

Title: The Money Laundering and Terrorist Financing (Amendment) Regulations 2023. SI (Statutory Instrument) No: 1371 Other departments or agencies: None Contact for enquiries: Marco Dryburgh	De minimis assessment
	Date: 11/12/2023
	Type of regulation: Domestic
	Date measure comes into force: 10/01/2024
Cost of Preferred (or more likely) Option: 10-year total of -£2,303,000	Equivalent Annual Net Direct Cost to Business per year (EANDCB in 2022 prices) -£0.208m

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

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. 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 measures to identify and prevent money laundering and terrorist financing. This includes Enhanced Due Diligence (EDD) in relation to politically exposed persons¹.

Politically exposed persons (PEPs) are individuals entrusted with prominent public functions, such as politicians and senior members of the military. The Financial Action Task Force (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.

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). 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 and the other money-laundering supervisors which oversee and enforce regulated firms' compliance with the MLRs).

There are longstanding concerns among PEPs that some financial institutions do not fully apply the FCA guidance on the treatment of PEPs as intended.² 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 family members should 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.

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 was intended to ensure that regulated firms reflect this in their approach to conducting enhanced due diligence.

¹ 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.

² Financial Conduct Authority, ['FG17/6: The Treatment of Politically Exposed Persons for Anti-Money Laundering Purposes'](#)

The secondary legislation will therefore clarify in law the explicit difference between domestic and non-domestic PEPs, that is already established in guidance, and will require that domestic PEPs and their RCAs be subject to a lesser extent of enhanced due diligence, in the absence of other risk factors outside of their position as a domestic PEP.

Relatedly, FSMA 2023 also committed the FCA to conduct, and publish the conclusions of, a review into how financial institutions are following its guidance on the treatment of PEPs. This review will also consider whether the FCA's guidance on PEPs remains appropriate, and the FCA will be required to amend its guidance if the review finds it necessary to do so.

If the FCA review finds that the guidance is no longer appropriate, it will publish draft revised guidance for consultation, taking into account the Treasury's amendment to the MLRs, within the 12-month timeframe given for the review (i.e. by 29 June 2024). This process is however, separate to the proposed statutory instrument and so is out of the scope of this impact assessment.

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

The policy objective is to ensure that financial and credit institutions apply to domestic PEPs, and their RCAs, a level of Enhanced Due Diligence which is more proportionate to their Money Laundering/Terrorist Financing risk.

The intended effect is that regulated firms (including but not limited to the financial sector) that currently apply a blanket approach to EDD on domestic and non-domestic PEPs review and amend their processes and controls, as appropriate, to ensure that domestic PEPs and their RCAs receive a lower level of EDD than non-domestic PEPs in the absence of other risk factors.

3. What policy options have been considered, including any alternatives to regulation? Please justify preferred option.

In considering policy options we have considered all options available to the Government to meet its commitment under FSMA 2023 to amend the MLRs to ensure that personal banking and credit institutions apply to domestic PEPs a lesser level of Enhanced Due Diligence which is more proportionate to their level of risk.³

Option 1: Legislate now to clarify that domestic PEPs should be treated as lower risk as a starting point (preferred option):

The Money Laundering Regulations will be amended via statutory instrument to clarify that domestic PEPs and their RCAs should be treated as lower risk than non-domestic PEPs as a starting point, in the absence of other risk factors. This meets the Government's commitment to clarify in law what is already present in guidance: that domestic PEPs and their RCAs should be considered lower risk, and regulated firms should apply a lesser form of EDD in the absence of other enhanced risk factors.

Acting now is also the preferred option to ensure that domestic PEPs and their RCAs are treated proportionally by all regulated firms. The benefit of this policy is that it will reduce the administrative EDD requirements placed on domestic PEPs and their RCAs by some financial institutions and ensure that EDD carried out is proportional to their risk. It should also support a reduction in the difficulties in accessing banking faced by some domestic PEPs and their RCAs, by reducing compliance risk/costs for personal banking and credit institutions in relation to these customers.

