



HM Treasury

Anti-money laundering supervisory regime:

**response to the consultation and
call for further information**

March 2017



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1 Introduction

Background

1.1 In October 2015, the government published the 'National risk assessment of money laundering and terrorist financing' (the NRA). This assessment identified and assessed the money laundering and financing of terrorism risks faced by the UK.

1.2 In April 2016, the government published an 'Action plan for anti-money laundering (AML) and counter terrorist finance' (the action plan) setting out how the public and private sector will work together to take priority areas for reform forward and tackle money laundering in all its forms. It focused on three priorities: a more robust law enforcement response; reforming the supervisory regime; and increasing the UK's international reach. Since then, the UK demonstrated global leadership at the Anti-Corruption Summit in May 2016, where leaders set out their ambition to tackle corruption in the world's first Global Declaration against Corruption. And the government is enhancing the law enforcement response through the Criminal Finance Bill, which will provide new powers to build the intelligence picture, disrupt money launderers and terrorists, recover criminal proceeds and protect the integrity of the UK's financial system.

1.3 In the action plan, the government launched a review of the UK's AML supervisory regime. The NRA had found that the effectiveness of the supervisory regime in the UK is inconsistent and, whilst some supervisors are highly effective in some areas, there is room for improvement across the board including in understanding and applying a risk-based approach to supervision and in providing a credible deterrent. The number of professional body supervisors in some sectors risks inconsistencies of approach. And data is not yet shared between supervisors freely or frequently enough, which exposes some supervised sectors to risk where there are overlaps in supervision.

1.4 Through the action plan, the government launched a 'Call for information on the AML supervisory regime' (the call for information) to build the evidence base, and announce reforms. As part of the commitment to simplify and improve legislation and its implementation, the government has separately completed a 'Cutting red tape review of the UK's AML and counter financing for terrorism (CFT) regime' (the cutting red tape review). The cutting red tape review identified ways to improve the effectiveness of the supervisory regime by removing unnecessary burdens but without having a material impact on the fight against money laundering. Responses were received from supervisors, supervised businesses and their representative organisations as well as civil society. The government is grateful for all the contributions made by respondents through the call for information and the cutting red tape review.

1.5 This is the government's response to the call for information and the cutting red tape review, and includes a request for further views on proposals to increase oversight of professional body supervisors.

1.6 Chapter 2 considers how different AML supervisors interpret their obligations in the Money Laundering Regulations (the regulations) in various ways, which can create inconsistencies. It also sets out the government's intention to address these inconsistencies, and strengthen the regime, by clarifying the obligations on all supervisors through the regulations.

1.7 Chapter 3 considers views on the effectiveness of supervisors, and feedback from respondents on the effectiveness of statutory supervisors including the Financial Conduct Authority (the FCA). It also considers inconsistent approaches to supervision in sectors where several supervisors are active. This is primarily the case for accountancy and legal services, where

23 supervisors are active, of which 22 are professional bodies. This chapter sets out the government's response, including the intention to create a new Office for Professional Body AML Supervision (the Office), hosted by the FCA, to work closely with professional body supervisors to help, and ensure, they meet the high standards expected of an AML supervisor, as well as to facilitate collaboration between professional body AML supervisors, statutory supervisors, and law enforcement. It also seeks further views on the powers this new Office should have to carry out this task effectively. Responses should be submitted by 26 April 2017, and details of how to submit responses are provided in Annex B.

1.8 Chapter 4 focuses on the quantity and quality of AML/CFT guidance issued by industry and supervisors, which, as both the cutting red tape review and the call for information highlighted, can create unnecessary burdens for business whilst introducing risk into the regime. The government will work with supervisors to address any unnecessary and contradictory guidance, ensuring businesses are provided with guidance that clearly sets out how they can tackle money laundering risks. The FCA will also publish new guidance on the treatment of domestic and foreign Politically Exposed Persons (PEPs), their family members and their known close associates, which they will consult on shortly. This will ensure that the provisions on PEPs are implemented in a proportionate and risk-based manner, so such persons and their families are not unreasonably hindered in legitimate access to financial services.

Key themes

1.9 Across the regime, respondents felt supervisors should have a consistent core package of powers to access information from their populations and to penalise those that facilitated money laundering. However, respondents felt supervisors should retain discretion to ensure penalties are proportionate, effective and dissuasive. There was also support for supervisors developing and implementing a single supervisory risk assessment in each sector, drawing on common risk factors across sectors to improve consistency across the regime. To facilitate cooperation with law enforcement, most respondents agreed supervisors should introduce single points of contact and adequate safeguards on the handling of sensitive information. There was also support for supervisors training their staff, as well as their populations, on existing and emerging AML/CFT risks. Respondents to the cutting red tape review suggested some supervisors, especially the FCA, sometimes adopt a prescriptive approach to supervision, which can lead to both over-compliance with the regulations as well as a less effective regime. To bolster public confidence in the regime, most respondents to the call for information agreed supervisors should publish their enforcement activity, and provide Treasury with annual returns detailing their AML activity.

1.10 Respondents to the call for information also felt that the FCA's risk-based approach to AML supervision focused too heavily on the largest firms, with less scrutiny of smaller firms. This is in line with the IMF's findings in its 2016 Financial Sector Assessment Programme (FSAP) of the UK. In the cutting red tape review, some businesses felt advice given by FCA staff was often misinterpreted as requirements rather than recommendations. To address this, businesses would welcome greater opportunity to discuss with their supervisor how they developed their approach to identify and manage their AML risks. The cutting red tape review also suggested that HM Revenue and Customs (HMRC) could support Money Service Businesses (MSBs) in accessing wider financial services by providing evidence of their compliance with the regulations.

1.11 Respondents also strongly supported greater oversight of the regime, to monitor supervisors' compliance with the regulations and strengthen coordination. In particular, respondents suggested that increased oversight should ensure consistent approaches across supervisors operating in the same sector. Respondents also noted that greater oversight could hold supervisors to account for their performance, and that it could address the perceived risk

that professional bodies' representative functions undermine their regulatory objectives. Increased government oversight should be complemented by new powers to effectively drive up standards within the system, including powers to monitor professional bodies' activities, and to penalise poor practice. Respondents agreed that government should focus on ensuring supervision is effective, rather than the number of supervisors.

