EXPLANATORY MEMORANDUM TO

THE MONEY LAUNDERING AND TERRORIST FINANCING (AMENDMENT) REGULATIONS 2019

2019 No. 1511

1. Introduction

1.1 This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 These Regulations update the UK's existing anti-money laundering legislation to implement changes in the EU's anti-money laundering framework.

2.2 Specifically, these Regulations amend the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (S.I. 2017/692) (the "MLRs") to implement amendments made by EU Directive 2018/843 (the "Amending Directive") to EU Directive 2015/849 (the "Fourth Anti-Money Laundering Directive"). The Fourth Anti-Money Laundering Directive gave effect to the updated Financial Action Task Force ("FATF") standards which promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system.

2.3 In addition, the Regulations amend the Terrorism Act 2000 (c.11) and the Proceeds of Crime Act 2002 (c.29) in order to align the definitions of the "regulated sector" in those Acts with the amendments made by the Amending Directive. The Regulations also make amendments to the Companies Act 2006 (c.46) and other companies legislation in order to implement requirements in the Amending Directive relating to companies.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

3.2 As the instrument is subject to negative resolution procedure there are no matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business at this stage.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is all of the United Kingdom.

4.2 The territorial application of this instrument is all of the United Kingdom.

5. European Convention on Human Rights

5.1 The Economic Secretary to the Treasury, John Glen MP, has made the following statement regarding Human Rights:

"In my view the provisions of the Money Laundering and Terrorist Financing (Amendment) Regulations 2019 are compatible with the Convention rights."

6. Legislative Context

6.1 The Fourth Anti-Money Laundering Directive was implemented in the UK in June 2017, primarily through the MLRs. The Amending Directive amended certain parts of the Fourth Anti-Money Laundering Directive on 19 June 2018.

6.2 Among other changes outlined below, the Amending Directive brings some additional businesses into the scope of the anti-money laundering regulatory framework: described as "obliged entities" in the Fourth Anti-Money Laundering Directive, these are defined as "relevant persons" in the MLRs (see regulation 8) and as businesses in the "regulated sector" in the Terrorism Act 2000 and the Proceeds of Crime Act 2002.

6.3 One minor provision in the Amending Directive about safe-deposit boxes was required to be transposed by 10 January 2019. This was done by the Money Laundering and Terrorist Financing (Miscellaneous Amendments) Regulations 2018 (S.I. 2018/1337).

6.4 The UK is required to transpose the remainder of the legislative framework of the Amending Directive by 10 January 2020, which is within the period of the latest extension to the UK's membership of the European Union ("EU").

6.5 The Amending Directive was cleared from scrutiny by the Commons European Scrutiny Committee on 31 January 2018 and the Lords European Scrutiny Committee on 19 December 2017.

7. Policy background

What is being done and why?

7.1 Money laundering and terrorist financing undermines the integrity and stability of our financial markets and institutions. It is a global problem and the UK must play its part in strengthening its regime, adhering to international standards and working with international partners. Money laundering is also a key enabler of serious and organised crime, which costs the UK at least £37 billion every year.

7.2 The UK is a founding member and strong supporter of the FATF, which sets global anti-money laundering and counter-terrorist financing ("AML"/"CTF") standards. These standards, as outlined in the FATF Recommendations and Methodology, are generally incorporated into UK law through the transposition of EU directives. As a leading member of the FATF, the UK will continue updating anti-money laundering policies according to international standards, ensuring the UK's AML/CTF regime is kept up to date, effective and proportionate.

7.3 The Fourth Money Laundering Directive is a key part of the regulatory framework for addressing and mitigating the risks related to money laundering and terrorist financing. The Fourth Money Laundering Directive updated EU AML/CTF policy to reflect the 2012 update to the FATF standards. In order to increase the regulatory regime's effectiveness against the context of evolving trends, technological developments and the exploitation of regulatory loopholes, the Amending Directive amends certain aspects of the Fourth Money Laundering Directive.

7.4 The UK shares the objectives which the Amending Directive seeks to achieve and played a significant role in the negotiation of the Amending Directive. The UK government's objective through transposing the Amending Directive by these

Regulations is to combat illicit finance and address emerging risks while minimising the burden on legitimate business.

