

The Money Laundering Regulations 2007

OFT Response to HM Treasury's Review

August 2011

OFT1362

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1 INTRODUCTION

1.1 The Office of Fair Trading (OFT) is a non-ministerial government department. It is the UK's competition and consumer authority and its mission is to make markets work well for consumers. The majority of the OFT's work consists of:

- analysing markets
- enforcing consumer and competition law
- undertaking advocacy
- working with partners to deliver information and education programmes to businesses and consumers.

1.2 The OFT has been a Supervisory Authority under the Money Laundering Regulations 2007 (The Regulations) since December 2007. Businesses supervised by the OFT are either estate agents or consumer credit financial institutions (CCFIs). CCFIs are consumer credit lenders who are not authorised by the FSA or supervised by HMRC as a money service business (MSB).

1.3 As at 1 August 2011, the OFT has registered a total of 12,158 businesses: 5,601 businesses as CCFIs and 6,668 businesses as estate agents.¹

1.4 The OFT's AML supervisory approach aims to:

- raise awareness of our supervised population of the Regulations and of the need to register with us
- respond to complaints and intelligence received regarding allegations of non-compliance with the Regulations by individual firms

¹ 111 businesses are registered as both.

- provide advice and guidance to businesses.
- 1.5 This approach reflects the OFT's duty under the Regulations to ensure that those it supervises comply with the Regulations which are designed to protect them from being used for money laundering or terrorist financing.
- 1.6 The OFT welcomed HMT's review of the implementation of the Regulations and provided input based upon its experience of being a supervisor. The OFT shares HMT's aim of ensuring an effective regime which reduces burdens on business where possible. These principles have been the basis of the OFT's supervisory approach to date and they underpin this response to the consultation on possible changes to the Regulations.
- 1.7 The OFT response focuses on the questions raised in the consultation which are most relevant to the OFT.

2 OFT RESPONSE

Should the existing criminal sanctions be wholly or partly repealed?

- 2.1 All businesses covered by the Regulations are considered to undertake activity that is of a high risk of being used for money laundering or terrorist financing. Businesses are required to reduce this risk by putting in place risk based policies and procedures as required by the Regulations. This risk based approach is intended to enable them to focus on areas where they are most vulnerable.
- 2.2 The OFT believes that the current range of powers provided under the Regulations allow it to be an efficient and effective supervisor of these activities and considers the removal of the possibility of criminal sanctions to be detrimental to the effectiveness of the regime. Our concern remains that relevant businesses will have less incentive to comply with the requirement to put in place appropriate risk based policies and procedures in order to prevent their business being used for money laundering or terrorist financing.
- 2.3 We understand that some businesses contend that the existence of criminal sanctions deters them from implementing risk based policies and procedures. Whilst this may be so in some cases, it has not been our experience that such sanctions encourage over compliance. On the contrary, we have found that the advantage of criminal sanctions has been to encourage businesses that are unaware and/or unwilling to address the requirements of the Regulations, into compliance. We have in general found high levels of non-compliance with the Regulations and a few businesses failed to respond to simple reminders as to the need to comply until they received a letter setting out the powers to impose unlimited financial penalties and/or prosecute.
- 2.4 The OFT agrees that criminal sanctions should not be used disproportionately and all AML supervisors are subject to a range of appropriate checks and balances, for instance, those contained in the

Regulators' Compliance Code. The OFT's AML Enforcement Principles² make clear that the power to prosecute criminal breaches is reserved for the most serious cases where persuasion has been ineffective.

- 2.5 The OFT, therefore, favours retention of the current approach of making supervisors accountable for the use of the discretion to prosecute as part of an overall enforcement policy, rather than removing the power to prosecute altogether.
- 2.6 However, if HMT nevertheless decides to reduce criminal sanctions we suggest that they are retained for the most serious breaches of the Regulations, for example, failure to verify the identity of customers.

Should new powers be granted to supervisors allowing them to order or require actions by business to mitigate the potential negative impacts from the loss of criminal sanctions?