Option 2: Do not legislate, i.e., do not pass clarifying legislation:

The FCA, for instance, already has guidance that firms must follow outlining that domestic PEPs and their family members should be treated as lower risk than non-domestic PEPs and may be subjected to a less intrusive form of EDD (with examples provided to illustrate this). However, some financial institutions have

³ <https://hansard.parliament.uk/lords/2023-06-13/debates/A8511EC4-642A-4821-AF02-2642C57562DF/FinancialServicesAndMarketsBill>

applied the Regulations in a disproportionate manner. Without clarifying legislation, it is likely that this would continue, and some domestic PEPs would continue to experience disproportionate due diligence requirements and difficulties accessing banking services. Additionally, not legislating this amendment to the MLRs would mean the Government would have to pass primary legislation to amend the FSM Act to remove the requirement within the Act to bring forward secondary legislation.

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 customers firms need to conduct enhanced checks. The current regulations are necessary to ensure the UK remains in line with global AML/CFT standards, and clarification is intended to help ensure that regulated firms correctly apply a risk-based approach, as intended by the Regulations, to enhanced due diligence in relation to domestic PEPs and their RCAs.

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

To do this, please set out the following:

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

Regulated firms' compliance officers will have to read the UK's updated regulations and related public advisory notice.

A number of firms (which we estimate to be small) who do not currently apply the rules correctly will need to update their policies and procedures to ensure that, when risk-assessing customers, their starting point should be that domestic PEPs and their family members pose a lower risk than non-domestic PEPs.

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

Every firm that is regulated under the Money-Laundering Regulations firm (total – approximately 101,098 in 2021/22) will have to read the legislation, with associated familiarisation costs.

However, we estimate that only a small number of firms will have to change their EDD processes in relation to domestic PEP customers and their RCAs, in order to comply with the regulations. We estimate this to be at most approximately 10 large personal banking and credit institutions, representing the vast majority of the market for personal banking, based on complaints made by PEPs about disproportionate treatment. (See **Annex A** below). While regulated entities outside of these personal banking and credit institutions may also need to change their processes in order to comply, we do not have any complaints or other data on which to estimate this impact and would expect it to be small.

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

The familiarisation cost is a one-off cost born by all regulated firms in the first year. This is estimated at a total of **£0.221 million**. (See **Annex B** below).

For the small number of firms that we estimate will have to change their EDD processes, our best estimate is that this will represent a total impact of -£257,000 per year i.e. delivering savings (not costs) overall (See Annex C below).

Overall, combining both lines above, the total impact is expected to be **-£2.303 million** over a period of 10 years, while the Equivalent Annual Net Direct Cost to Business per year is averaged at **-£0.208 million** for the first 5 years.

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 requirements on following a risk-based approach to carrying out due diligence on customers.

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

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

No

b) Disproportionate burdens on micro, small, and medium businesses (below 500 employees).

No

c) Significant gross effects despite small net impacts

No

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

Some PEPs have argued that difficulties accessing financial services acts as a disincentive to enter or stay in significant roles of public service. This legislative change is intended to address those difficulties, which could have a positive effect in this regard.

e) Significant novel or contentious elements

No

Sign-off for de minimis assessment: SCS

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

SCS of Sanctions and Illicit Finance team

Signed: ***Emily Bayley***

Date: 06/12/2023

SCS of Better Regulation Unit

Signed: ***Phil Witcherley***

Date: 08/12/2023

Sign-off for de minimis assessment: Minister

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

(Name, Ministerial role)

Signed: ***Baroness Vere, Treasury Lords Minister***

Date: 11/12/2023

Further information sheet

Annex A: Estimate for total number of impacted business relationships between personal banking and credit institutions, and domestic PEPs and their relatives and close associates

To arrive at an estimate for the number of PEPs and their RCAs which are likely to receive a lower level of Enhanced Due Diligence as a result of this measure, we use firms which have been the subject of complaints from PEPs in relation to their application of EDD as a proxy for the number of firms which will need to modify their treatment of PEPs.

This legislation applies to all firms under the Regulations. However, we are only aware of complaints about the treatment of PEPs and RCAs by personal banking and credit institutions.

As a result, we assume as a starting point that no behaviour change will be required by regulated firms which are not personal banking and credit institutions.