7.5 There are over 100,000 businesses within scope of the MLRs, requiring businesses to know their customers and manage their risks. The MLRs are deliberately not prescriptive, providing flexibility in order to promote a proportionate and effective risk-based approach to combating money laundering and terrorist financing.

New relevant persons

7.6 Part 2 of the MLRs is amended to expand the scope of regulated sectors to add new categories of relevant persons subject to the requirements in the MLRs, including registration and customer due diligence ("CDD") requirements.

7.7 In particular, the definition of tax adviser is expanded to include those who offer material aid or assistance on tax matters. The scope of regulated businesses in the property agency sector is expanded to include the letting agency sector for high value transactions with a monthly rent of EUR 10,000 or more. Art market participants for transactions exceeding EUR 10,000, including art galleries, auction houses and freeport operators storing high-value art, are also brought into scope of the legislation. Freeports are areas designated as special zones for customs purposes, usually defined as a place to carry out business inside a country's land border but where different customs rules apply. Cryptoasset exchange providers and custodian wallet providers are also brought into scope of the MLRs, to ensure the UK meets evolving global standards and fully addresses emerging risks.

7.8 Regulation 14A within Part 2 of the amended MLRs sets out the definition of custodian wallet providers and cryptoasset exchange providers. The latter includes where the firm or sole practitioner offers exchange services as creator or issuer of any of the cryptoassets involved (often this is referred to as an "initial coin offering" by industry). This is because initial coin offerings are another point of exchange at which those in possession of illicit funds could launder their money into a new, clean cryptoasset, obfuscating the original source or purpose of such funds. The definition of cryptoasset exchange providers also extends to operating a machine which automates such an exchange, commonly known as a cryptoasset automated teller machine ("CATM").

7.9 The Amending Directive requires the UK to regulate "virtual currency" exchange providers and wallet providers. The FATF standards refer to "virtual asset" service providers. The UK government has chosen to use the definition of "cryptoasset" in these Regulations instead of the term "virtual currency". The UK's Cryptoasset Taskforce previously set out that "cryptoasset" includes exchange, security and utility tokens. The government considers that all relevant activity involving all three types of cryptoassets should be captured in AML/CTF regulation. Respondents to the consultation on the implementation of the Amending Directive agreed with this approach and were of the view that the "virtual currency" definition in the Amending Directive should be broadened in scope. In adopting the UK's taskforce definition, it also confines the scope of cryptoassets to those using distributed ledger technology, which HM Treasury considers is a more specific and precise definition that still meets the EU's ultimate intention to regulate this sector for AML/CTF purposes.

Customer due diligence and enhanced due diligence

7.10 The instrument makes amendments to Part 3 of the MLRs in relation to CDD measures to be taken by regulated businesses. Letting agency businesses must apply CDD

measures in relation to both the tenant and landlord for rental agreements with a monthly rent of EUR 10,000 or more. Art market participants must apply CDD measures when carrying out transactions equivalent to EUR 10,000 or more in relation to the sale of a work of art. CDD measures must also be carried out by cryptoasset exchange providers and custodian wallet providers entering into a business relationship and in other specified cases in line with other relevant persons. CATM operators must also carry out CDD for all exchanges of money for cryptoassets, whatever the amount. The reason for this is that the government has seen evidence that CATMs could be used for illicit purposes, such that setting a value threshold could see repeat business or "smurfing" just below this threshold to circumvent CDD measures.

7.11 The instrument makes several amendments to regulation 28 of the MLRs on CDD measures. Firstly based on FATF recommendations 10.8 and 22.1, the instrument introduces an explicit CDD requirement for relevant persons to take reasonable measures to understand the ownership and control structure of their customers. Secondly, to require relevant persons to take reasonable measures to verify the identity of senior managing officials when the beneficial owner of a body corporate cannot be identified.