- 2.7 **Sanctions on company officials:** If HMT decide to withdraw criminal sanctions the OFT would advise that it puts in place a power to apply civil penalties on company officials to replace Regulation 47. Without that power directors and equivalent officers would be able to escape liability for the actions of their companies in circumstances where a lack of knowledge or the commission of the offence arises from their own negligence. There is evidence that personal sanctions drive compliance as most respondents to the OFT's Drivers of Compliance consultation stated that they, and individuals within their organisations, were concerned about the implications of personal sanctions such as criminal penalties.³
- 2.8 **Policies and procedures in writing:** Currently Regulation 20 requires businesses to have risk based policies and procedures in place but it does not specify that businesses should keep these in writing. This

² OFT1094 – May 2011

³ OFT1227 – May 2010

would clearly be the best evidence that such policies and procedures exist and of their content. It would also ensure that staff have easy access to the information and that they are applied consistently across the organisation. The OFT has found that 93 per cent of businesses it has inspected have had in place either no, or very poor, written policies and procedures. This has been indicative of a failure to carry out a proper risk assessment and poor compliance in the areas that were not covered in procedures. This has made inspections more costly both for the supervisor and for the business as assessment of the policies and procedures can only be carried out during the visit to the premises.

- 2.9 OFT strongly recommends a change to Regulation 20 to require that policies and procedures are in written form. We contend that documenting policies and procedures does not represent an additional burden on businesses as most should have them in writing in order to ensure consistency and proper training across the business. Nor do they need to be extensive for small businesses as they need only be proportionate to the size and complexity of the business. The OFT would accept that single trader businesses with no, or few staff, could be exempt from this requirement.
- 2.10 **Making applications for registration of 'no effect:** We have previously suggested in our response to HMT's call for evidence that consideration be given to simplifying the process for dealing with applications for registration which are incomplete because the registration and/or the limited information required at registration has not been provided. The Regulations provide that in such cases the OFT has to follow the 'Minded to refuse' process which requires the OFT to issue a formal notice specifying that it is minded to refuse the application and the grounds for that refusal. The business can then make representations to the OFT following which a formal decision notice is issued. The business then has a right of appeal to the First-Tier Tribunal (Consumer Credit).
- 2.11 The OFT suggests that the AML regime would benefit from the long standing process allowed for in respect of applications for a consumer credit licence under the Consumer Credit legislation. This allows for applications that are not accompanied by the correct fee or information

required on the form to be made of 'no effect'. The business is warned that if missing payment and/or information is not received within a specified time their application will be of 'no effect'.

- 2.12 As with the consumer credit licensing regime, businesses are in breach of the law if they are not registered with the OFT before they start engaging in relevant activity. The 'no effect' process has not led to businesses being denied the ability to rectify omissions and consequently delaying the commencement of their credit business activity. Businesses are given time to rectify omissions before the application is declared of 'no effect'.
- 2.13 The benefits of a 'no effect' process would be to reduce OFT time and costs where the business refuses, or continually fails, to provide the fee and/or information. It reduces costs which are effectively passed onto, at least in part, other businesses that provide complete applications given the self funding nature of the regime. Experience of registration has highlighted for us the practical implications for the OFT and business of a formal, high level process. Such a measure would also be beneficial to a future supervisor who may wish to integrate consumer credit licensing with AML registration. Having two quite different processes for equivalent circumstances would pose difficulties in integrating and providing user friendly systems for business.

Should a debt purchaser be able to rely on customer due diligence (CDD) previously performed by the seller?

- 2.14 Regulation 17 provides for businesses to rely on the CDD measures of specified businesses⁴ under certain conditions. This is potentially a useful provision which prevents duplication of CDD and relieves the burdens on business and the consumer. Debt purchasers may seek to rely on the CDD checks carried out by the initial lenders from which they buy debts. Currently these businesses can only legally rely on CDD carried out by an FSA authorised firm such as a bank. However, they also purchase many

⁴ Listed in Regulation 17(2)

debts from finance companies that are not FSA authorised firms and in these circumstance the debt purchase must carry out its own CDD.

