

EXPLANATORY MEMORANDUM TO
THE MONEY LAUNDERING AND TERRORIST FINANCING (AMENDMENT)
REGULATIONS 2023

2023 No. 1371

1. Introduction

- 1.1 This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of His Majesty.
- 1.2 This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

- 2.1 These Regulations amend the existing United Kingdom (“UK”) anti-money laundering and counter terrorist financing legislation.
- 2.2 The instrument clarifies in The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (the “MLRs”) the explicit difference between domestic and non-domestic politically exposed persons (“PEPs”). It is to clarify in law that for the purposes of applying the MLRs, domestic PEPs pose a lower risk of money laundering and terrorist financing than non-domestic PEPs, and must be subject to a lesser extent of Enhanced Due Diligence (EDD) by firms regulated under the MLRs, in the absence of other risk factors unrelated to their position as a domestic PEP. This provision is already established in guidance.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

- 3.1 These Regulations are made under the powers contained in section 49 of the Sanctions and Anti-Money Laundering Act 2018 (c. 13) and make changes to the MLRs as required under section 77 of the Financial Services and Markets Act 2023 (c. 29) (“FSMA 23”). In accordance with section 77(6)(b), they must be laid within 12 months of the date of Royal Assent (i.e. the Regulations must be laid by 28 June 2024). These Regulations were laid on 14 December 2023.
- 3.2 These Regulations are subject to the negative procedure as required in section 77(6)(a) of FSMA 23
- 3.3 The MLRs were made under section 2(2) of the European Communities Act 1972 (c. 68) but, following the repeal of paragraph 15 of Schedule 8 of the European Union (Withdrawal) Act 2018 (c. 16), specific procedural and publication requirements are not required for this instrument.

4. Extent and Territorial Application

- 4.1 The territorial extent of this instrument is all of the UK.
- 4.2 The territorial application of this instrument is all of the UK.

5. European Convention on Human Rights

- 5.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

6. Legislative Context

- 6.1 This instrument amends the MLRs. The MLRs have been amended from time to time by various instruments to retain and support the objective to combat illicit finance and address emerging risks.
- 6.2 This instrument delivers the commitment referred to in section 77(3) of FSMA 23, to distinguish in legislation between domestic PEPs and non-domestic PEPs for the purposes of assessments under regulation 35(3) of the MLRs. In accordance with requirements under section 77(6) of FSMA 23, this instrument is laid within 12 months of Royal Assent of FSMA 23.

7. Policy background

What is being done and why?

- 7.1 The objective of this legislation is to clarify in law that for the purposes of applying the MLRs, domestic PEPs pose a lower risk of money laundering and terrorist financing than non-domestic PEPs, and must be subject to a lesser extent of Enhanced Due Diligence (EDD) by firms regulated under the MLRs, in the absence of other risk factors unrelated to their position as a domestic PEP.
- 7.2 EDD on PEPs is a requirement of the UK's current MLRs, which require regulated sectors to apply a range of measures to identify and prevent money laundering and terrorist financing. The National Crime Agency (NCA) assesses it is a realistic possibility that over £100 billion pounds is laundered every year through the UK or through UK corporate structures.
- 7.3 PEPs are individuals entrusted with prominent public functions, such as politicians and senior members of the military. The FATF, as the global standard-setter for anti-money laundering and counter terrorism financing (AML/CTF) regulation, recommends that Governments' anti-money laundering regulations make provision to mitigate the higher risk that PEPs are targeted for bribery and corruption.
- 7.4 The UK's MLRs stipulate that financial institutions and other regulated firms must apply EDD to PEPs as well as to their relatives and close associates (RCAs). This could include, for instance, checks to understand the source of the customer's funds and the reason for transactions. The MLRs, however, are not prescriptive about precisely how this information is gathered, leaving it for firms to decide what is proportionate, informed by guidance (from the Financial Conduct Authority (FCA) and the other anti-money laundering and counterterrorism financing supervisors which oversee and enforce regulated firms' compliance with the MLRs).
- 7.5 There are longstanding concerns among PEPs that some financial institutions do not fully apply the FCA guidance on the treatment of PEPs as intended.¹ Specifically, some personal banking and credit institutions have been alleged to treat all PEPs as equally high-risk, while the FCA guidance is clear that domestic PEPs (i.e., PEPs such as politicians who are entrusted with public functions by the UK) and their RCAs

¹ <https://www.fca.org.uk/publications/finalised-guidance/fg17-6-treatment-politically-exposed-persons-peps-money-laundering>

should, in the absence of any other risk factors, be treated as lower-risk and receive a lower level of EDD as a result compared to non-domestic PEPs. The result is that some financial institutions appear to apply the regulations in a disproportionate manner, resulting in negative effects in the form of overly burdensome EDD requirements on lower-risk PEPs and their RCAs, and difficulties accessing financial and other services.

- 7.6 In response to these concerns, in Summer 2023, the Government committed in the Financial Services and Markets Act (FSMA) to amend the MLRs to make it clear that the starting point for AML/CTF-regulated firms when considering their treatment of domestic PEPs and their RCAs should be to treat them as inherently lower-risk than non-domestic PEPs. This amendment is intended to ensure that regulated firms reflect this in their approach to conducting EDD.