7.12 Further amendments to regulation 28 set out the circumstances under which electronic identification processes may be considered in undertaking CDD measures. Specifically, the use of electronic identification processes is permitted where these are: independent of the person whose identity is being verified, secure from fraud and misuse and capable of providing an appropriate level of assurance that the person claiming a particular identity is in fact the person with that identity. Treasury-approved guidance for each sector will provide a more detailed discussion of the elements of secure electronic identification.

7.13 New regulation 30A creates a requirement on relevant persons to check beneficial ownership registers of legal entities in scope of the People with Significant Control (PSC) requirements before establishing a business relationship. Relevant persons who find a discrepancy between the beneficial ownership information on the registers and the information which is made available to them in the course of carrying out CDD, will be required to report these discrepancies to Companies House. Guidance on how to report relevant discrepancies will be provided within the updates to the sector-specific guidance.

7.14 Regulation 30A also requires Companies House to take appropriate actions to investigate and, if necessary, resolve the discrepancy in a timely manner. Discrepancy reports are excluded from public inspection.

7.15 The instrument also amends specific customer risk factors in relation to enhanced customer due diligence ("EDD") measures in regulation 33, which are required for business relationships with a person established in a high-risk third country or in relation to any relevant transaction where either of the parties is established in a high-risk third country. The instrument defines what 'established in' means to ensure clear interpretation.

Policies, Controls and Procedures

7.16 The instrument also makes two further amendments in Part 2 based on the latest FATF recommendation concerning the policies, controls and procedures for regulated businesses. Firstly, based on FATF recommendation 15.2, relevant persons must ensure that they have policies to ensure they undertake risk assessments prior to the launch or

use of new products or business practices, as well as new technologies. Secondly, based on FATF recommendation 18.2(b), parent undertakings must also ensure they have group-wide policies on the sharing of information about customers, customer accounts and transactions for AML/CTF purposes.

7.17 Relevant persons must also take appropriate measures to ensure agents used for the purposes of its regulated business receive AML/CTF training, ensuring a first line of defence against illicit finance.

Bank Account Portal

7.18 The instrument inserts a new Part 5A into the MLRs, which requires the establishment of a mechanism for the FIU and competent authorities to access details pertaining to UK bank accounts, building society accounts, certain credit union accounts and safe-deposit boxes. The details that can be accessed are limited to details about the account/safe-deposit box itself (the IBAN number, roll number or alternative, date of account opening/lease beginning, date of account closing/lease ending, and duration of a lease) as well as details about the account holder and beneficial owner, or safe deposit box owner, lessee, controller or key holder (their name, date of birth, address and ID number provided under regulations 28-29 and 33-37 of the MLRs). This does not impose any additional requirements for institutions to collect data. Law enforcement cannot use this mechanism to access details about transaction history or contents of an account or safe deposit box.

7.19 The instrument outlines the purposes for which such access is permitted, and other conditions for access. Senior officers are required to record any requests that they refuse, and the Home Office must report to Parliament every year on law enforcement access to the account and safe deposit box data. Provisions for record keeping are outlined.

7.20 Part 5A imposes a duty on banks, building societies, safe deposit box providers and some credit unions to respond to requests via the automated mechanism. There is also a requirement on credit institutions and providers of safe custody services to retain records which are accessible through the portal for at least 5 years. Both requirements are enforceable by the FCA, the relevant supervisor, alongside the other MLRs.

7.21 Under the Crime and Courts Act 2013 (c.22), intelligence collected by the NCA can be shared within the NCA for the purposes of any other investigation.

Supervision, approval and registration

7.22 In Part 6 of the MLRs, the instrument makes amendments to the duties of supervisory authorities and introduces professional secrecy requirements on supervisors of credit and financial institutions, so as to meet requirements in the Amending Directive.

7.23 Other amendments permit the Financial Conduct Authority ("FCA") and HMRC to publish information about a direction issued under regulation 25 (about measures to be taken by parent undertakings of third country branches or subsidiaries) or about suspension or cancellation of a person's registration under Part 6 of the MLRs. This is in order to increase transparency about penalties under the MLRs and act as a deterrent to improve compliance with the regulations.

7.24 The instrument also explicitly provides for HM Treasury to share certain information with the Office for Professional Body AML Supervision ("OPBAS") within the FCA.