1.12 Responses to both the cutting red tape review and the call for information highlighted issues with the AML guidance available to businesses. Issues raised included too much guidance; not enough guidance; inconsistent guidance; and out-of-date guidance. Inadequate guidance could create uncertainty for businesses as they comply with their obligations, increasing unnecessary burdens as well as potential risks to the UK regime.

Next steps

1.13 The government's aim is for the AML/CFT regime to make the UK's financial system a hostile environment for illicit finance. The responses to the call for information and the cutting red tape review demonstrated that government, and supervisors, can do more to ensure a consistently high standard of supervision across the regime, minimising potential opportunities for money laundering as well as the burden on legitimate businesses.

1.14 Therefore, the government:

- intends to clarify the obligations on all supervisors through the new regulations, including requiring that they:
 - draw on common factors as they develop risk assessments for their populations, including those identified in the NRA, to ensure consistency across the regime. Where several supervisors monitor populations with similar characteristics, they will be able to develop common risk assessments
 - monitor their populations, and take action as necessary to ensure their compliance with the regulations, including issuing effective, proportionate and dissuasive penalties as appropriate, and hold records of their investigations and decisions to take, or not to take, disciplinary action
 - have powers to request information from their populations, to ensure their awareness and risk assessments are underpinned by up to date and accurate evidence
 - share information with other supervisors where it would help strengthen the regime, and hold details of their supervised populations, including supervisory records, to facilitate engagement with law enforcement
 - ensure their staff are appropriately trained to identify, assess and manage current and emerging AML risks
 - provide information to inform the Treasury's Annual Supervision Report, which will be expanded to include new questions on enforcement activity, to increase transparency and strengthen public confidence in the regime
 - have sufficient safeguards in place to ensure potential conflicts of interest do not undermine their decisions in the public interest where professional bodies both advocate for and supervise their members. This should include ensuring their advocacy and supervisory functions are operationally independent, and having an appointed person to engage with law enforcement and other supervisors on AML issues

- will introduce a new Office for Professional Body AML Supervision to work with professional bodies to help, and ensure, compliance with the regulations. The Office will be hosted by the FCA. It will carry out this function separately from its existing supervisory teams, and it will be funded through a new fee on professional body supervisors that the FCA will consult on in due course. Through this Response, the government seeks further information on the Office's mandate, and its powers to:
 - set out, in guidance, how professional bodies should fulfil their obligations under the regulations
 - monitor professional bodies' activities, including requiring their staff to provide information or attend interviews on request, and will participate in on-site visits
 - work with professional bodies to ensure they meet their obligations under the regulations, and if necessary to ensure compliance it may publicly censure or recommend that Treasury remove a professional body as an AML supervisor
 - liaise with others across the regime to discuss and share best practice to help ensure consistent high standards across supervisors, especially where statutory and professional body AML supervisors monitor the same sectors, and to strengthen collaboration between professional body AML supervisors, statutory supervisors, and law enforcement
- welcomes work by the FCA and all other supervisors to continually review and improve their risk-based approach to supervision, taking on board the issues raised through the call for information and the cutting red tape review to strengthen the regime.
- will work with a reformed Money Laundering Advisory Committee (MLAC) to approve one piece of AML guidance for each sector. These will be complemented by the Joint Money Laundering Steering Group (JMLSG) Guidance and FCA's Financial Crime Guide. All guidance will be subject to end-user tests, to help businesses implement the guidance. Once in place, the Office will work with drafters of guidance so that the approval process is more efficient and transparent.

1.15 The obligations on supervisors will be clarified, and key guidance updated and published, by June 2017, when the new regulations are implemented in line with the transposition of the Fourth Money Laundering Directive. The government will consult on the draft regulations that will underpin the Office over the summer, then they will be finalised and laid before Parliament in the autumn. The government expects the Office to be fully operational by the start of 2018.

1.16 These reforms take forward the government's commitment to review the supervisory regime in the Action Plan. It complements wider government work to deliver on the commitments in the Action Plan, addressing issues identified in the NRA to strengthen the UK's anti-money laundering regime. The Criminal Finances Bill will strengthen law enforcement's powers to investigate, and punish, money laundering and terrorist financing activity. The Fourth Money Laundering Directive, which will be transposed by June 2017, will bring the UK's AML/CFT regime into line with the latest Financial Action Task Force (FATF) standards.

2 Supervisors' obligations

This chapter looks at how different supervisors take different approaches to monitoring and managing AML risks. It discusses how government could clarify its expectations of supervisors to ensure a consistently high standard of supervision across the regime, minimising potential opportunities for money laundering and unnecessary burdens on businesses, and sets out the government's response.

The identification and mitigation of risk

2.1 Whilst some supervisors already collaborate to monitor each other's risk identification and management processes, the majority of supervisors supported greater government oversight to ensure consistency. This should be proportionate, and could be integrated into the existing Annual Supervisors Returns process.

2.2 Some supervisors noted that they already have powers to access information on their populations' activities, and this underpins their approach to identifying and managing AML risks. Several professional bodies noted that while they do not have powers to compel their members to comply with requests for information or access to their premises, failure to cooperate results in immediate referral to the supervisor's disciplinary process. Respondents broadly supported making access to their populations' information and premises a universal requirement of a supervisor, though industry respondents noted the timescales for providing information should be reasonable. Several respondents suggested all supervisors should have a broad power to request information, and discretion to tailor requests depending on the type of business concerned and wider circumstances.

2.3 The FCA and the SRA also highlighted their 'deep dive' reviews and their thematic reviews, which highlight risks amongst their regulated firms, whilst deepening their understanding of how their monitoring affected business practices. Industry respondents, and most supervisors, agreed thematic reviews should be used more widely, and the findings could be usefully shared through Anti-Money Laundering Supervisors Forum (AMLSF)/Affinity Group discussions on emerging trends. However, respondents also cautioned that thematic reviews were most useful when strategically targeted at key risks and completed quickly. Mandating their frequency would undermine the risk based approach, whilst imposing unnecessary burdens on businesses. Deep dive reviews were considered a useful complement to day to day monitoring, but not a replacement.