Explanations

What did any law do before the changes to be made by this instrument?

- 7.7 As noted above, the UK's MLRs stipulate that financial institutions and other regulated firms must apply enhanced due diligence (EDD) to PEPs as well as their relatives and close associates (RCAs) but did not distinguish between domestic and non-domestic PEPs.

- 7.8 The MLRs, however, are not prescriptive about precisely how regulated firms undertake due diligence and other regulatory requirements, leaving it for firms to decide what is proportionate, informed by guidance and a risk-based approach.

Why is it being changed?

- 7.9 The change is being made in order to deliver on the commitment in s. 77 of FSMA 2023 and thereby ensure that banks and other regulated firms reflect in the due diligence applied to domestic PEPs and their RCAs the lower risk which the Government considers domestic PEPs pose in relation to money laundering and terrorist financing, in comparison to the risk posed by non-domestic PEPs.

What will it now do?

- 7.10 Following this change the MLRs will be clear that domestic PEPs and their RCAs must be subject to a lesser extent of enhanced due diligence, in the absence of other risk factors unrelated to their position as a domestic PEP.

8. European Union Withdrawal and Future Relationship

- 8.1 This instrument does not trigger statement requirements under the European Union (Withdrawal) Act 2018 (c. 16).

9. Consolidation

- 9.1 There are no current plans to consolidate the MLRs.

10. Consultation outcome

- 10.1 No public consultation has been carried out in respect of this instrument.

11. Guidance

- 11.1 HM Treasury will not be issuing specific guidance to accompany this instrument.

- 11.2 The MLRs allow for relevant persons to consider any guidance which has been issued by the FCA or issued by any other supervisory authority or appropriate body and approved by HM Treasury. To avoid confusion and inconsistent guidance within sectors, HM Treasury approves a single piece of guidance for each sector regulated under the MLRs, drafted either by the supervisory authority/authorities, or by another appropriate body.
- 11.3 The existing guidance for each sector will be updated by the relevant supervisory body or appropriate body, in order to accommodate the changes made by this instrument. This revised guidance will then subsequently be approved by HM Treasury.

12. Impact

- 12.1 The impact on business, charities or voluntary bodies is that compliance officers in firms regulated under the MLRs will have to read the UK's updated regulations and related public advisory notice.
- 12.2 A number of firms (which we estimate to be small) who currently apply, as a starting point, the same level of EDD to domestic and non-domestic PEPs will need to update their policies and procedures to ensure that they apply a lower level of EDD to domestic PEPs, in the absence of other enhanced risk factors. While these firms will incur a one-off cost for changing policies and procedures, in the long run there should be marginal savings from applying a lower level of EDD to domestic PEPs. Overall, the total impact is expected to be -£2.303 million (in savings) over a period of 10 years, while the Equivalent Annual Net Direct Cost to Business per year is averaged at -£0.208 million (in savings) for the first 5 years.
- 12.3 There is no, or no significant, impact on the public sector.
- 12.4 A de minimis Impact Assessment is submitted with this memorandum and published alongside the Explanatory Memorandum on the [legislation.gov.uk](https://www.legislation.gov.uk) website.

13. Regulating small business

- 13.1 The legislation applies to activities that are undertaken by small businesses.
- 13.2 No specific action is proposed to minimise regulatory burdens on small businesses
- 13.3 The basis for the final decision on what action to take to assist small businesses is that the MLRs apply to all businesses in scope of the regulated sector regardless of the size of business and therefore small businesses cannot be exempt from requirements under the MLRs if they fall within scope of the Regulations.
- 13.4 All those in scope of the regulated sector must apply a risk-based approach to complying with the requirements under the MLRs and therefore the burden on small businesses may be mitigated in some respect as not all of the measures in this instrument affect the whole of the regulated sector.

14. Monitoring & review

- 14.1 The approach to monitoring of this legislation is that no separate monitoring of the impact of this legislation is intended as the MLRs are already subject to a review clause (Regulation 108). The first post-implementation review clause was published by HM Treasury on 22 June 2022, and another review will be required prior to the 26 June 2027. This instrument does not include a statutory review clause and, in line with

the requirements of the Small Business, Enterprise and Employment Act 2015 (c. 26), Baroness Vere has made the following statement:

“It would not be appropriate to carry out a formal review of this measure because its impact is expected to be too low for a full review to be proportionate to its aims. The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (S.I. 2017/692) themselves were reviewed on the 22 June 2022 and this includes the enhanced due diligence requirements in regulation 33.”

15. Contact

- 15.1 Marco Dryburgh and Ben Young at HM Treasury (Email: Marco.Dryburgh@hmtreasury.gov.uk and Ben.Young@hmtreasury.gov.uk) can be contacted with any queries regarding the instrument.
- 15.2 Emily Bayley, Deputy Director for Sanctions and Illicit Finance, at the HM Treasury can confirm that this Explanatory Memorandum meets the required standard.
- 15.3 Baroness Vere, Treasury Lords Minister, at HM Treasury can confirm that this Explanatory Memorandum meets the required standard.