This is in order to facilitate information sharing for the purposes of HM Treasury's functions under the MLRs and the functions of OPBAS.

7.25 There are also changes to the existing registration provisions. The FCA must maintain a register of cryptoasset exchange providers and custodian wallet providers. HMRC may maintain a register of letting agents and art market participants, and relevant firms must register within 12 months after the register is established. Further amendments to regulation 56 of the MLRs mean that in future a person must not act as a money service business ("MSB") or a trust or company service provider ("TCSP") until their application has been determined by the supervisory authority. This will help mitigate the risk of corrupt or complicit MSBs or TCSPs operating in the UK financial system.

7.26 Newly obliged letting agency businesses, tax advisers and art market participants must ensure beneficial owners, officers and managers have applied to their supervisory authority before 10 January 2021 for approval under regulation 26 of the MLRs.

7.27 Further, all approval applications to self-regulatory supervisors must include sufficient information to determine whether the applicant has a relevant criminal conviction. This is in order to address concerns about supervisors relying solely on self-certification and therefore persons convicted of relevant criminal offences acting in key roles within regulated firms.

Cryptoasset businesses

7.28 The instrument inserts new regulations 56A and 58A among other amendments to Part 6 of the MLRs, which outline requirements for cryptoasset businesses and the FCA's duties when registering these businesses, including the application of a 'fit and proper' test. From 10 January 2020, new cryptoasset businesses must be registered before they can carry on cryptoasset activity. A transitional period for cryptoasset businesses operating before that date will last until 10 January 2021. New regulation 58A(4)(c) and an equivalent amendment to regulation 58(4) are added in order to clarify the scope of the fit and proper test, which requires the registering authority to consider the skills, experience and ability to act with probity of the applicant and any officer, manager or beneficial owner of the applicant before approving or refusing the registration of cryptoasset businesses as well as MSBs, TCSPs and Annex 1 financial institutions.

7.29 New regulation 60A sets out obligations on cryptoasset exchange providers and custodian wallet providers prior to establishing a business relationship or entering into a transaction as part of its activities for which it is registered, where the activity is not subject to the protections of the Financial Ombudsman Service and/or the Financial Services Compensation Scheme. In this case, they must inform the customer that the activity is not subject to such protections. This is to avoid potential consumer confusion over the regulatory protections they may or may not have by entering into a business relationship or transaction with a cryptoasset firm, newly regulated by the FCA but only for AML/CTF purposes.

7.30 The instrument also amends Part 8 of the MLRs in relation to information and investigation, conferring new powers on the FCA in relation to cryptoasset service providers. Regulation 74A sets out reporting requirements which cryptoasset exchange providers and custodian wallet providers must meet. This will allow the FCA to perform its role as an evidence-based supervisor. This is a large new market for the FCA and it wants to be able to understand the nature of financial crime risks in the sector and compare it with other regulated sectors. It will also help the FCA request information

in order for it to calculate how much it should charge supervised firms for their ongoing regulated status.

7.31 Regulation 74B enables the FCA to appoint a skilled person, or require a skilled person to be appointed, to carry out a report concerning a matter relating to the exercise of the FCA's functions under the MLRs. Typically, the skilled person reviews the firm's AML controls and effectiveness in more detail and recommends actions that are then agreed by the firm to mitigate AML risks. This tool should be regarded as a benefit to firms registered under the MLRs. The absence of this remedial AML supervisory tool means that the FCA would be forced to take crypto firms who are new to AML regulation, and who may not know what adequate compliance with these regulations looks like, either to enforcement or to force a suspension of their activities sooner than they might otherwise have done.

7.32 Regulation 74C gives the FCA the ability to give a direction in writing to a cryptoasset exchange provider or custodian wallet provider, for example, to remedy a failure to comply with a requirement under the MLRs. The FCA already has powers for the majority of its AML supervised population to address such risk/harm by imposing a requirement on a firm. A similar power under the Financial Services and Markets Act 2000 (c. 8) has been specifically used to address money laundering risk 47 times in the past 5 years by the FCA. The current powers, involving courts or the FCA's civil enforcement processes under the MLRs, can be time consuming and may not enable swift action by the FCA. This will harmonise the provisions at the FCA's discretion in its oversight across the sectors that make up its supervisory population.