2.4 Respondents agreed that a single supervisory risk assessment across the regime would need to be very high level, and therefore less useful for supervisors in their day to day monitoring of their populations. However, sector specific risk assessments would help ensure consistency across supervisors. These risk assessments should reflect risks across the regime where possible, for example those identified as cross cutting in the NRA, to help ensure the assessments are comparable across sectors where practical. AML risk assessments should also be integrated into supervisors' wider approach to supervision, to minimise unnecessary burdens on business.

Penalties and enforcement

2.5 There was broad support from respondents for all supervisors having consistent penalties, especially to address the perceived risk that discrepancies could incentivise 'supervisor shopping.' Industry respondents generally supported all supervisors being required to levy a scalable fine to penalise malpractice, suggesting this would improve certainty. However, supervisors contended that a formula could not take into account all the possible aggravating and mitigating factors, from the scale of the breach to the size of the firm to prior disciplinary records, and still be

effective. Some professional body supervisors noted that implementing a formula for fines would require changes to their constitutions, or legislation.

2.6 Some respondents suggested that all supervisors should abide by a common framework for the use of penalties, to help ensure consistency across the regime. It was thought that greater oversight of supervisors' application of penalties against that framework would ensure that the powers are used proportionately, effectively and dissuasively. The majority of supervisors noted that they already publish enforcement plans, or are prepared to do so, in order to help deter criminals whilst building public confidence in the regime. One supervisor noted that it also publishes its investigatory activity, which helps the public understand how its monitoring leads to enforcement action.

2.7 Several supervisors cautioned against publishing enforcement statistics, because it could lead the public to draw incorrect conclusions about specific supervisors and their populations. Some felt the Treasury should publish enforcement statistics from across the regime in its Annual Supervision Report.

2.8 Respondents unanimously agreed that all supervisors should have the power to expel their members. These powers are subject to internal disciplinary processes. While industry respondents strongly supported a new independent appeals process, especially if supervisors are granted new powers, supervisors contended that a single appeals process for AML issues would be difficult to implement in practice due to AML being integrated into their wider supervision.

2.9 One respondent noted that not all supervisors currently have adequate monitoring and disciplinary arrangements, while another suggested that supervisors should increase resources for these functions. This should include resources to effectively monitor their populations' compliance, staff a whistle-blowing team and operate an independent disciplinary process.

Information Sharing

2.10 Both law enforcement and supervisory organisations recognised that information sharing helps tackle money laundering and terrorist financing risk. For example, it enables supervisors to consider the outcomes of investigations when assessing their members' risk. Industry were also in favour of greater information sharing.

2.11 However, law enforcement are often cautious about sharing sensitive information where it risks prejudicing investigations, or could cause commercial harm, if misused. While some supervisors felt law enforcement would feel more comfortable sharing intelligence if law enforcement better understood how they supervised, both law enforcement and supervisors agreed more safeguards could, and should, be put in place to facilitate information sharing. In particular, law enforcement and some supervisors agreed that the appointment of single points of contact would improve engagement. Several supervisors were willing to agree Memorandums of Understanding with law enforcement to underpin engagement, and one supervisor suggested supervisors should only employ supervisory staff that pass a fit and proper test.

2.12 The majority of respondents agreed a single public register of businesses and individuals registered under the regulations would help address information gaps whilst ensuring unregulated firms are captured. That said, some supervisors contended that a new register would likely be very expensive to create and maintain, for the benefit of a relatively limited number of potential users, and others noted that a business' inclusion on a register could be misinterpreted as regulatory approval.

Ensuring high standards of awareness

2.13 Respondents noted that there is already a legal obligation on businesses to ensure their staff are appropriately aware of ML/TF risks, and that there are a range of training opportunities available. However, the quality of these varies widely. Some suggested that government endorsement of high quality courses, or the creation of government-endorsed qualifications, would help businesses identify high quality opportunities. Others cautioned that businesses are best placed to choose training for their employees, taking into account their sector, business activities and the needs of their staff. Several supervisors noted that they already provide AML training courses for their populations. One supervisor suggested supervisors should apply a fit and proper test prior to admitting new members.

2.14 Many industry respondents to the call for information felt supervisory staff could better understand their sectors, especially relevant innovative products and emerging risks. This could help ensure more effective assessments and a more strategic allocation of resources. The cutting red tape review also found some businesses felt that their supervisors' approaches are too prescriptive, and as those businesses complied with their supervisors' expectations they were both tackling money laundering risks less effectively while over-complying with the regulations. This diverted resources from activities that could actually be targeted at addressing money laundering risks.

2.15 Some respondents to the call for information felt a national qualification could help ensure consistent standards of supervision across supervisors. Several supervisors agreed that as adequate training is compulsory for their populations, it should also be compulsory for supervisors. A national qualification for AML supervision would help ensure a consistent approach to supervision across the regime. Others contended that they already train their staff and there is no evidence that their staff need more training. Some respondents noted that there are few training opportunities for supervisory staff, and that government could usefully set the standard for supervisors. Others felt attendance at AMLSF improved their staff's awareness. It was suggested that AMLSF could be enhanced as an awareness raising opportunity, if specific seminars by supervisors, government or law enforcement were added to the agenda. Several respondents highlighted that the focus should be on ensuring expertise is effectively applied to address money laundering risks, rather than on completing the training itself.

Transparency

2.16 To underpin public confidence in the regime, almost all respondents agreed that all supervisors should provide an annual return for Treasury's Annual Supervision Report. Some respondents suggested that the scope of the return could be expanded to enhance transparency of specific issues in the regime, e.g. enforcement.

