FINANCIAL ACTION TASK FORCE

Mutual Evaluation
Fourth Follow-Up Report

Anti-Money Laundering and Combating the Financing of Terrorism

UNITED KINGDOM

16 October 2009

Following the adoption of its third Mutual Evaluation (MER) in June 2007, in accordance with the normal FATF follow-up procedures, the United Kingdom was required to provide information on the measures it has taken to address the deficiencies identified in the MER. Since June 2007, the United Kingdom has been taking action to enhance its AML/CFT regime in line with the recommendations in the MER. The FATF recognizes that the United Kingdom has made significant progress and that the United Kingdom should henceforward report on a biennial basis on the actions it will take in the AML/CFT area.

THIRD MUTUAL EVALUATION OF THE UNITED KINGDOM:

SECOND FOLLOW-UP REPORT

Application to move from regular follow-up to biennial updates

Note by the Secretariat

Key decision:
Does the Plenary agree that the United Kingdom (UK) has taken sufficient action to be moved from regular follow-up to biennial updates and that the UK be asked provide a biennial update to the Plenary in two years time (October 2011)?

I. Introduction

1. The third mutual evaluation report (MER) of the UK was adopted on 29 June 2007. At the same time, the UK was placed in a regular follow-up process. [1] The UK reported back to the FATF in June 2009. The UK indicated that it would report to the Plenary again in October 2009 concerning the additional steps taken to address the deficiencies identified in the report, and apply to move from regular follow-up to biennial updates.

2. This paper is based on the procedure for removal from the regular follow-up, as agreed by the FATF plenary in October 2008[2]. The paper contains a detailed description and analysis of the actions taken by the UK in respect of the core and key Recommendations rated PC or NC in the mutual evaluation, as well as a description and analysis of the other Recommendations rated PC or NC, and for information a set of laws and other materials (Annex 1). The procedure requires that a country "has taken sufficient action to be considered for removal from the process – to have taken sufficient action in the opinion of the Plenary, it is necessary that the country has an effective AML/CFT system in force, under which the country has implemented the following Recommendations at a level essentially equivalent to a C or LC, taking into consideration that there would be no re-rating": Recommendations 1, 3 - 5, 10, 13, 23, 26, 35 - 36, and 40 and Special Recommendations I – V (set of core and key Recommendations). The UK was rated partially compliant (PC) or non-compliant (NC) on the following Recommendations:

Core Recommendations[3] rated NC or PC
R.5

1 For details regarding the follow-up process, please refer to the FATF mutual evaluation procedures dealing with the follow-up process (§35 and following).

2 Third Round of AML/CFT Evaluations Processes and Procedures, paragraph 39c and 40.

3 The core Recommendations as defined in the FATF procedures are R. 1, SR II, R. 5, R. 10, R. 13 and SR IV.

Key Recommendations[4] rated NC or PC
none
Other Recommendations rated PC
R.9, R.11, R.12, R.18, R.21, R.24, R.33, R.34, SR.VII
Other Recommendations rated NC
R.6, R.7, R.22

3. As prescribed by the Mutual Evaluation procedures, the UK provided the Secretariat with a full report on its progress. The Secretariat has drafted a detailed analysis of the progress made for Recommendation 5 (see rating above), as well as an analysis of all the other Recommendations rated PC or NC. A draft analysis was provided to the UK (with a list of additional questions) for its review, and comments received; comments from the UK have been taken into account in the final draft. During the process, the UK has provided the Secretariat with all information requested.

4. As a general note on all applications for removal from regular follow-up: the procedure is described as a *paper based desk review*, and by its nature is less detailed and thorough than a mutual evaluation report. The analysis focuses on the Recommendations that were rated PC/NC, which means that only a part of the AML/CFT system is reviewed. Such analysis essentially consists of looking into the main laws, regulations and other material to verify the technical compliance of domestic legislation with the FATF standards. In assessing whether sufficient progress had been made, effectiveness is taken into account to the extent possible in a paper based desk review and primarily through a consideration of data provided by the country. It is also important to note that these conclusions do not prejudge the results of future assessments, as they are based on information which was not verified through an on-site process and was not, in every case, as comprehensive as would exist during a mutual evaluation.

II. Main conclusion and recommendations to the Plenary

5. ***Core Recommendations:*** The UK has taken substantive action towards improving compliance with Recommendation 5, and nearly all of the deficiencies identified in the MER relating to the customer due diligence (CDD) framework have been addressed by the Money Laundering Regulations 2007. Although a few shortcomings remain, the UK has taken sufficient action to bring its compliance to a level essentially equivalent to LC.

6. ***Key Recommendations:*** The UK had previously been rated either C or LC on all of the Key Recommendations.

7. ***Other Recommendations:*** The UK has also made progress in addressing deficiencies in other Recommendations, especially R.6, R.7, R.12, R.24, and SR.VII. It should be noted, however, that since the decision of whether or not the UK should be removed from the regular follow-up process will be based solely on the decisions regarding the Core Recommendations (in this case, R. 5 only), this paper does not provide more detailed analyses regarding these other Recommendations.

8. ***Conclusion:*** Given the progress on R.5, the UK has reached a satisfactory level of compliance with all core Recommendations and key Recommendations. Consequently, it is recommended that this would be an appropriate circumstance for the Plenary to remove the UK from the regular follow up process, with a view to having it present its first biennial update in October 2011.

[4] The key Recommendations are R. 3, R. 4, R. 26, R. 23, R. 35, R. 36, R. 40, SR I, SR III, and SR V. Such recommendations are carefully reviewed when considering removal from the follow-up process.

