.7 occasional transactions) X £19 (average estimated EDD cost) X 769.5 (30% of the total 425 total FCA regulated firms operating overseas + 50% of the total 1284 HMRC supervised Money Service Businesses) = £20,347,748.59.

Average number of occasional transactions with **Nigeria** based on bank data (1977.545 occasional transactions) X 19 (average estimated EDD cost for occasional transaction) X 769.5 (30% of the total 425 total FCA regulated firms operating overseas + 50% of the total 1284 HMRC supervised Money Service Businesses) = £28,912,703.32.

Average number of occasional transactions with **Bulgaria** drawing on comparison of Nigeria South Africa transaction figures and CHAPs data (52.88 occasional transactions) X 19 (average estimated EDD cost) X 769.5 (30% of the total 425 total FCA regulated firms operating overseas + 50% of the total 1284 HMRC supervised Money Service Businesses) = £773,214.45.

Average number of occasional transactions with **Vietnam** drawing on comparison of Nigeria South Africa transaction figures and CHAPs data (59.84 occasional transactions) X 19 (average estimated EDD cost) X 769.5 (30% of the total 425 total FCA regulated firms operating overseas + 50% of the total 1284 HMRC supervised Money Service Businesses) = £874,953.19.

Average number of occasional transactions with **Croatia** drawing on comparison of Nigeria South Africa transaction figures and CHAPs data (11.1 occasional

transactions) X 19 (average estimated EDD cost) X 769.5 (30% of the total 425 total FCA regulated firms operating overseas + 50% of the total 1284 HMRC supervised Money Service Businesses) = £162,781.99.

Average number of occasional transactions with **Cameroon** drawing on comparison of Nigeria South Africa transaction figures and CHAPs data (2 occasional transactions) X 19 (average estimated EDD cost) X 769.5 (30% of the total 425 total FCA regulated firms operating overseas + 50% of the total 1284 HMRC supervised Money Service Businesses) = £20,347.75.

**TOTAL ANNUAL EDD COST FOR ALL SIX COUNTRIES = £62,931.910.74.**

#### 4. Country specific annual saving from not having to apply EDD to new HRTC customers

Annual monetised benefits of removing **Cayman Islands** = 1054 (average number of new customers per year based on 2% of existing customers) X 19 (average estimated EDD cost) X 3 (to equate for the fact that customers are likely to access more than one regulated service) = £60,078.00.

Annual monetised benefits of removing **Panama** = 36 (average number of new customers per year based on 2% of existing customers) X 19 (average estimated EDD cost) X 3 (to equate for the fact that customers are likely to access more than one regulated service) = £2,053.14.

Annual monetised benefits of removing **Jordan** = 360.6 (average number of new customers per year based on 2% of existing customers) X 19 (average estimated EDD cost) X 3 (to equate for the fact that customers are likely to access more than one regulated service) = £20,554.20.

Annual monetised benefits of removing **Albania** = 3009.74 (average number of new customers per year based on 2% of existing customers) X 19 (average estimated EDD cost) X 3 (to equate for the fact that customers are likely to access more than one regulated service) = £171,555.18.

#### 5. Country specific annual saving from not having to apply EDD to occasional HRTC transactions

Average number of occasional transactions with **Cayman Islands** drawing on comparison of Nigeria South Africa transaction figures and CHAPs data (180.9 occasional transactions) X 19 (average estimated EDD cost) X 769.5 (30% of the total 425 total FCA regulated firms operating overseas + 50% of the total 1284 HMRC supervised Money Service Businesses) = £2,645,207.32.

Average number of occasional transactions with **Panama** drawing on comparison of Nigeria South Africa transaction figures and CHAPs data (3 occasional transactions) X 19 (average estimated EDD cost) X 769.5 (30% of the total 425 total FCA regulated firms operating overseas + 50% of the total 1284 HMRC supervised Money Service Businesses) = £40,695.50.

Average number of occasional transactions with **Jordan** drawing on comparison of Nigeria South Africa transaction figures and CHAPs data (68.2 occasional transactions) X 19 (average estimated EDD cost) X 769.5 (30% of the total 425 total FCA regulated firms operating overseas + 50% of the total 1284 HMRC supervised Money Service Businesses) = £997,039.68.



*Average number of occasional transactions with Albania drawing on comparison of Nigeria South Africa transaction figures and CHAPs data (19.5 occasional transactions) X 19 (average estimated EDD cost) X 769.5 (30% of the total 425 total FCA regulated firms operating overseas + 50% of the total 1284 HMRC supervised Money Service Businesses) = £284.868.48.*

**TOTAL ANNUAL EDD SAVING FOR ALL FOUR COUNTRIES = £4,222,051.50.**