The UK Financial Intelligence Unit

7.33 In addition, a new Schedule 6A is inserted into the MLRs. This ensures that the UK Financial Intelligence Unit ("FIU") takes appropriate steps to cooperate with foreign FIUs and securely provides information in response to external requests, where possible, with foreign FIUs. This Schedule places into law the information sharing that is currently already done by the FIU on an administrative basis, and involves no change to the operation of the FIU, nor imposes any additional burdens. The Schedule sets out the conditions and restrictions on the further dissemination of information provided to foreign FIUs by the UK FIU and the use of information received from foreign FIUs.

Companies legislation

7.34 The Companies Act 2006 is amended to make clear how long information about beneficial ownership can be made available for public inspection. The registrar is also given a new power to resolve a discrepancy in specified circumstances. The Limited Liability Partnerships (Application of Companies Act 2006) Regulations 2009 (S.I. 2009/1804); the Unregistered Companies Regulations 2009 (S.I. 2009/2436); and the Scottish Partnerships (Register of People with Significant Control) Regulations 2017 (S.I. 2017/694) are amended to reflect these changes.

Consequential amendments

7.35 These Regulations update the definition of "specified disclosure obligations" in the MLRs, Terrorism Act 2000 and Proceeds of Crime Act 2002, to reflect the updated disclosure obligations under Regulation (EU) No 2017/1129. They also update a reference to the MLRs in the Electronic Money Regulations 2011 (S.I. 2011/99). HM Treasury has consulted with the SI Registrar and as that correction represents only a small part of this instrument the procedure for free issue has not been applied.

Amendments to the Terrorism Act 2000 and Proceeds of Crime Act 2002 are made to align with the changes relating to relevant persons.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

8.1 This instrument does not relate to withdrawal from the European Union.

9. Consolidation

9.1 The MLRs revoked and replaced the previous 2007 Regulations along with amendments and the changes made to transpose the Fourth Money Laundering Directive. There are no current plans for a further consolidation of the MLRs.

10. Consultation outcome

10.1 The government launched an 8-week consultation on 15 April 2019 entitled "Transposition of the Fifth Money Laundering Directive". It outlined how the government intended to implement the Amending Directive. The consultation closed on 10 June 2019, with the government receiving over 200 responses from a cross-section of stakeholders including supervisors, industry, civil society organisations, academics and government departments. The government also ran a series of events during the consultation period where stakeholders were given the opportunity to take part in interactive discussions about the proposals and issues in the consultation document. A copy of the consultation is available at: https://www.gov.uk/government/consultations/transposition-of-the-fifth-money-laundering-directive

10.2 Responses to the consultation were broadly supportive of the overall policy objectives of the Amending Directive. Comments, evidence, and views from stakeholders received as part of this consultation process were taken into consideration and informed final government decisions on transposition. For example, there was significant engagement from respondents on the scope of the new AML/CTF regime for cryptoassets. Respondents unanimously agreed that publishers of open-source software and, by extension, non-custodian wallet providers, should not be brought into scope of AML/CTF regulation and the government is legislating accordingly.

10.3 The government also took on board significant evidence and agreement that both firms offering exchange services between cryptoassets and fiat currency and between cryptoassets should be required to fulfil AML/CTF obligations. There was also broad agreement that firms involved in the issuance of new cryptoassets and cryptoasset ATMs should be required to fulfil AML/CTF obligations.

10.4 Furthermore, there was significant engagement on electronic identification processes. Responses agreed that additional clarification is needed on what constitutes secure electronic identification processes but were mixed on the question of whether this clarification should be included in the MLRs themselves or in government-approved guidance. The government therefore decided to take a high-level, principles-based approach to the Regulations, in line with the general approach to CDD in the regulations. More detailed discussion of the elements of secure electronic identification will be covered in HM Treasury-approved guidance for each sector.

10.5 An area where consultation responses were mixed was around obligations to report discrepancies in beneficial ownership information of relevant persons.