2.17 As above, the majority of supervisors said they already publish annual reports on their enforcement activity, or indicated that they would be prepared to do so. They felt this helped inform their populations whilst deterring criminals and building public confidence. One supervisor highlighted that it also publishes reports on its investigations, and suggested other supervisors should be more transparent around how day to day monitoring leads to investigations. Another supervisor suggested that publishing an annual enforcement plan should be a condition of being an AML supervisor. A civil society respondent suggested that all supervisors should meet the Macrory enforcement principles – this would involve publishing their enforcement policy, individual actions and advice on appeals.

2.18 Other supervisors cautioned that transparency should not provide a ‘roadmap for criminals’ or harm business by releasing sensitive information, and should be carefully communicated to assure the public and build confidence in the UK’s regime.

2.19 Several supervisors suggested Treasury could introduce a requirement through legislation to ensure all supervisors provide an annual return. Alternatively, Treasury could agree a Memorandum of Understanding or a binding agreement with AML supervisors, setting out minimum terms of service including providing an annual return.

Government Response

2.20 The government recognises there are benefits to a range of supervisors monitoring the UK’s AML regime. It ensures the risks of diverse and innovative products are assessed by experts that understand their sectors, and are effectively managed. It also enables AML supervision to be integrated into wider oversight of business activities, reducing regulatory burdens and improving competitiveness. However, while there are benefits to having a range of supervisors, the effectiveness of supervision is inconsistent. Different supervisors can take different approaches to measuring and managing risks amongst their supervised populations, to promoting transparency around their activities and to training their staff to be aware of emerging risks. This creates an uneven playing field for business while also increasing the risk that criminals could exploit the UK’s financial system.

2.21 Therefore, the government intends to introduce reforms to ensure all AML supervisors meet common standards, and cooperate with their counterparts and law enforcement. This will ensure a consistently high standard of AML supervision across the regime, whilst cutting unnecessary burdens on business.

2.22 Supervisors will be required to draw on common factors as they draw up their risk assessments for their populations, including those identified in the NRA, to ensure consistency across the regime. Where several supervisors monitor populations with similar characteristics, they will be able to develop common risk assessments, and the government encourages them to do so.

2.23 All supervisors will be required to monitor their populations, and take action where necessary to ensure compliance with the regulations. The government recognises that supervisors require discretion to issue effective, proportionate and dissuasive penalties within this common framework, and they will be able to decide for themselves which disciplinary measures and complementary appeals processes they need to ensure their populations comply with the regulations. The disciplinary measures will operate alongside other powers and procedures available in the regulations. In addition, the government will strengthen supervisors’ accountability by requiring them to maintain records of any actions taken in the course of their supervision, and reasons for deciding not to impose disciplinary measures in a particular case.

2.24 Supervisors will also have powers to require their populations provide appropriate information, or attend a meeting, to help ensure their risk assessments are underpinned by up to date and accurate evidence. The government recognises that onsite visits helps supervisors monitor their populations and builds trust – should a business refuse to cooperate voluntarily with an onsite visit, the government expects supervisors to adapt their approach accordingly to ensure that member’s compliance with the regulations. Close collaboration between supervisors is key to ensuring the UK’s AML supervisory regime is effective and efficient, and the government expects all supervisors will attend AMLSF, and other forums where relevant, to facilitate this.

2.25 Supervisors will be required to cooperate with other supervisors, and hold information on their populations, including their supervisory records, to facilitate engagement with law

enforcement. Professional body supervisors will also be required to appoint single points of contact to liaise with other supervisors and law enforcement. The government expects these reforms will facilitate the flow of useful information across the regime and with law enforcement, strengthening the regime without requiring a new central database, which would be expensive to create and maintain.

2.26 To ensure high awareness of current and emerging risks in the regime, employers must continue to provide appropriate training for their staff to help them identify and respond to risk. Going forward, this obligation will be extended to supervisory organisations. The government will continue to encourage supervisors to make available appropriate courses designed to meet their populations' needs.

2.27 The government intends to legislate to clarify these obligations by June 2017, as required by the Fourth Money Laundering Directive, and will publish an Explanatory Memorandum alongside the regulations. The draft regulations were published alongside this Response and the government welcomes views on whether they fulfil the government's policy intent by 12 April 2017.

2.28 The government will review these requirements in line with its obligations under the Small Business, Enterprise and Employment Act 2015, in particular to ensure the objectives in the regulations continue to be appropriate, assess the extent to which they achieved and also consider if the objectives could be achieved with less onerous regulation.

3 Supervisors' effectiveness

This chapter notes respondents' emphasis that the focus should be on the effectiveness of supervision, rather than the number of supervisors, and considers how statutory supervisors, including the FCA, have responded to feedback on their approach. It also discusses how increased government oversight could ensure high standards, especially where several supervisors are active in one sector. The government sets out its response, including its intention to increase oversight of professional body supervisors, and seeks further views on the scope and powers of that oversight function by 26 April 2017.

The supervisory regime

3.1 Respondents highlighted the strong advantages of having a range of AML supervisors in helping ensure that a diverse range of innovative products are fully understood and that their risks are minimised. There was broad agreement that close cooperation between supervisors helps improve consistency and addresses risks within and across sectors. Participation in strategic meetings, including AMLSF and the Affinity Groups, provides useful opportunities for supervisors to work together to develop and share best practice. There was, therefore, broad support for attendance at AMLSF being compulsory for supervisors, though some noted video conferencing should be an option for those based outside of London. One respondent suggested membership be expanded to supervised businesses as observers.

3.2 That said, most industry respondents felt they encountered inconsistencies in the supervisory approach, especially where they did business across sectors. A civil society respondent noted the Hampton Review, which found multiple regulators operating in the same area contributes to duplication, contradiction and inefficiency. Whilst some industry respondents favoured reducing the number of supervisors or greater pooling of resources within sectors, suggesting this would enhance expertise and lead to a more efficient allocation of resources, other respondents contended that it could reduce the benefits of specialist expertise.

3.3 In addition, professional body supervisors highlighted practical challenges to pooling of resources, including incompatibility between professional body by-laws and across devolved administrations, as well as the risk that larger organisations could erode the benefits of niche expertise their smaller counterparts contributed to the regime. In general, the possible removal of an organisation as an AML supervisor was felt to be a more effective incentive for improvement than the pooling of resources.