III. Overview of the UK's progress

A. Overview of the main changes since the adoption of the MER

9. The most significant AML/CFT reforms enacted are the *Money Laundering Regulations 2007*; these regulations replace the Money Laundering Regulations 2003 with updated provisions that implement in part European Directive 2005/60/EC (the Third Money Laundering Directive). The Regulations provide for various steps to be taken by the financial services sector and other persons to detect and prevent money laundering and terrorist financing. Obligations are imposed on "relevant persons" (defined in regulation 3 and subject to the exclusions in regulation 4), who are credit and financial institutions, auditors, accountants, tax advisers and insolvency practitioners, independent legal professionals, trust or company service providers, estate agents, high value dealers and casinos. All institutions engaged in the 13 "financial activities" outlined by the FATF, and all relevant categories of DNFPBs are regulated under this legislation.

10. The Regulations strengthen requirements for customer identification, including applying CDD when there are doubts about previously obtained CDD documents or data, beneficial ownership, obtaining information on the purpose and nature of the business relationship, ongoing due diligence, and enhanced due diligence in high-risk situations. The Regulations also include new requirements dealing with, *inter alia*, PEPs, correspondent banking, shell banks, and overseas branches and subsidiaries. New Guidance complements the Regulations, and the Counter-Terrorism Act 2008 (amending previous law) came into effect in November 2008.

11. In addition, the UK has encouraged the development of supplementary guidance by relevant parties. As a result guidance issued by the following groups has been approved:

- The Joint Money Laundering Steering Group (JMLSG) – which has produced guidance for the financial services sector.
- HM Revenue & Customs – which has produced guidance for MSBs and TCSPs.
- The Combined Committee of Accountancy Bodies – which has produced guidance for accountants.
- The Notary Profession – which has produced guidance for notaries.
- Guidance for other sectors exists and is currently in the process of being approved.

12. The UK authorities indicate that a significant feature in the UK is that approved guidance is formally recognised in the Money Laundering Regulations and other provisions, and therefore carries a particular legal significance in the UK's AML regime. Government-approved industry guidance is also explicitly referred to in the FSA's Handbook of Rules and Guidance. A 2008 decision by the Financial Services Authority in the case of Sindicatum Holdings Ltd[5] provides a useful example of the enforceability of approved industry AML guidance. The failure to follow the JMLSG guidance, or to operate adequate alternative methods of customer due diligence, lead the FSA to conclude that there had been major breaches of the firm's anti-money laundering requirements, and thus breaches of the FSA's systems and control rules. This led to the imposition of a financial penalty. However, the Secretariat has not done a full analysis as to whether the guidance now broadly constitutes "other enforceable means" as defined in the AML/CFT Methodology, as the UK agrees this would be considered in its next mutual evaluation.

[5] Published on 29 October 2008, and available at: - www.fsa.gov.uk/pubs/final/sindicatum.pdf

13. The Counter-Terrorism Act 2008 came into effect on 27 November 2008. Schedule 7 sets out new powers for the Treasury to direct financial and credit institutions to apply a range of financial restrictions in respect of business with persons in a non-EEA country of money laundering, terrorist financing or proliferation concern. There are also monitoring and enforcement provisions.

14. The Transfer of Funds (Information on the Payer) Regulations 2007, which took effect on 15 December 2007, provides for the enforcement of the obligations set out in EC Regulation 1781/2006/EC on information on payer information accompanying funds transfers. SR IX is implemented in the UK by EC Regulation 1889/2005 of 26th October 2005; the Control of Cash (Penalties) Regulations 2007 took effect on 15th June 2007 and provide for the enforcement of the obligations set out in EC Regulation 1889/2005. These regulations provide for penalties for failing to declare movements of cash as required under article 3 of the Community Regulation, and an appeal mechanism.

B. The legal and regulatory framework

15. Primary legislation in the UK is referred to as an "Act". Acts may authorise the Government to issue secondary legislation, also referred to as regulations or "Statutory Instruments." The UK Treasury, in exercise of the powers conferred by section 2(2) of European Communities Act 1972 and by sections 168(4)(b), 402(1)(b), 417(1) and 428(3) of the Financial Services and Markets Act 2000 issued the Money Laundering Regulations 2007 (Statutory Instrument 2007 No. 2157).

16. The MLRs were made on 24 July 2007, laid before Parliament on 25 July 2007, and entered into force on 15 December 2007. They can therefore be considered equivalent to "law or regulation" for the purposes of the AML/CFT Methodology.

IV. Review of the measures taken in relation to the Core Recommendations

Recommendation 5 – rating PC

R. 5 (Deficiency 1): JMLSG Guidance only partly deals with identification where there are doubts regarding previously obtained customer identification data. There is no requirement in law or regulation.

17. Regulation 7(1)(d) fully addresses this previous deficiency. It indicates that:

> ... a relevant person must apply customer due diligence measures when he—
>
> (d) doubts the veracity or adequacy of documents, data or information previously obtained for the purposes of identification or verification.

R. 5 (Deficiency 2): It is not specifically required by law or regulation to verify that any person purporting to act on behalf of the customer is so authorised.

18. The MLRs 2007 do not impose a direct requirement in this regard.

R. 5 (Deficiency 3): There is no requirement in law or regulation to: identify the beneficial owner or take reasonable measures to verify the identity of the beneficial owner, or to determine who are the natural persons that ultimately own or control the customer, including those persons who exercise ultimate effective control over a legal person or arrangement. (Deficiency 4): The wording of the guidance does not create an obligation to verify beneficial ownership in any situation; there is no

obligation to verify the beneficial owner before or during the course of establishing a business relationship or conducting transactions for occasional customers.

19. There are now requirements in regulation to identify and verify beneficial owners. "Beneficial owner" is defined in regulation 6 of the MLRs, is generally broad, and includes *inter alia*:

- For a body corporate, any individual who owns or controls (directly or indirectly) more than 25% of the shares or voting rights in the body, or otherwise exercises control over the management of the body.

- For a partnership, any individual who is ultimately entitled to or controls (whether directly or indirectly) more than 25% share of the capital or profits or more than 5% of the voting rights, or otherwise exercises control over the management of the partnership.