10.6 There was significant interest in the government's approach to the national register of bank account ownership. It is a requirement of the Amending Directive which the government will endeavour to implement in the most effective way for the UK system, taking considerable input from industry, competent authorities, law enforcement and civil society into account.

10.7 The government will soon publish its formal response to the consultation. This response document will summarise the stakeholder responses submitted and set out the legislative changes and reasoning behind them.

11. Guidance

11.1 HM Treasury will not be issuing guidance to accompany the instrument.

11.2 This instrument and the MLRs are part of an implementation system that includes guidance from supervisors and industry. One set of guidance is prepared per regulated sector, which is then approved by HM Treasury to ensure consistency in compliance across sectors and accurate interpretation of the MLRs. This approach leverages the supervisors' and industry's in-depth knowledge of individual sectors and risks associated with the sector.

11.3 The Joint Money Laundering Steering Group's guidance for financial services, including cryptoasset exchange providers and custodian wallet providers, is available at: http://www.jmlsg.org.uk.

11.4 The Consultative Committee of Accountancy Bodies' guidance is available at http://ccab.org.uk.

11.5 The Legal Sector Affinity Group's guidance is available at https://www.sra.org.uk/solicitors/code-of-conduct/guidance/guidance/Anti-money-laundering (as well as other legal supervisors' websites).

11.6 HMRC's guidance for trust and company service providers is available at https://www.gov.uk/government/publications/anti-money-laundering-guidance-for-trust-or-company-service-providers.

11.7 HMRC's guidance for high value dealers is available at https://www.gov.uk/government/publications/anti-money-laundering-guidance-for-high-value-dealers.

11.8 HMRC's guidance for money service businesses is available at https://www.gov.uk/government/publications/anti-money-laundering-guidance-for-money-service-businesses.

11.9 HMRC's guidance for estate agents and letting agents will be available at https://www.gov.uk/government/publications/money-laundering-regulations-2007-supervision-of-estate-agency-businesses.

11.10 The Gambling Commission's guidance for casinos is available at: https://www.gamblingcommission.gov.uk/for-gambling-businesses/Compliance/General-compliance/AML/The-Prevention-of-Money-Laundering/The-prevention-of-money-laundering-and-combating-the-financing-of-terrorism-contents.aspx.

11.11 The British Art Market Federation's guidance for the art sector will be available at https://tbamf.org.uk/.

12. Impact

12.1 The instrument will mean that in scope regulated businesses will need to meet familiarisation and compliance costs. The costs for supervisors will involve up-scaling costs to meet ongoing costs of supervision. These costs will be funded by fees paid by each supervisor's respective regulated population.

12.2 The impact on the public sector is predominantly the costs incurred by the statutory supervisors (FCA, HMRC and the Gambling Commission) in implementing any changes. It is not anticipated that there will be any significant impact on charities or voluntary bodies.

12.3 A full Impact Assessment will be published alongside the Explanatory Memorandum on the legislation.gov.uk website when an opinion from the Regulatory Policy Committee has been received.

13. Regulating small business

13.1 This legislation applies to activities that are regulated by the MLRs, regardless of the size of the business. The requirements of the Amending Directive transposed by this instrument do not allow for the exemption of small businesses or any exemptions based on size.

13.2 The impact assessment will provide further detail on the impact of this instrument on business across regulated sectors.

13.3 No specific action is proposed to minimise regulatory burdens on small businesses as this is not permitted under the Amending Directive.

14. Monitoring & review

14.1 This instrument requires HM Treasury, from time to time, to carry out a review of the regulatory provisions contained in this instrument and publish a report setting out the conclusions of the review. The first report must be published before 26 June 2022 to align with the first review of the MLRs. Subsequent reports must be published at intervals not exceeding 5 years.

15. Contact

15.1 Andrew Ryan at HM Treasury can be contacted with any queries regarding the instrument.

15.2 Giles Thomson, Deputy Director for Sanctions and Illicit Finance at HM Treasury can confirm that this Explanatory Memorandum meets the required standard.

15.3 John Glen MP, the Economic Secretary to the Treasury at HM Treasury can confirm that this Explanatory Memorandum meets the required standard.