3.4 Overall, all supervisors, and some industry respondents, highlighted that the focus should be on the effectiveness of supervision, not the number of supervisors. To ensure supervisors provide consistently high standards of supervision, respondents strongly supported government setting clear standards for effective supervision with detailed guidance and greater oversight to help supervisors comply effectively.

3.5 One respondent highlighted that FATF has endorsed the Spanish supervisory model, where a single organisation hosts the Financial Intelligence Unit and directly monitors those involved in activities at risk of money laundering. However, another respondent noted a single supervisor would need to be large to be effective, with different departments for different sectors, and it would lose the benefits of working within a wider supervisory framework.

Accountability

3.6 Respondents agreed clearer AML standards for supervisors should be complemented by greater oversight of the regime. Supervisors felt a new oversight body could helpfully develop standards of effective supervision, while industry suggested it should assess supervisors' effectiveness to ensure high and consistent standards within sectors and across the regime, with investigatory and disciplinary powers to hold supervisors to account. A civil society respondent suggested that an oversight body should make professional bodies accountable to Parliament, as well as their members, and ensure organisational independence between their advocacy and supervisory teams. Many felt that an oversight body should have a detailed understanding of its sectors, and the regime, and that it should provide strategic insights to inform future NRAs.

3.7 There was a mixed response to the suggestion that the National Audit Office (NAO) should scrutinise supervisory performance. While industry suggested that the NAO's expertise might be useful in some areas, supervisory respondents questioned the relevance of its public spending expertise to AML supervision. Supervisory respondents agreed Treasury could provide greater oversight if appropriately resourced, and noted that integrating oversight into an existing body would reduce the potentially high costs of creating a new organisation. Other respondents suggested a new organisation, modelled on the Legal Services Board or the Financial Reporting Council, would best oversee the system, and that an oversight body's activities could be funded by a levy or fee on supervisors.

3.8 Many industry respondents felt that MLAC's mandate should be reviewed, and its mandate and membership extended. Several supervisory respondents felt MLAC's appointments procedure should be more transparent, and that supervisors should have greater representation if MLAC were to take on a more significant role in overseeing the supervisory regime. However, an industry respondent cautioned that supervisors' representation and influence at MLAC may undermine its effectiveness if it were to act as an oversight body.

The effectiveness of statutory supervisors

3.9 In its 2016 FSAP of the UK, the IMF noted that around a fifth of global banking activity is booked in the UK, and its size, complexity, range of products and services, volume of transactions and interconnectedness with the international financial system exacerbates the risks of money laundering in the banking sector. The FCA has highlighted that a number of banks must do more to manage money laundering and terrorist financing risks, including stronger governance, better quality customer risk assessments and greater awareness of potential vulnerabilities in their products, services and distribution lines.

3.10 Respondents to the call for information felt that the FCA's risk-based approach to AML supervision focused too heavily on the largest firms, with less scrutiny on smaller firms. This is in line with the IMF's findings. In the cutting red tape review, several businesses highlighted they did not feel the FCA's staff took into account the specific nature of the sector and clients of their business when assessing their AML systems and processes. Instead, the FCA would focus on issues that could be easily measured or compared to other businesses. In addition, businesses felt advice given by FCA staff was often misinterpreted as requirements rather than recommendations. To address this, they would find it helpful if they had greater opportunities to explain how they developed their models to effectively address risks in their sector, meeting their obligations under the regulations and the FCA's expectations. Whilst the FCA noted it would welcome discussions on these issues, some businesses did not feel this was the case and felt it would be safer to reform their systems as instructed, especially as their compliance staff sometimes focused on self-preservation above cutting crime.

3.11 The cutting red tape review also suggested that HMRC could support MSBs in accessing wider financial services by providing evidence of their compliance with the regulations.

Professional body supervisors

3.12 Most industry respondents favoured greater independence between professional bodies' supervisory and advocacy functions, noting the potential conflict of interest. A civil society respondent highlighted Sir David Clementi's review of the legal regulatory framework, which recommended professional bodies separate their advocacy and supervisory roles. One industry respondent noted fully separating supervision from advocacy would increase burdens on business, as AML monitoring would be separated from wider supervision of business activities, but felt this could be acceptable if there was a substantial increase in standards. Several respondents noted that legal professional bodies in England and Wales already maintain separate management and governance structures for advocacy and supervisory work within the same organisation, but one legal supervisor noted that this was very expensive and it may be more efficient to completely separate the two functions.

3.13 An industry respondent contended that, in practice, professional body supervisory teams are often separate from the advocacy teams. This respondent also emphasised that integrating AML monitoring into a wider framework increases supervisors' opportunities to identify and manage risks. Supervisory respondents agreed, and noted specific circumstances where advocacy and supervisory teams can effectively collaborate to raise AML standards – for example, because there are more opportunities to engage members to raise awareness of emerging risks.

3.14 Several supervisors also emphasised that there is no evidence of a potential conflict of interest undermining the quality of supervision. Instead the interests of supervisors' members and the public are aligned because supervisors' members would also expect strong action to be taken to penalise money launderers and safeguard the reputation of the profession. In practice, several supervisors noted existing safeguards against potential conflicts of interest include a complaints process, independent disciplinary procedures and external feedback as well as, in some cases, separate departments for advocacy and supervisory activity. Other supervisors highlighted their existing safeguards also include allowing experienced and impartial individuals to provide an independent and external perspective, as lay members participate in regulatory committees.

3.15 Some respondents noted that forcing professional bodies to separate their AML supervision from wider regulatory supervision would introduce a two-tier regulatory system, where professional bodies are trusted to supervise for many regulated activities but not AML/CFT. Mandating separation would also cause substantial upheaval within the sector, and government could intervene more effectively by working with professional bodies to address perceived conflicts of interest and ensuring clearer segregation of roles and responsibilities. A civil society respondent noted that greater accountability, possibly through a new oversight body, would help ensure supervisory functions operate more autonomously.