HMT holds the following estimates of the number of domestic PEPs and RCAs with relationships with UK credit institutions for the period of February- April 2023. This data covers 10 firms, the majority of which are known to have received complaints from PEPs in relation to their application of EDD.

	PEPs - Feb to Apr 23	RCAs – Feb to Apr 23	Combined – Feb to Apr 23
Total	8,000	12,000	20,000

While this information only covers 10 particular personal banking and credit institutions, according to market data supplied to HM Treasury by the market intelligence company, Mintel, we know that these firms represent *at least* 87% of the main personal current account market.⁴ Therefore even if some personal banking and credit institutions outside of these 10 are impacted, relatively few additional PEPs or their RCAs are likely to be affected.

It is important to note that these figures are not indicative of the number of individual domestic PEPs in the UK, given that the data will include some duplication where individual PEPs hold accounts with multiple of the 10 firms.

It should also be noted that the data is a snapshot of PEP volumes during one three-month period and may not be representative of normal volumes outside this period.

Best estimate:

We propose to use as a medium bound estimate the total above. While there are reasons why this could be an underestimate (set out in the high bound estimate) there are also reasons to consider this an overestimate (set out in the low bound estimate). It is therefore reasonable to take the medium bound figure of 20,000 as the best estimate.

Best estimate: 20,000

Low bound estimate:

Our low bound estimate recognises that not all business relationships with domestic PEPs and RCAs may be impacted by the proposed change in legislation. This legislation is designed to prevent the disproportionate application of EDD on domestic PEPs and RCAs and clarifies what is already contained in guidance: namely, that a lesser form of EDD must be employed where a domestic PEP or RCA is classed as lower risk, in the absence of other risk factors.

There will be instances therefore where personal banking and credit institutions identify wider enhanced risk factors in a domestic PEP or RCA's risk profile that preclude a lesser form of EDD, and the legislation will have no impact in these cases. It is not possible to quantify how many domestic PEPs and RCAs do not have any other enhanced risk factors as banks will have individual risk assessment procedures in line with a risk-based approach.

⁴ <https://www.mintel.com>

Similarly, we cannot know how many firms have changed their behaviour as a result of recent FCA engagement as part of its review of the treatment of PEPs, until after the conclusion of the review in June. Some financial institutions with business relationships with domestic PEPs or RCAs are likely already to have acted to change their processes to ensure compliance with the guidance (and incoming legislation) following initial engagement with the FCA, and the legislation will therefore not have any further impact on these relationships.

Because of these caveats, we propose to set the lower bound of the business relationships with PEPs at 50% of the business relationships with personal banking and credit institutions.

Low bound estimate: 20,000 / 2 = 10,000

High bound estimate:

A high bound estimate for the number of business relationships between domestic PEPs and RCAs and personal banking and credit institutions can be reached by assuming that all personal banking and credit institutions will need to modify their treatment of PEPs as a result of this measure.

The total number of PEP business relationships in the personal banking and credit market can be derived by taking as a starting point the assumption that the 10 firms used as a basis for the medium bound figure represent 87% of this market, given that we know these 10 firms represent at least 87% of the entire personal banking and credit market (covering both PEP and non-PEP customers).

The combined figure of domestic PEPs and RCAs (20,368) can therefore be grossed up to 100% to arrive at a higher-bound estimate for all domestic PEP and RCA relationships with personal banking and credit institutions in the UK:

$$20,000 * (100/87) = 22,989$$

We can assume further for the upper bound figure that all domestic PEPs and RCAs contained in this adjusted total have no enhanced risk factors that preclude a lower level of EDD and are all currently subject to a disproportionate level of EDD that will need to be reduced following legislative change.

Higher bound estimate: 22,989

Annex B: Calculating total familiarisation costs

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 requirements for PEPs.

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 hour⁵, and the median wage for a financial institution managerial compliance officer role is £ 31.93 per hour⁶. 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 updated PEPs requirements, and at least 1-2 compliance officers for other medium and larger firms.

Word count = 562.

Average time to read 562 words = $562/14280 = 0.039356$ hours (2.4 minutes).

Total familiarisation costs = 0.039356 hours X £31.93 X (101, 098 [total number of regulated firms]⁷ + 74, 803⁸ [number of non-sole practitioner firms]) = **£221,043.7**

Best estimate for total familiarisation costs for all changes = £0.221 million.