- For a trust, any individual who is entitled to a specific interest in at least 25% of the capital of the trust property, or any individual who has control over the trust. ("Specific interest" is further defined to include a vested interest which is in possession or in remainder or reversion; "control" means a power under the trust instrument to dispose of, advance, lend, invest, pay or apply trust property; vary the trust, add or remove a person as a beneficiary; appoint or remove trustees; direct, or withhold consent to or veto the exercise of power).

- In any cases outside of a body corporate, partnership or trust, beneficial ownership means the individual who ultimately owns or controls the customer or on whose behalf a transaction is being conducted.

20. "Customer due diligence measures" is defined as:

a) identifying the customer and verifying the customer's identity on the basis of documents, data or information obtained from a reliable and independent source;

b) identifying, where there is a beneficial owner who is not the customer, the beneficial owner and taking adequate measures, on a risk-sensitive basis, to verify his identity so that the relevant person is satisfied that he knows who the beneficial owner is, including, in the case of a legal person, trust or similar legal arrangement, measures to understand the ownership and control structure of the person, trust or arrangement.

c) obtaining information on the purpose and intended nature of the business relationship.

21. The requirement to identify and verify beneficial owners applies before or during the course of establishing a business relationship and when conducting transactions for occasional customers. Regulation 7 requires every "relevant person" to conduct customer due diligence (*i.e.* identifying and verifying customers and beneficial owners as described above) when he:

- establishes a business relation;

- carries out an occasional transaction (which is defined as a transaction outside of a business relationship amounting to EUR 15 000 or more, whether the transaction is carried out in a single operation or several operations which appear to be linked);

- suspects money laundering or terrorist financing;

- doubts the veracity or adequacy of documents, data or information previously obtained for the purposes of identification or verification.

22. These requirements do not specifically cover those wire transfers in accordance with SR.VII (*i.e.*, wire transfers of EUR 1 000 or more). The UK's implementation of Regulation (EC) No. 1781/2006 of the European Parliament and the Council of 15 November 2006 on information on the payer accompanying transfers covers identification of the customer but not necessarily the beneficial owner.

R. 5 (Deficiency 5): There is no explicit obligation to obtain information on the purpose and nature of the business relationship in the UK in all cases.

23. This is now fully addressed. Regulation 5(c) defines "Customer due diligence measures" to include "obtaining information on the purpose and intended nature of the business relationship."

R. 5 (Deficiency 6): A requirement to conduct ongoing monitoring does not exist in law and regulation. Nor is there a general requirement that ongoing due diligence should include scrutiny of transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with the institution's knowledge of the customer, their business and risk profile, and where necessary, the source of funds. The limited procedures for on-going due diligence in the guidance only apply for higher risk scenarios. (Deficiency 7): There is no general obligation that documents, data or information collected under the CDD process be kept up-to-date and relevant by undertaking reviews of existing records.

24. The new regulations generally address these previous deficiencies, as regulation 8 requires relevant persons to conduct ongoing monitoring of a business relationship and keep records up-to-date. "Ongoing monitoring" is defined as:

a) scrutiny of transactions undertaken throughout the course of the relationship (including, where necessary, the source of funds) to ensure that the transactions are consistent with the relevant person's knowledge of the customer, his business and risk profile; and

b) keeping the documents, data or information obtained for the purpose of applying customer due diligence measures up-to-date.

25. While there is a requirement that the information be kept up-to-date, the regulations do not specify that a review be undertaken to do this.

R. 5 (Deficiency 8): There is no general requirement to take additional steps when there is a higher risk scenario, whatever that higher risk scenario may be, although the Guidance makes it clear that this is expected.

26. Regulation 14 describes in detail when enhanced due diligence and on-going monitoring is required. In summary enhanced due diligence is required when:

- The customer is not present. In this situation, under regulation 14(2), the business is prompted to apply one or more of three measures, *i.e.* additional checks on documents, data or information; supplementary measures to verify the documents; or arranging for the first payment to be made from a bank account in the customers name.

- There is a correspondent banking relationship. In this situation, under regulation 14(3), a series of further checks are required; these take the form of further checks on the respondent institution, including an assessment of their AML controls, internal controls, documenting the responsibilities of the parties, and that appropriate CDD checks are carried out. (See paragraphs 36-37).

- A politically exposed person (PEP) is involved. Regulation 14(5) defines a PEP. Regulation 14(4) requires additional steps to be taken; in particular that there is senior management approval for dealing with the PEP; steps are required to take adequate measures to establish the source of the wealth; and enhanced ongoing monitoring is required where necessary. (See paragraphs 33-35).

- There is any other higher risk situation.

R. 5 (Deficiency 9): Provisions for reduced/simplified CDD are overly broad—providing a full exemption from CDD in respect of financial institutions from certain countries (not just reduced); this is not based on an actual risk assessment, either by the UK itself or by the financial institution, which would confirm the assumption of low risk.

27. This deficiency is not addressed, as full exemptions from CDD are still allowed under the new MLR 2007. Regulation 13 "Simplified Due Diligence" indicates that CDD is not required in the circumstances of regulation 7(a) (when establishing a business relationship); 7(b) (carrying out an occasional transaction); or 7(d) (when there are doubts about the veracity or adequacy of previously obtained CDD data) when the customer is, *inter alia*:

- a credit or financial institution subject to the Third EU Money Laundering Directive;

- a credit or financial institution situation in a non-EEA state imposing requirements equivalent to those of the Third EU Money Laundering Directive and supervised for compliance with those requirements;

- a company whose securities are listed on a regulated market subject to specified disclosure obligations.