- 2.15 The OFT acknowledges that debt purchasers find it very difficult to carry out CDD on their customers as debtors often refuse requests to confirm their identity. There is no incentive for the customer to provide identification in these circumstances and pressure cannot be brought to bear on them without infringing the OFT's Debt Collection Guidance.⁵ In consequence the OFT would seek to include CCFIs within Regulation 17(2) especially as CCFIs are subject to the same rules as the authorised firms under the Regulations.
- 2.16 The success of the introduction of this provision would be dependant on the initial lenders agreeing to the use of their CDD measures by the debt purchasers and anecdotal evidence would suggest that such agreement in many instances is not given. The OFT would ask that should HMT be minded to implement this provision that it looks further into this matter. It may facilitate compliance with the Regulations to make those initial lenders jointly and severally liable for a failure to provide relevant CDD details when required.

Should there be a general de-minimis exclusion for very small businesses or a reduction on the requirements placed on such businesses.

- 2.17 The OFT has sympathy with HMT's proposal to reduce the burdens on micro businesses and we estimate that approximately five per cent of the businesses registered with the OFT would currently benefit from this exclusion.⁶ However, the OFT is concerned that this exclusion will:

⁵ OFT664 – July 2003 (updated December 2006)

⁶ Businesses with a stated annual turnover at registration of less than £14,000 (used as an approximate stand-in for the proposed 15,000 euro limit).

- create a loophole that could be actively exploited allowing money launderers a safer outlet for 'smurfing'⁷ criminal assets
- lack clarity for business as turnover levels will change and exchange rates fluctuate. Businesses may be within the supervisory regime without themselves, or the OFT, knowing about it. This will increase burdens, and costs, directly on business and via the increased cost of supervision
- be difficult and costly to monitor compliance as
 - businesses often carry out supervised activity as part of their overall business model so relevant turnover will be difficult to identify
 - the OFT has no access to the accounts of sole traders and partnerships
 - published accounts for limited companies and limited liability partnerships are not available until a considerable time after the period to which they refer
 - any power to require information will have limited use as circumstances giving rise to a suspicion that turnover exceeds 15,000 euros will often not exist or be available
- increase calls to the OFT's AML helpline from business. The costs of addressing such queries would be met by businesses that remain within the regime.

2.18 In view of this the OFT does not favour a general exclusion but suggests that further work is carried out to ascertain whether there could be a

⁷ Also known as 'structuring', it is the practice of executing numerous, often small, financial transactions (such as the taking out and early repayment of loans) in a specific pattern calculated to avoid the creation of certain records and reports required by law or otherwise giving rise to a suspicion of money laundering which is reportable to the Serious Organised Crime Agency.

reduction on the requirements placed on very small businesses by the Regulations. A reduction on the requirements placed on business will retain a level of protection for the business from being used for money laundering and/or terrorist financing whilst achieving the Government's aim of reducing burdens on business.

Do you agree that non-lending credit institutions should be exempt from the Regulations?

- 2.19 We understand HMT's intention is to focus the AML regime on those who are true lenders and remove those businesses such as gyms, dentists and vets, that allow customers to pay in installments over 12 months. The OFT agrees that such businesses are likely to pose a low risk of money laundering or terrorist financing and therefore supports this proposal. However, care will need to be taken in the wording of the exclusion to ensure clarity for business, the OFT and any future supervisor. The OFT is happy to work with HMT on this issue to ensure that a workable definition is reached which achieves its aims.
- 2.20 There is no reliable source of information on the number or proportion of businesses that may be considered a 'non lending credit institution'. However, the OFT's estimates suggest that as many as 85% of consumer credit financial institutions with a category A licence under the Consumer Credit Act 1974 may be 'non lenders'. Analysis of a sample of AML registered businesses suggests a lower figure of 54 per cent (approximately 3,000 of the businesses currently registered with the OFT).
- 2.21 This would significantly reduce the number of businesses paying the fees which fund the OFT's AML compliance work. The shortfall could not realistically be covered by efficiency improvements and the OFT would work with HMT in deciding on the balance between increasing fees and reducing activity.