High estimate for total familiarisation cost = $(562/10,500) \times 47.69 \times 219,876 = £561,245$

Low estimate for total familiarisation cost = $(562/18,000) \times 21.12 \times 131,926 = £87,570$

High/low estimates: the above calculations are replicated, using the 75th and 25th 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)⁹.

⁵ 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>

⁶ 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/occupation4digitsoc2010asetable14>

⁷This figure is from the Annual Supervisory Returns for 2021/2022.

⁸ This figure is from the Annual Supervisory Returns for 2021/2022.

⁹ 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.

Annex C: Anticipated impacts to businesses who do not currently comply with the regulations

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 4th 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)¹⁰. Further work on the cost of CDD and EDD is taking place as part of a separate consultation in relation to the MLRs, which should allow these estimates to be further tested and updated, if appropriate.*

CPI adjusted	CDD lower	EDD lower	EDD upper	EDD mid-point
2017	£3	£5.25	£26	£15.63
2022	£3.65	£6.38	£31.61	£19

We do not have a costing for a lesser form of EDD, but we can try to quantify it by identifying the difference between the upper and lower costs of EDD to find an estimate for the savings to banks. To estimate the savings of moving to a lesser form of EDD when EDD is estimated to be the lowest figure (£6.38), we assume that the cost of a lesser form of EDD will fall between the cost of CDD and EDD and calculate savings accordingly.

Best estimate

We can take the difference between the mid-point of EDD (£19) and the lower bound of EDD cost (£6.38) = £12.62.

This means that as a result of the legislation, banks who are not currently complying with the legislation will save £12.62 per domestic PEP to whom they subsequently accurately apply a lower level of EDD.

Best estimate: £12.62

Lower bound estimate

For the purposes of a lower bound estimate the cost of a lesser form of EDD to the mid-point between the lowest estimated cost of EDD (£6.38) and the lowest estimated cost of CDD (£3.65) = £5.02.

We can estimate the minimum savings to business therefore by taking the difference between the lowest cost of EDD (£6.38) and the estimated cost of lesser EDD (5.02) = £1.36.

Lower bound estimate: £1.36

Upper bound estimate

The biggest possible difference between EDD and a lesser form of EDD can be found by identifying the difference between EDD's upper cost limit (£31.61) and its lower limit (£6.38) = £25.23.

This means that as a result of the legislation, banks who are not currently complying with the legislation will save £25.23 per domestic PEP to whom they subsequently accurately apply a lower level of EDD.

Upper bound estimate: £25.23

¹⁰The assumption that financial crime compliance costs have increased broadly in line with business inflation is supported by recent industry studies.

Annex D: Calculations

Number of business relationships impacted	Multiplied by cost of EDD changes (negative indicates savings)			Overall impact	
Best estimate	20,000	*	Best estimate	-£12.62	-£252,400.00
			Low estimate	-£1.36	-£27,200.00
			High estimate	-£25.23	-£504,600.00
Low estimate	10,000	*	Best estimate	-£12.62	-£126,200.00
			Low estimate	-£1.36	-£13,600.00
			High estimate	-£25.23	-£252,300.00
High estimate	22,989	*	Best estimate	-£12.62	-£290,121.18
			Low estimate	-£1.36	-£31,265.04
			High estimate	-£25.23	-£648,979.47

Year	Familiarisation cost (one-off in first year)	Best estimate of business cost	Total impact to business (negative indicates savings)
2024	£0.221 million	-£252,400.00	-£31,400
2025	-	-£252,400.00	-£252,400.00
2026	-	-£252,400.00	-£252,400.00
2027	-	-£252,400.00	-£252,400.00
2028	-	-£252,400.00	-£252,400.00
2029	-	-£252,400.00	-£252,400.00
2030	-	-£252,400.00	-£252,400.00
2031	-	-£252,400.00	-£252,400.00
2032	-	-£252,400.00	-£252,400.00
2033	-	-£252,400.00	-£252,400.00
5-year total			-£1,041,000
10-year total			-£2,303,000

EANCDM: 5-year total (-£1,041,000) / 5 = **-£208,200**