Government response and further questions

3.16 The government agrees the focus should be on the effectiveness of supervision, not the number of supervisors. It notes that all supervisors, including FCA and HMRC, are implementing a risk-based approach to supervision to ensure resources are strategically allocated according to where they can have the best effect. As supervisors continually monitor and review their approach, this ensures the right balance is struck between managing risk and minimising unnecessary burdens on business. This approach reflects best practice, and is endorsed by FATF.

3.17 That said, the call for information and the cutting red tape review have identified areas for improvement across the regime, and the government will look to address these issues and strengthen the regime through the reforms set out below.

3.18 The government agrees that the MLAC provides an important forum for policy development. It will use a revitalised MLAC this year to review and feedback on the operation of an effective and proportionate AML/CFT regime in the UK, implementing FATF standards and EU Money Laundering Directives and informing their development. It will also provide a forum for engagement between industry, government, supervisors, law enforcement and the private sector to ensure evidence based policy making, and for sharing threat assessment and emerging risks across different sectors.

The performance of statutory supervisors

3.19 The government notes that the IMF highlighted AML supervision is a priority for the FCA. The FCA's focus on the largest, most systemic banks reflects the higher risk such banks pose, as these banks account for 95% of the UK's retail banking market and 77% of the UK's wholesale market. The FCA has a strong understanding of the risks these banks pose, which has been enhanced through the Systematic AML Programme, which provides deep dive reviews of the 14 major retail and investment banks operating in the UK on a four yearly cycle. And this is delivering results – in its 2016 FSAP of the UK, the IMF noted that senior management in many banks, including large banks, appear to be prioritising AML. And last month, the FCA issued a £163m fine to Deutsche Bank for failing to maintain an adequate AML framework, which had resulted in the bank being used by unidentified customers to transfer approximately \$10billion from Russia to offshore bank accounts.

3.20 That said, the government and the FCA recognise more attention should be given to smaller banks, as is demonstrated by the call for information and the cutting red tape review. The government welcomes the FCA's most recent reforms that continue to enhance its approach to supervision in this area. The FCA has increased the resources allocated to smaller firms to improve communications and carry out more onsite visits. It has also introduced a new data return programme covering a range of businesses to help inform its overall risk assessments. Looking forward, the FCA has introduced a programme of risk assurance visits directed at smaller firms to test whether their lower-risk ratings remain accurate.

3.21 Likewise, HMRC and the Gambling Commission continue to strengthen oversight of their sectors. HMRC's interventions and penalties due to non-compliance are increasing year on year - in 2015/16 HMRC issued around 1200 penalties, 70% more than in 2014/15. In particular, HMRC has completed a comprehensive programme of visits to MSBs to enhance its understanding of the risks within this sector – and will publish its findings shortly. HMRC provides guidance to ensure its populations are aware of their obligations under the regulations, which the cutting red tape review noted is held in especially high regard by many supervisors and businesses for its usability. HMRC has also produced a series of webinars for the accountancy, estate agency and trust or company service provider sectors, which have been well received, and will be extended to all sectors this year. In addition, HMRC has a strong and rigorous outreach programme as it works closely with other accountancy service provider AML supervisors, to ensure all businesses in the sector are supervised, and compulsorily deregistered more accountancy services providers in 2015/16 than in 2014/15.

3.22 The Gambling Commission has recently added a new condition to gambling operator licences to ensure that operators take responsibility for identifying, assessing and managing the money laundering risks in their businesses. It requires operators to undertake and review money laundering risk assessments at least annually, and ensure that their policies, procedures and

controls are effective in mitigating the risks identified. The Gambling Commission also places substantial emphasis on operators learning from compliance failings and incorporates lessons learned into its compliance and supervisory approach.

The performance of professional body supervisors

3.23 The government agrees increased oversight will help ensure supervisors provide a consistently high standard of supervision. As several business respondents to the call for information highlighted, this would be most useful where multiple supervisors operate in the same sector. In practice, this primarily refers to the accountancy and legal services sectors where 23 supervisors are active, of which 22 are professional bodies.

3.24 In addition, whilst the government recognises that no evidence has been provided to suggest professional body supervisors' supervisory activities and decisions have been unduly influenced by their dual role as advocates for their members, the perception of this risk, as highlighted in the NRA, remains. The regulations will require that professional bodies ensure their supervisory and advocacy functions are operationally separate and greater oversight is key to ensuring professional bodies' supervisory activities are not undermined by their advocacy role.

3.25 To provide increased oversight and more consistent and effective supervision, the government will introduce a new Office for Professional Body AML Supervision. As set out below, the Office will focus its work on the accountancy and legal sectors, where multiple professional bodies work together to provide AML supervision. It will provide a centre of expertise and, once in place, will help inform government's analysis of the AML regime, including future National Risk Assessments.

3.26 The Office will work with professional bodies to develop high standards of supervision and hold them to account for their performance. The Office and professional body supervisors should liaise with statutory supervisors across the regime to discuss and share best practice to help ensure consistently high standards across supervisors, especially where statutory and professional body supervisors monitor the same sectors. This includes HMRC as a supervisor of accountancy and trust and company service providers. The Office will also liaise with other organisations as appropriate, including the Legal Services Board and the Financial Reporting Council, to ensure a consistent approach to professional bodies, and with law enforcement to facilitate the flow of information across the regime.

3.27 The Office will have an ongoing dialogue with professional bodies as it sets out guidance on how they might meet their obligations in the regulations, drawing on and promoting best practice in the sector. As far as appropriate, the Office's guidance will cover all obligations on professional bodies under the regulations from ensuring operational independence between their advocacy and supervisory teams, to ensuring they monitor their members and take necessary action to ensure their members' compliance with the regulations, to ensuring they provide adequate training for their staff and their members.

3.28 Where the Office considers the professional bodies could strengthen their AML/CFT supervision by adopting common standards that are not required by the regulations, it should encourage professional bodies to adopt those standards voluntarily. If necessary, the Office may request that Treasury consider amendments to the regulations to strengthen the obligations on professional body supervisors.