28. Similar to those indicated in the 2007 MER, these exemptions are overly broad—providing a full exemption from CDD (rather than just reduced measures, for which the third point above is cited as an example in the AML/CFT Methodology). The UK authorities indicate that there has been a process of collective risk assessment in relation to these requirements at the EU level, to which the UK was party, and to whose conclusions the UK subscribes. Where the relied-upon person is outside the EEA, it must be supervised for compliance in a way that is equivalent to the requirements of the 3rd Money Laundering Directive. That followed the adoption of an EU common position in this respect. The assessment process for equivalence for non-EEA countries is undertaken at a collective level by member states participating in the EU Committee on the Prevention of Money Laundering and Terrorist Financing. The list may be reviewed, in particular in the light of public evaluation reports adopted by the FATF, FSRBs, the IMF or the World Bank according to the revised 2003 FATF Recommendations and Methodology. To help businesses understand which jurisdictions meet the latter condition the UK has published a list of non-EEA jurisdictions that meet those criteria based on the EU common position.

R. 5 (Deficiency 10): The exemption from CDD within the context of a business relationship could still apply when money laundering is suspected.

29. This deficiency is fully addressed, as the exemptions from CDD indicated above specifically exclude 7(c)—when money laundering or terrorist financing is suspected. CDD is therefore still required in these circumstances.

R. 5 (Deficiency 11): Once the business relationship has commenced, it is not a specific requirement to terminate the business relationship if proper CDD cannot be conducted.

30. This deficiency is fully addressed. Regulation 11 requires that:

> 11.—(1) Where, in relation to any customer, a relevant person is unable to apply customer due diligence measures in accordance with the provisions of this Part, he—
>
> a) must not carry out a transaction with or for the customer through a bank account;
>
> b) must not establish a business relationship or carry out an occasional transaction with the customer;
>
> c) must terminate any existing business relationship with the customer;
>
> d) must consider whether he is required to make a [STR] disclosure.

R. 5 (Deficiency 12): There is no enforceable obligation to apply CDD to existing customers on the basis of materiality and risk.

31. There is now a legal obligation to apply CDD to existing customers on the basis of materiality and risk. Regulation 7(2) requires that "Subject to regulation 16(4), a relevant person must also apply customer due diligence measures at other appropriate times to existing customers on a risk-sensitive basis." Regulation 16(4) indicates that "as soon as reasonably practicable on or after 15 December 2007, all credit and financial institutions carrying on business in the UK must apply CDD and conduct ongoing monitoring of all anonymous accounts and passbooks in existence on that date and in any even before such accounts or passbooks are used." The UK authorities point out that they do not allow anonymous accounts and passbooks (as was also the conclusion in the 2007 MER); rather this provision is incorporated in order to properly transpose the Third Money Laundering Directive.

R. 5 (Deficiency 13): A number of measures are mentioned only in JMLSG guidance and have no significance in respect of MSBs or the non-supervised sector other than as guidance.

32. This issue did not pertain to a deficiency in a legal obligation, rather to guidance issued to the financial sector (which was substantially followed) which was not issued to the non-supervised sector. As indicated in the introduction, CDD and other AML/CFT obligations now apply to the full range of financial institutions.

Recommendation 5, Overall conclusion

33. The UK has made significant progress in improving compliance with R. 5. The new MLRs 2007 impose requirements that adequately address the main concerns raised in the MER about: the identification and verification of beneficial owners, CDD when there are doubts about the veracity of previously obtained CDD data, obtaining information on the purpose and intended nature of the business relationship, ongoing due diligence and keeping CDD records up-to-date, enhanced CDD for higher-risk situations, identifying CDD on existing customers based on materiality and risk, and terminating business

relationships if CDD cannot be completed. There is still not a direct obligation to verify that any person purporting to act on behalf of the customer is so authorised, and full exemptions to CDD for certain customers still exist that go beyond the FATF standards. Nevertheless, the UK has addressed the major concerns that were identified in relation to R.5; the CDD legal framework has been enhanced to a level that is essentially equivalent to an LC.

V. Review of the measures taken in relation to other Recommendations rated NC or PC

Recommendation 6 (NC): No currently enforceable obligations with regard to PEPs.

34. Regulations 20(2)(c) and 14(4) – 14(6) have created new PEP provisions. Regulation 20(2)(c) requires financial institutions to establish and maintain appropriate and risk-sensitive AML/CFT policies and procedures, which must include, inter alia, policies and procedures to determine whether a customer is a PEP. This does not specifically cover situations where an existing customer may become a PEP; nor is there a corresponding requirement to determine whether the beneficial owner of a customer is a PEP.

35. Regulation 14(5) and (6), supplemented by Schedule 2 of the MLR 2007, define PEPs. The PEP provisions (regulation 14(4)) require a relevant person who proposes to have a business relationship or carry out an occasional transaction with a PEP to:

- obtain senior management approval;
- take adequate measures to establish the source of wealth and source of funds involved, and
- conduct enhanced on-going monitoring.

36. Regulation 14(5) says "a politically exposed person" means a person who is—

a) an individual who is or has, at any time in the preceding year, been entrusted with a prominent public function by—

(i) a state other than the United Kingdom;
(ii) a Community institution; or
(iii) an international body, including a person who falls in any of the categories listed in paragraph 4(1)(a) of Schedule 2;

b) an immediate family member of a person referred to in sub-paragraph (a), including a person who falls in any of the categories listed in paragraph 4(1)(c) of Schedule 2; or

c) a known close associate of a person referred to in sub-paragraph (a), including a person who falls in either of the categories listed in paragraph 4(1)(d) of Schedule 2.

Recommendation 7 (NC): ***No currently enforceable obligations pertaining to correspondent banking***

37. Regulation 14(3) imposes enhanced due diligence requirements on correspondent banking relationships. It says:-

(3) A credit institution ("the correspondent") which has or proposes to have a correspondent banking relationship with a respondent institution ("the respondent") from a non-EEA state must—
a) gather sufficient information about the respondent to understand fully the nature of its business;

b) determine from publicly-available information the reputation of the respondent and the quality of its supervision;

c) assess the respondent's anti-money laundering and anti-terrorist financing controls;

d) obtain approval from senior management before establishing a new correspondent banking relationship;

e) document the respective responsibilities of the respondent and correspondent; and

f) be satisfied that, in respect of those of the respondent's customers who have direct access to accounts of the correspondent, the respondent—

(i) has verified the identity of, and conducts ongoing monitoring in respect of, such customers; and
(ii) is able to provide to the correspondent, upon request, the documents, data or information obtained when applying customer due diligence measures and ongoing monitoring.