Do you agree that UK estate agents who arrange for the sale and purchase of overseas property by their clients should be regulated?

- 2.22 The OFT supports HMT's proposal as otherwise it appears to us that UK estate agents dealing in overseas properties will not be supervised by a UK supervisor. Neither will a non-UK supervisor, based for instance where the overseas property is for sale, be able to exercise supervisory powers over them.
- 2.23 This situation is the result of the definition of estate agent in Regulation 3(11) being given by reference to section 1 of the Estate Agents Act 1979. In interpreting the scope of section 1 and in particular its reference to 'dispose of or acquire an interest in land', it is necessary to construe the statute as a whole. Therefore, as 'disposing of an interest in land' is defined by reference to UK land law concepts, the argument is that section 1 and the statute as a whole only applies to the stated activities in relation to land in the UK.

Proposals to increase powers of AML supervisors

- 2.24 The OFT welcomes the proposed improvements to the powers of supervisors including:
- powers to impose penalties when obstructed in exercising powers under the Regulations
 - clear powers to make enquiries of persons who reasonably appear to be relevant persons
 - share information with each other
 - tackle non payment of fees by de-registering businesses.
- 2.25 **Penalty for failure to provide information:** Currently the Regulations provide only the power to seek a Court Order on breach of a Notice under Regulation 37; breach of the Court Order being then contempt of court allowing the Court to impose a fine and/or a prison sentence.

There is, then, no incentive for a recalcitrant business to produce information on receipt of a Notice. Businesses not wishing to provide information may well be tempted to see whether a Supervisor will seek a Court Order, that is, whether they have the resource to input to a costly and time consuming process. It is our view that the ability to apply a penalty in addition to seeking a court order when obstructed in executing our powers would speed up and simplify the processes currently in place and also give supervisors the ability to be more effective. The need to apply such sanctions would be rare but it would support our policy to help those businesses that want to comply and demonstrate to those that do not that we will issue appropriate penalties.

- 2.26 **Sharing information between supervisors:** The Regulations provide no information sharing powers for supervisors. Sharing information is particularly important for the OFT due to the number of adjoining areas of responsibility with Schedule 3 supervisors⁸ and overlapping areas of responsibility with other public sector supervisors.
- 2.27 **Extending the power to make enquiries:** The OFT supports the proposal for supervisors to have clear powers to make enquiries of persons who reasonably appear to be relevant persons. An amendment to the Regulations would remove supervisors' present uncertainty as to their ability to make enquiries of someone suspected (however reasonable that suspicion may be) of carrying out relevant activity. The power cannot be used to obtain proof that a person should be, for example, registered with the OFT. Similarly the powers given by Regulation 38 to enter the premises and conduct enquiries with persons that reasonably appear to be relevant persons can also not be used effectively.
- 2.28 Such an amendment to the Regulations would give the OFT the ability to be more effective in supervising businesses reducing the risk of such

⁸ For example, estate agency work, which in general is supervised by the OFT, can be carried out by solicitors and supervised by their professional bodies or carried out on the same premises as businesses supervised by the Council for Licensed Conveyancers

businesses being used for money laundering or terrorist financing and be fair to all businesses.

- 2.29 **Enforcing the payment of fees and charges:** The OFT supports the proposal that supervisors be given additional powers to enforce the payment of fees and charges payable under the Regulations including the power to de-register a business where there is sustained non-payment.
- 2.30 The power to tackle non payment of annual fees by de-registering businesses is something which the Regulations were intended to provide. However, our experience has shown that the Regulations would benefit from clarifying the original intention. Such a power provides a more cost effective tool to incentivise payment of fees than pursuing small individual debts through the courts. For the year 2010-11 approximately 1,100 (9 per cent) of our registered businesses failed to pay their annual fee despite reminders.
- 2.31 However, the OFT considers that the cost and complexity of the representations and appeals process involved in cancelling registrations is not appropriate for the administrative breaches of not supplying information and a required fee. It is our view that the failure to pay appropriate fees and charges should have a simpler approach as described in paragraphs 2.10 - 2.13 above.