3.29 Professional bodies should take the Office's guidance into account as they fulfil their obligations under the regulations. The Office's guidance will not be binding, so professional bodies may develop their own risk-based approach to supervision if they feel it is appropriate and meets the legal obligations. However, if a professional body chooses to take its own

approach, rather than follow the Office's guidance, the Office may investigate them to ensure they continue to comply with their obligations in the regulations.

3.30 To ensure the Office can hold professional bodies to the standards laid out in regulations, the Office will have powers to monitor their activities, including powers to require professional bodies provide information, and that their staff attend interviews, as well as to be present during visits to members' premises. Where the Office receives sensitive information held by professional body AML supervisors, it will be protected by appropriate safeguards.

3.31 The Office will also have powers to intervene where it sees poor practice, including a power to publicly censure those that do not meet their obligations under the regulations. If necessary, the Office may recommend that Treasury remove a professional body's role as an AML supervisor. These powers will be complemented by appropriate safeguards, including appropriate appeal mechanisms.

Q1: Are these powers to monitor supervisors' activities and penalise poor practice sufficient? If more powers should be added, which powers might be?

Q2: Should the Office's powers to request information or attendance at interviews be extended to supervisors' members as well as supervisors themselves?

3.32 The government has committed to deliver new functions through existing organisations wherever possible, to minimise the number of new non-departmental public bodies. The Office's objectives are closely aligned with those of the Financial Conduct Authority, which holds overarching responsibility for protecting the integrity of UK financial markets. In addition, the FCA already oversees professional body supervision of regulated activities under Part XX of the Financial Services and Markets Act 2000, including several professional body AML supervisors. Therefore, the FCA will host the new Office. The Treasury will retain oversight of, and policy responsibility for, the AML supervisory regime.

3.33 The government recognises that the FCA already has a role in the AML regime, as the supervisor of banks and other financial services firms. To ensure the Office's role is distinct from that of the existing supervisory teams, the Office will be created as a new team within the FCA. It will have a separate identity and representation at relevant meetings. The Office will also have its own chapter in the FCA's Annual Report, where it will publish its progress against its objectives, its priorities for the coming year and its expectations around emerging risks. The Office will also raise its own funding for its activities through a new fee on those it oversees – the FCA will consult on the details of how this fee will operate in due course.

Q3: Should the Office report annually on other issues, in addition to its performance against its objectives in that year, priorities for the coming year and expectations around emerging risks? If so, which issues should the Office report on?

Q4: The government envisages the Office having representation at the Money Laundering Advisory Committee and the Anti-Money Laundering Supervisors Forum, and engaging with the Accountancy and Legal Affinity Groups. What role could the Office best fulfil in each forum, and are there other fora the Office should attend – if so, which?

3.34 The Office will help improve the quality and effectiveness of AML supervision. It will work with professional bodies to ensure consistently high standards across the regime while retaining the benefits professional bodies bring to the AML system. The government's primary intention is not to reduce the number of professional body supervisors. That said, if a professional body no longer wishes to fulfil the role of an AML supervisor, or the Office recommends one be removed, the Treasury stands ready to amend the list of AML supervisors in the regulations accordingly

3.35 The government expects that the AML supervisory landscape will continue to evolve over time, as organisations choose to take up, or step back from, the responsibility of an AML supervisor. Given these possibilities, the government is keen to understand how AML supervision in the legal and accountancy sectors might develop. The government does not envisage the Office directly supervising AML activities.

Q5: How might the AML supervisory regime evolve over the next five to ten years, especially in the legal and accountancy services sectors? What are the advantages and disadvantages to the potential options – how might government help minimise the disadvantages?

Q6: Are there other issues you would like government to take into account as it considers increasing the oversight of AML supervision in the accountancy and legal sectors?

3.36 The government welcomes views on these questions. Details of how to respond are provided in Annex B, and the deadline for views to be submitted is 26 April 2017.

4 Supervisory guidance

This chapter looks at the guidance on identifying and managing money laundering risks, which is provided by industry and supervisors. It considers how inconsistencies across guidance, as well as the volume of guidance, can impose unnecessary burdens on business. This chapter also considers options to address these issues, and sets out the government's response.

4.1 The cutting red tape review highlighted that the quantity of guidance issued for supervised businesses, and differences in guidance between supervisors, can increase uncertainty and compliance costs for businesses, and create risks within the regime. Respondents to the Review also suggested that guidance often does not sufficiently distinguish between legal requirements and best practice, and businesses are not sure which pieces of guidance should take precedence where there are inconsistencies. Most industry and supervisory respondents to the call for information agreed, noting that JMLSG's guidance and the FCA's Financial Crime Guide do cross refer, but the documents should be more clearly complementary and easier to understand. That said, respondents to the call for information also highlighted that these two pieces of guidance are held in high regard by businesses.

4.2 Some respondents to the call for information felt a core, high level guidance document applicable across the regime could usefully reduce duplication whilst improving overall consistency and understanding. Others suggested this would be too high level to be useful, and could cut across the JMLSG's guidance. Many respondents noted that sector-specific guidance is drafted by industry experts, and it would be difficult for government to match their understanding.

4.3 There was strong support for continued Treasury oversight of guidance, both to provide legal safe harbour for users and also to help ensure guidance across the regime is consistent. However, in line with the cutting red tape review's findings, several supervisory respondents suggested that the process for approving guidance should be more transparent and efficient. In particular, respondents underlined the importance of ensuring that guidance is kept up to date, especially to recognise how innovative approaches and new technologies can aid compliance. Several respondents called for a more active role for AMLSF and MLAC in the guidance approval process.

4.4 The cutting red tape review also highlighted that some businesses felt guidance, and their supervisors, placed substantial emphasis on hard copy documents for customer due diligence checks, which was said to be inefficient, biased against digital business models, and unnecessarily gold plated the regulations. Many businesses felt guidance should be updated, and kept up to date, to reflect technological developments. In addition, the cutting red tape review also highlighted that, whilst there are no legislative barriers to one business relying on due diligence checks on a customer carried out by a second business, the liability for carrying out due diligence properly lies with the first. Some businesses felt that guidance emphasised this to the extent of discouraging reliance, whilst different supervisors recommend different types of checks be carried out for due diligence. The difficulties businesses face when relying on each other's due diligence increases burdens on both businesses and consumers.