38. While regulation 14 imposes requirements for correspondent banking relationships outside the EEA, there are no corresponding requirements for correspondent relationships in other EEA countries. In addition, while there is a requirement to assess the respondent's anti-money laundering terrorist financing controls, there is not a requirement to subsequently ascertain that those controls are adequate and effective before proceeding with the correspondent relationship.

Recommendation 9 (PC)

R.9 (Deficiency 1) The information provided concerning the CDD process makes only a limited reference to beneficial owners (i.e. for certain businesses and not all customers).

39. Regulation 5(b) is clear (see discussion of beneficial ownership under Recommendation 5 above); CDD means, inter alia, identifying the beneficial owner when necessary, and carrying out risk-sensitive verification.

R.9 (Deficiency 2) There is no enforceable requirement that the financial institutions be satisfied that the introducer will make ID and other relevant documentation available upon request.

40. Regulation 17 allows relevant persons to rely upon a range of other parties to conduct CDD, provided that the other person consents to being relied on, and the relevant person remains liable for any failure to apply such measures. The parties that can be relied upon include, *inter alia*:

- A credit or financial institution which is an authorised person (*i.e.* licensed by the FSA) or a lawyer or accountant in the UK which is also supervised for compliance with the MLRs 2007.

- A person in the UK who carries on business in another EEA state that is: a credit or financial institution, auditor, insolvency practitioner, external accountant, tax advisor or independent legal professional subject to mandatory professional registration and supervised for compliance with the Third EU Money Laundering Directive.

- A person who carries on business in a non-EEA state meeting the criteria immediately above but also subject to requirements equivalent to those laid out in the Third EU Money Laundering Directive.

41. Regulations 19(4) and (5) require that financial institutions relied upon will make documentation available on request. In particular, regulation 19(5) indicates:

> (5) A person referred to in regulation 17(2)(a) or (b) who is relied on by a relevant person must, if requested by the person relying on him within the period referred to in paragraph (4)—
>
> a) As soon as reasonably practicable make available to the person who is relying on him any information about the customer (and any beneficial owner) which he obtained when applying customer due diligence measures.
>
> b) As soon as reasonably practicable forward to the person who is relying on him copies of any identification and verification data and other relevant documents on the identity of the customer (and any beneficial owner) which he obtained when applying those measures.

42. There is no corresponding obligation placed on the primary institution in the UK to satisfy itself that the introducer will make ID and other relevant documentation, nor is there a requirement for the primary institution to immediately obtain the CDD information.

R.9 (Deficiency 3) Financial institutions are not required to satisfy themselves that the third party is regulated and supervised (in accordance with Recommendation 23, 24 and 29), and has measures in place to comply with, the CDD requirements.

43. Regulation 17(2)(b)*(ii)* provides that a person can only rely on a second person who is supervised to a sufficient standard, equivalent to the requirements of the Third EU Money Laundering Directive. The person placing reliance on another is required to have reasonable grounds to believe that the person relied upon meets those tests.

R.9 (Deficiency 4) In determining in which countries the third party that meets the conditions can be based, competent authorities only to some extent take into account information available on whether those countries adequately apply the FATF Recommendations.

44. This deficiency has only been partly addressed. Under Regulation 17(1) businesses must have reasonable grounds for believing that the 'equivalent supervision' test is met. Under Regulation 17, the person relied upon has to be subject to supervision in the UK or supervision equivalent to that required under the Third EU Money Laundering Directive. Where a person relied upon is outside the EEA four tests must be satisfied relating to *(i)* the nature of the business, *(ii)* it being subject to mandatory registration *(iii)* being subject to requirements equivalent to those in the Third Money Laundering Directive; and *(iv)* being supervised for compliance with *(iii).*

45. Where the person relied on is in an EEA member other that the UK test *(iii)* does not apply, as those jurisdictions are required to give effect to the 3MLD.

46. In assessing whether *(iii)* is satisfied, a person is assisted by a list published by the UK of non-EEA jurisdictions that it considers operate money laundering policies and procedures equivalent to those laid down in the Third Money Laundering Directive. This follows the EU agreement on a common position on which countries meet this equivalency. That agreement was guided principally by the decisions reached in recent mutual evaluations of FATF members. Nevertheless, this is still a deficiency as some jurisdictions granted equivalency (whether within the EEA or outside) might not have yet fully implemented the Directive, or the FATF standards.

Recommendation 11 (PC)

R.11 (Deficiency 1) There is no specific obligation to pay special attention to all complex, unusual large transactions, or unusual patterns of transactions, that have no apparent or visible economic or lawful purpose. The expectation in guidance only covers the JMLSG covered part of the financial sector.

47. Regulation 20(2)(a)*(i)* & *(ii)* require that relevant persons establish and maintain appropriate and risk-sensitive policies and procedures... in order to prevent activities related to money laundering and terrorist financing, and that these must include policies and procedures which provide for the identification and scrutiny of *(i)* complex or unusually large transactions and *(ii)* unusual patterns of transactions which have no apparent economic or visible lawful purpose. As regulation 20 requires scrutiny of transactions, this could be said this meets the "examine" part of R.11. There is not an explicit requirement set out findings in writing, but this could be implied from the other requirements as at least partially covered.

R.11 (Deficiency 2) There is no specific requirement to examine as far as possible the background and purpose of such transactions and to set forth findings in writing.

48. There is no specific requirement in this area. This is partly covered in practice under regulation 8, which requires that "A relevant person must conduct ongoing monitoring of a business relationship". Regulation 8 (2) defines "Ongoing monitoring" of a business relationship to mean -

a) scrutiny of transactions undertaken throughout the course of the relationship (including, where necessary, the source of funds) to ensure that the transactions are consistent with the relevant person's knowledge of the customer, his business and risk profile; and

b) keeping the documents, data or information obtained for the purpose of applying customer due diligence measures up-to-date.

49. Regulation 19(2)(b) requires record keeping in respect of any transaction which is subject of ongoing monitoring as transactions covered by regulation 20 would be.

Recommendation 12 (PC)

Scope

50. In general, the MLRs apply to the full range of DNFBPs defined in the AML/CFT Methodology. Regulation 3 refers to the application of the regulations to "relevant persons", which includes not only the full range of financial activities defined by the FATF, but also all DNFBPs in the situations specified in the AML/CFT Methodology (although for dealers in precious metals and stones this category is included in the broader category of "high-value dealers" in the regulations). However, there are several exemptions from this scope, as indicated in Regulation 4 ("Exclusion"). Specifically, regulation 4(2) indicates that the regulations do not apply to a person who falls within regulation 3 if they engage in financial activity on an occasional or very limited basis. This includes:

- when a person's total annual turnover in respect of the financial activity does not exceed GBP 64 000;
- the financial activity is limited in relation to any customer to no more than one transaction exceeding EUR 1 000 (whether in a single transaction or several that appear linked);
- the financial activity does not exceed 5% of the person's total annual turnover;

- the financial activity is ancillary and directly related to the person's main activity;
- the financial activity is provided only to customers of the person's main activity and not offered to the public.

51. These exclusions appear to go beyond the FATF Methodology, which allows for exemptions for financial institutions (not DNFBPs) where there a financial activity is carried out on an occasional or very limited basis (having regard to quantitative and absolute criteria).

R.12 (Deficiency 1) Applying R.5: Similar deficiencies as indicated under R.5 (no law or regulation to require CDD when there are doubts about the previously obtained data; no requirements to identify beneficial owner, etc.). Some CDD requirements are in guidance, which are not legally binding.

52. See above (re Recommendation 5). The CDD requirements in the UK regulations apply to all relevant persons including DNFPBs as defined by the FATF.

R.12 (Deficiency 2) For casinos, CDD is not required above the 3,000 euro threshold, and it is not clear that casinos can adequately link the incoming customers to individual transactions.

53. Regulation 10 places specific obligations on casinos to identify their customers prior to entry to the casino gaming facilities, or prior to access to remote gaming facilities, or where the customer reaches a 2 000 EUR threshold. Where the 2 000 EUR threshold is used the casino must satisfy the Gambling Commission (which supervises casinos for AML purposes) that the casino has procedures in place to monitor and record for each customer: the total value of chips purchased from or exchanged within the casino; the total money paid for the use of gaming machines; or the total money paid or staked in connection with facilities for remote gaming by each customer

R.12 (Deficiency 3) Estate agents are not required to identify the buyer.

54. The UK authorities indicate that the combination of Regulation 3(1)(f) and Regulation 5 address the risks of money laundering by focusing on the seller of any property. In the UK it is the property seller who is normally the customer of the estate agent, as the estate agent will look to the seller for his instructions and for payment. However, if an estate agent were to assist in a real estate transaction on behalf of the buyer, then that person would become a customer of that agent and CDD would have to be conducted. The Regulations also cover "independent legal professionals" in the situations defined in the FATF standards, so any other independent legal professional acting for the buyer, or bank, or other mortgage lender, must identify the buyer if they are their customers.

R.12 (Deficiency 4) Applying R.6: No requirements with regard to PEPs that will apply to any of the DNFBPs.

55. Regulation 3, Regulation 14(4) – (5), and Regulation 20(2)(c) apply the PEP requirements to all relevant persons (*i.e.* regulated businesses) including DNFPBs.

R.12 (Deficiency 5) Applying R.8: For DNFBPs, there is no obligation to have policies in place or take such measures as may be necessary to prevent the misuse of technological developments in ML/FT.

56. There is not a specific obligation for this. However, DNFPBs are now subject to the same regime as other businesses, as they are all "relevant persons". This includes a general obligation to apply on a risk-sensitive bases enhanced customer due diligence and enhanced ongoing monitoring in any situation which by its nature can present a higher risk of money laundering or terrorist financing (Regulation 14(1)(b)).

R.12 (Deficiency 6) Applying R. 9: For DNFBPs, there are currently no enforceable obligations with regard to introduced business.

57. See the description of Recommendation 9 above, as this also applies to DNFBPs.

R.12 (Deficiency 7): Applying R.10: Certain record-keeping requirements in the FSA rules and JMLSG Guidance do not apply to DNFBPs: no requirement that records must be sufficient to permit reconstruction of individual transactions so as to provide, if necessary, evidence for prosecution of criminal activity; no explicit requirement in law or regulation to maintain records of account files.

58. Regulations 19 and 20 contain broad record-keeping requirements for all relevant persons, including DNFBPs. In particular regulation 19 requires all relevant persons to keep records that are the supporting records (consisting of the original documents or copies) in respect of a business relationship or occasional transaction which is the subject of customer due diligence measures or ongoing monitoring for five years. However, this does not include a specific obligation that the records must be sufficient to permit reconstruction of individual transactions so as to provide, if necessary, evidence for prosecution of criminal activity; or that this includes account files and business correspondence, although this seems broadly covered under the general obligation.

R.12 (Deficiency 8) Applying R.11: For DNFBPs, there is no specific obligation to pay special attention to all complex, unusual large transactions, or unusual patterns of transactions, that have no apparent or visible economic or lawful purpose. (Deficiency 9) There is no requirement to examine as far as possible the background and purpose of such transactions and to set forth findings in writing. (Deficiency 10) No requirement to keep such findings available for competent authorities and auditors for at least five years

59. See the description of Recommendation 11 above, which also applies to the DNFBPs.

Recommendation 18 (PC)

R.18 (Deficiency 1) There is no enforceable obligation for financial institutions not to enter into, or continue, correspondent banking relationships with shell banks.