Government response

4.5 The government agrees the range of guidance available to businesses must be streamlined to help ensure all businesses adopt consistently high quality approaches to manage risks, strengthening the regime. This will also minimise unnecessary burdens on businesses, as well as reduce duplicated efforts across supervisors.

4.6 Once the Fourth Money Laundering Directive is transposed in June, the guidance industry and supervisors provide their populations must be updated to reflect the new regulations. The Treasury will work with supervisors and industry to develop single pieces of guidance tailored to the nature and risks of each sector.

4.7 The government agrees sector-specific guidance can be effectively complemented by overarching guidance applicable across the regime. At present, these details are set out in the FCA's Financial Crime Guide, which provides detailed case studies on good and bad AML practice, and the JMLSG's guidance, which provides details on how to manage risks in a range of circumstances. The government has considered a number of options to streamline these two pieces of guidance, with a view to creating a single point of reference. However, a new piece of guidance would likely duplicate the FCA's Financial Crime Guide as well as the JMLSG's guidance, increasing burdens on users whilst adding little value. Whilst they could be merged to create a single point of reference for businesses, this would conflate the two products that serve very different purposes.

4.8 Therefore, the Treasury will review the FCA's Financial Crime Guide and the JMLSG's guidance as they are updated to reflect the Fourth Money Laundering Directive. It will ensure the FCA's Financial Crime Guide and the JMLSG's guidance clearly complement each other, and the single sector guidance.

4.9 Going forward, the government will work with a reformed MLAC to approve one piece of AML/CFT guidance for each sector. This process will also ensure that all AML guidance reflects feedback from the intended users on its readability and functionality, including clearly distinguishing between legal obligations and best practice, in response to the cutting red tape review's findings. In addition, the Treasury will continue to ensure that a supervisor considers whether a business followed relevant guidance when it decides whether that business has contravened the Regulations, reflecting businesses' support for the safe harbour status of guidance in their responses to the call for information.

4.10 Once established, the Office for Professional Body AML Supervision will work with industry and professional bodies as they develop their guidance for the legal and accountancy services sectors. Once the Office is content that the guidance meets the necessary criteria, including feedback from intended users on its usability and functionality, it will pass the guidance to Treasury and MLAC. This will improve the transparency and efficiency of the guidance process.

4.11 The government notes that robust customer due diligence is key to an effective AML/CFT regime, and the UK's regulations require due diligence checks be carried out in line with international best practice and EU law. Whilst there are no legislative barriers to businesses relying on each other's due diligence checks, many businesses choose not to do so, both because they are ultimately responsible for carrying out due diligence checks on their customers, and for commercial reasons. That said, the government does recognise the burdens these obligations place on businesses and consumers and, as the cutting red tape review highlighted, full customer due diligence can sometimes be unnecessary. Therefore the government is looking to help reduce these burdens where possible.

4.12 The new regulations, once implemented in June, will provide businesses with flexibility to apply simplified due diligence checks if they feel it is appropriate, in line with the risk based approach. The consolidation of guidance, as outlined above, will also streamline the recommended approach to due diligence checks across the regime, helping businesses rely on checks by businesses that are monitored by a different supervisor.

4.13 There will also be a significant expansion of third parties that can be relied upon, with the new regulations allowing reliance on all businesses in the regulated sector. The regulations clearly set out the circumstances in which businesses may rely on each other. The government understands that one of the barriers to reliance is that firms who are relied upon can be slow to provide the necessary CDD information, and is consulting on whether to specify a time period for providing this information to assist firms in developing reliance arrangements.

4.14 In addition, the government is looking to support the use of technology in accessing financial services, addressing the challenges highlighted by FinTech firms in the cutting red tape review and elsewhere. At Autumn Statement 2016, the government announced that it had agreed with JMLSG that they will update their guidance on electronic ID verification to support the use of technology in accessing financial services. Meanwhile, the FCA's Innovation Hub and Regulatory Sandbox has been approached by businesses offering new approaches to electronic ID.

A Full list of questions

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Q2: Should the Office's powers to request information or attendance at interviews be extended to supervisors' members as well as supervisors themselves?

Q3: Should the Office report annually on other issues, in addition to its performance against its objectives in that year, priorities for the coming year and expectations around emerging risks? If so, which issues should the Office report on?

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Q6: Are there other issues you would like government to take into account as it considers increasing the oversight of AML supervision in the accountancy and legal sectors?

B Responding to questions

Responding to this Call for Further Information

B.1 The government welcomes your views on the questions in this Call for Further Information.

B.2 In your response, please highlight the question number you are responding to for each answer.

B.3 Electronic responses are preferred and should be sent to: aml@hmtreasury.gsi.gov.uk

B.4 Questions or enquiries specifically relating to this consultation should also be sent to the above email address. Please include the words CALL FOR INFO VIEWS or CALL FOR INFO ENQUIRY (as appropriate) in your email subject. If you do not wish your views to be published alongside the government response to this consultation, please clearly specify this in your email.

B.5 Hard copy responses may be submitted to:

Call for Further Information – Oversight of the AML Regime

Sanctions and Illicit Finance Team

1 Blue, HM Treasury

1 Horse Guards Road

London

SW1A 2HQ

Confidentiality and Disclosure policy

B.6 Information provided in response to this consultation, including personal information, might be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004. If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice that public authorities must comply with and which deals, amongst other things, with obligations of confidence.

B.7 In view of this it would be helpful if you could explain to the Treasury why you regard the information you have provided as confidential. If government receives a request for disclosure of the information, the Treasury will take full account of your explanation, but it cannot give an assurance that confidentiality will be maintained in all circumstances.

B.8 An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Treasury. Your personal data will be processed in accordance with the DPA, and in the majority of circumstances, this will mean that your personal data will not be disclosed.

Timetable

B.9 The closing date for comments to be submitted is **26 April 2017**.

HM Treasury contacts

This document can be downloaded from
www.gov.uk

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