60. Regulation 16(1) bans correspondent banking relationships with shell banks. It indicates that "A credit institution must not enter into, or continue, a correspondent banking relationship with a shell bank." "Shell bank is defined as a credit institution, or an institution engaged in equivalent activities, incorporated in a jurisdiction in which it has no physical presence involving meaningful decision-making and management, and which is not part of a financial conglomerate or third-country financial conglomerate.

R.18 (Deficiency 2) No obligation to require financial institutions to satisfy themselves that respondent financial institutions in a foreign country do not permit their accounts to be used by shell banks.

61. Regulation 16(2) requires appropriate scrutiny of correspondent relationships. It says

> (2) A credit institution must take appropriate measures to ensure that it does not enter into, or continue, a corresponding banking relationship with a bank which is known to permit its accounts to be used by a shell bank.

Recommendation 21 (PC)

R.21 (Deficiency 1) There is no requirement for financial institutions to give special attention to business with countries which do not sufficiently apply FATF Recommendations. MLR 28 only covers FATF counter-measures, and the guidance of JMLSG only covers part of the financial sector. (Deficiency 2) No specific requirement to examine as far as possible the background and purpose of such transactions, and make written findings available for authorities.

62. There is not a specific requirement for financial institutions to give special attention to business with countries which do not sufficiently apply the FATF Recommendations. Regulation 7 of the MLRs 2007 requires institutions to determine the extent of customer due diligence measures on a risk-sensitive basis depending on the type of customer, business relationship, product or transaction. Information on the application of FATF standards would be a relevant factor to take into account in making this assessment. Regulation 14 requires that financial institutions apply enhanced due diligence and enhanced ongoing monitoring to any situation which by its nature can present a higher risk of money laundering or terrorist financing. Regulation 20 requires a relevant person to have policies and procedures for the identification and scrutiny of complex or unusual transactions. Any scrutiny of a transaction must involve consideration of the background and purpose of such transactions. If examination of transactions gives rise to suspicion a Suspicious Activity Report would be made to SOCA.

63. As noted in the MER, the JMSLG guidance contains a section called "national and international findings in respect of countries and jurisdictions", which specifies: "An MLRO should ensure that the firm obtains, and makes appropriate use of, any government or FATF findings concerning the approach to money laundering prevention in particular countries or jurisdictions." While this section of the JMSLG is not new, as noted in the introduction, a feature in the UK is that approved guidance, including the JMSLG guidance, is formally recognised in the Money Laundering Regulations and other provisions.

64. Since the last evaluation, Treasury has continued to issue notices drawing attention to jurisdictions of concern to the FATF.

65. In addition, the UK also now has access to a broader range of counter-measures as a result of amendments to the Counter-Terrorism Act (CT Act) which came into force in November 2008. Schedule 7 of the CT Act sets out powers for the Treasury to direct financial and credit institutions to apply a range of financial restrictions in respect of business with persons in a non-EEA country of money laundering, terrorist financing or proliferation concern. Part 1 of the Schedule sets out the conditions for giving a direction and provides that the Treasury may act in circumstances where: (a) the Financial Action Task Force has called for measures to be taken against a country because of the risk it presents of money laundering or terrorist financing; (b) the Treasury reasonably believe a country poses a significant risk to the UK's national interests because of the risk of money laundering or terrorist financing there; or (c) the Treasury reasonably believe a country poses a significant risk to the UK's national interests because of the development or production of nuclear, radiological, biological or chemical weapons there, or the facilitation of such development.

Recommendation 22 (NC): ***There are currently no requirements relating to foreign branches and subsidiaries***.

66. There are no new obligations in this regard pertaining to branches and subsidiaries of UK financial institutions located in other EEA countries. Nor is there a requirement that financial institutions ensure that their foreign branches and subsidiaries in other EEA countries observe AML/CFT measures consistent with the home country requirements consistent with the FATF Recommendations, or where the

AML/CFT requirements of the home and host countries differ, that branches and subsidiaries in the host country apply the higher standard, to the extent that the local laws and regulations permit.

67. Rather, there is the presumption that other EEA countries, which are required to implement the Third EU Money Laundering Directive, also observe AML/CFT measures that are consistent with UK requirements and the FATF Recommendations. Regulation 15 indicates that:

> A credit or financial institution must require its branches and subsidiary undertakings which are located in a non-EEA state to apply, to the extent permitted by the law of that state, measures at least equivalent to those set out in these Regulations with regard to customer due diligence measures, ongoing monitoring and record-keeping.

68. There is not a specific obligation for pay particular attention that this principle is observed with respect to their branches and subsidiaries in countries which do not or insufficiently apply the FATF Recommendations.

69. Where the non-EEA state does not permit the application of such equivalent measures by the branch or subsidiary located in that state, the credit or financial institutions must inform its supervisory authority accordingly and take additional measures to handle effectively the risk of money laundering or terrorist financing.

Recommendation 24 (PC)

R.24 (Deficiency 1) Currently no AML/CFT supervision for real estate agents or TCSPs that are not legal or accountancy professionals, or accountants that are not members of professional bodies (approximately 40,000).

70. The Regulations generally address these deficiencies. Regulation 23(1)(b) provides that The Office of Fair Trading now supervises estate agents. All TCSPs are also supervised. Regulation 23(1)(d)*(iii)* for example allocates responsibility for the supervision to HM Revenue and Customs unless a TCSP is otherwise supervised by the Financial Services Authority or a professional body, which supervises them for AML/CFT purposes.

71. Accountants (which are not already supervised by a professional body) are supervised by HM Revenue and Customs under Regulation 23(1)(d)*(iv)*.

R.24 (Deficiency 2) Current sanctions for Gambling Commission are not yet adequate, although this will change once the Gambling Act comes into force in September 2007.

72. The Gambling Commission is the supervisory authority for casinos in the UK in terms of the MLRs 2007. To meet this responsibility, the Commission has introduced statutory Guidance to casinos and remote casinos on the Prevention of Money Laundering and Combating the Financing of Terrorism, and a compliance programme. In cases of serious non-compliance, the commission can revoke or suspend a casino's licence to operate. Section 116 of the Gambling Act 2005 gives the Gambling Commission the power to review an operating licence (including a casino operating licence), inter alia, in circumstances where it suspects that the licensee may be unsuitable to carry on the licensed activities or thinks that a review would be appropriate. Habitual non-compliance with the Money Laundering Regulations 2007 and POCA could lead to a review of the operator's licence. In addition, the Commission's guidance on anti-money laundering is embedded in the Licence Conditions and Codes of Practice for casino operators as an ordinary code provision and casino operators are required to operate in accordance with our guidance. A breach of this ordinary code provision may be taken into account on a licence review. A review can result, amongst other things, in the issue of a warning and, in circumstances, where the licensed activity is carried

on in a manner which is inconsistent with the Commission's licensing objectives (and one of the licensing objectives is keeping crime out of gambling) or the licensee is unsuitable to carry on the licensed activities, suspension or revocation of the licence. In addition, any casino violating the MLR 2007 is, like any other regulated business, subject to a range of civil or criminal sanctions as laid in paragraphs 42 and 45 of the regulations.

R.24 (Deficiency 3) Notaries in England and Wales are not supervised for AML/CFT (unless they are also lawyers, or accountants that are members of professional bodies).

73. Under Regulation 23(1) (c)—which cross-references to Schedule 3 (the list of supervisory bodies)—the Faculty Office of the Archbishop of Canterbury supervises these notaries. The Faculty Office supervises notaries for a range of purposes.

Recommendation 33 (PC)

R.33 (Deficiency 1) While the investigative powers are generally sound, there are not adequate measures in place to ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities. (Deficiency 2) Information on the companies registrar pertains only to legal ownership/control (as opposed to beneficial ownership) and is not verified and is not necessarily reliable.

74. Regulation 5 (b) of the MLR 2007 introduced new requirements to identify the beneficial owner with regard to financial institutions and other DNFBPs; however, other additional measures have not been taken in this regard.

R.33 (Deficiency 3) Although the use of share warrants to the bearer is reportedly rare in the UK, there are no specific measures taken to ensure that they are not misused for money laundering other than the inclusion of "cash" in the POCA description.

75. The UK is not planning any change in the treatment of shares warrants to the bearer. Their use, as the MER notes, is rare. A UK company may only issue share warrants to the bearer if:

- it has authority in its articles to do so;
- the shares are fully paid;
- the shares have first been issued to a registered holder whose name is entered into the register of members.

Recommendation 34 (PC)

R.34 (Deficiency 1) While the investigative powers are generally sound, there are not adequate measures in place to ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal arrangements that can be obtained or accessed in a timely fashion by competent authorities. (Deficiency 2) There is no standardisation of beneficial ownership data held, and the nature of information collected will vary with the provision of any relevant guidance.

76. See the discussion of Recommendation 33. Although new requirements for identification of beneficial ownership of legal arrangements have been introduced for financial institutions and DNFBPs, there are no new measures outside of these institutions.

R.34 (Deficiency 3) Providers of trust services who are not lawyers, or accountants that are members of professional bodies, are not monitored for their AML/CFT obligations and so it is not clear how reliable the information they maintain would be.

77. All trust and company service providers are now supervised under the MLRs 2007 (regulations 23 (1) (a)*(ii)*, (c), and (d)*(iii)*).

Special Recommendation VII

SR.VII (Deficiency 1) The derogation set out in the EU regulation for wire transfers within the EU (classified as domestic transfers) is not in compliance with the FATF requirements under SR.VII.2.[6]

78. There has been a continuing policy debate within the FATF, which the UK believes has been resolved in a way that satisfies the concerns of members generally and those members that belong to supra-national jurisdictions like the EU.

SR.VII (Deficiency 2) The sanctions regime is not effective or dissuasive; since no sanctions can currently be applied it is doubtful as to whether any "enforceable obligations" are in place before 15 December 2007. (Deficiency 3) In terms of effectiveness, there are doubts about the current implementation of the very recent EU requirements, including the requirement to have in place effective risk-based procedures for identifying and handling wire transfers that are not accompanied by complete originator information, and about the existence of an effective compliance monitoring of financial institutions.

79. The Transfer of Funds (Information on the Payer) Regulations 2007 [SI 2007 No 3298] took effect on 15th December 2007. These regulations provide the FSA and HMRC with new powers to enforce the EU Wire Transfer Regulations, which have direct effect in the UK. The Regulations allow for the imposition of civil penalties and the prosecution of criminal offences. On conviction of a criminal offence a person is liable to a fine, or up to 2 yrs imprisonment, or both.

6 The FATF decided at the June 2007 Plenary to further consider this subject.

ANNEX 1:
LIST OF LAWS, REGULATIONS, AND OTHER MATERIAL PROVIDED BY THE UK AUTHORITIES

Money Laundering Regulations 2007:
www.opsi.gov.uk/si/si2007/uksi_20072157_en_1

The Money Laundering (Amendment) Regulations:
www.opsi.gov.uk/si/si2007/uksi_20073299_en_1

Joint Money Laundering Steering Group (JMLSG):
www.jmlsg.org.uk/bba/jsp/polopoly.jsp;jsessionid=air7o9dx8CW-?d=749

The Counter-Terrorism Act 2008:
www.opsi.gov.uk/acts/acts2008/ukpga_20080028_en_1

The Transfer of Funds (Information on the Payer) Regulations 2007:
www.opsi.gov.uk/si/si2007/uksi_20073298_en_1

The Control of Cash (Penalties) Regulations 2007:
www.opsi.gov.uk/si/si2007/uksi_20071509_en_1