

EXPLANATORY MEMORANDUM TO

THE OVERSIGHT OF PROFESSIONAL BODY ANTI-MONEY LAUNDERING AND COUNTER TERRORIST FINANCING SUPERVISION REGULATIONS 2017

2017 No. 1301

1. Introduction

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

2. Purpose of the instrument

- 2.1 This instrument makes provision for the Financial Conduct Authority's ("FCA") oversight of the professional bodies which have responsibility for supervising compliance with the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (the "MLRs").

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

- 3.1 None.

Other matters of interest to the House of Commons

- 3.2 As this instrument is subject to negative resolution procedure and has not been prayed against, consideration as to whether there are other matters of interest to the House of Commons do not arise at this stage.

4. Legislative Context

- 4.1 The Financial Action Task Force ("FATF") is the inter-governmental body that sets the international standards and methodology for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system. FATF also promotes and assesses the effective implementation of those standards. The latest standards were agreed by FATF member countries, including the UK, in 2012.
- 4.2 The Fourth Money Laundering Directive ("4MLD") seeks to give effect to those latest FATF standards.¹ Article 48.1 of 4MLD requires Member States to ensure that competent authorities monitor effectively and take the measures necessary to ensure compliance with the Directive. Under Article 48.9, those functions may be performed by self-regulatory bodies which represent members of a profession and have a role in supervising and monitoring them. Schedule 1 to the MLRs lists the professional bodies with such a role in the UK regime, referred to in the MLRs and in these Regulations as "self-regulatory organisations" ("SROs"). The Regulations provide the

¹ On 23 June 2016, the EU referendum took place and the people of the United Kingdom voted to leave the European Union. Until exit negotiations are concluded, the UK remains a full member of the European Union and all the rights and obligations of EU membership remain in force. During this period the Government will continue to negotiate, implement and apply EU legislation. The outcome of these negotiations will determine what arrangements apply in relation to EU legislation in future once the UK has left the EU.

FCA with responsibility and powers to ensure SROs carry out effective monitoring, and to impose sanctions should those requirements not be met.

5. Extent and Territorial Application

- 5.1 The territorial application of this instrument is all of the United Kingdom, except that regulation 24(1) does not apply to proceedings in Scotland.
- 5.2 This instrument extends to all of the United Kingdom, except for regulation 28 which extends only to Scotland.

6. European Convention on Human Rights

- 6.1 The Economic Secretary to the Treasury, Stephen Barclay MP, has made the following statement regarding Human Rights:
“In my view the provisions of the Oversight of Professional Body Anti-Money Laundering and Counter Terrorist Financing Supervision Regulations 2017 are compatible with the Convention rights.”

7. Policy background

What is being done and why

- 7.1 This instrument provides the FCA with a new role overseeing the anti-money laundering and counter terrorist financing (“AML” and “CTF”) supervision by the 22 SROs in the accountancy and legal sectors.
- 7.2 The policy objective is to make the UK’s AML and CTF supervision more consistent and effective, ensuring the UK’s financial system is a hostile environment for illicit finance, whilst minimising burdens on business.
- 7.3 The Treasury will retain oversight of, and policy responsibility for, the AML supervisory regime, including the appointment and removal of SROs from the role of AML supervisor, by making regulations to amend Schedule 1 to the MLRs.

Weaknesses in the current regime

- 7.4 In October 2015, the government published the ‘National risk assessment of money laundering and terrorist financing’ (the “NRA”). The NRA found that the effectiveness of the UK’s supervisory regime is inconsistent. The large number of SROs in some sectors was found to present a particular challenge; 22 SROs are active across the accountancy and legal sectors. Areas for improvement included supervisors’ understanding and application of a risk-based approach; supervisors’ provision of a credible deterrent; and the sharing of information both among supervisors and between supervisors and law enforcement.
- 7.5 In the subsequent ‘action plan for AML and CTF’, the government committed to reform the supervisory regime and launched a call for information. This call for information was followed by a call for further information and a consultation as the government further developed and refined its proposals. Article 48 of 4MLD requires the UK to ensure supervisors fulfil their obligations effectively.
- 7.6 These Regulations will provide the FCA with a new role to work with SROs to help them to, and ensure that they, fulfil their obligations. This addresses the risks identified in the NRA and fulfils our requirements under EU law.

Detail on how the policy will work

7.7 The government intends that the FCA and SROs will engage collaboratively as they strengthen the AML supervisory regime – the FCA will focus on outcomes. This instrument provides that the FCA among other things:

- must have regard to the importance of ensuring SROs comply with their obligations, in carrying out its functions and in publishing complementary guidance;
- may request information/documents from, or attendance by, an SRO or a connected person (such as an officer of the SRO), or seek a report from a “skilled person”;
- may issue direction to remedy, or prevent, a failure to comply with an obligation;
- may publicly censure an SRO, or recommend the Treasury make regulations removing it from its role as a supervisor, if that SRO has failed to comply with an obligation in the MLRs or a requirement under this instrument, or provided false or misleading information. These sanctions are complemented by safeguards in this instrument, so the FCA is required to consider whether an SRO took all reasonable steps to comply with a requirement and issue a warning notice prior to the taking the decision. If the FCA decides to censure it publicly, the SRO may appeal to the Upper Tribunal; and
- may impose a charge to recover the costs of its oversight of SROs and its work reviewing prospective SROs’ applications, and request information required to calculate the charge.

7.8 This instrument also provides for:

- limited criminal penalties, and for a person to be held in contempt for failure, in particular, to comply with an information requirement without reasonable excuse, in line with similar legislation on financial services;
- a process for a prospective SRO to apply to the Treasury via the FCA;
- an amendment to the Solicitors (Scotland) Act 1980 to enable the Law Society of Scotland to raise a fee in relation to its anti-money laundering role.

Consolidation

7.9 There are no plans to consolidate these Regulations with any other legislation.

8. Consultation outcome

8.1 This instrument has been developed and refined through substantial consultation, including meetings, correspondence and three public consultations:

- The call for information, which was published on 21 April 2016 and sought views on options to reform and strengthen the AML supervisory regime (available here: <https://www.gov.uk/government/publications/action-plan-for-anti-money-laundering-and-counter-terrorist-finance>);
- The 4 week call for further information, which was published on 16 March 2017 and announced the government’s intention to create a new team within

the FCA – the Office for Professional Body AML Supervision (“OPBAS”) – to oversee SRO supervision. The call for further information sought views on OPBAS’s mandate and powers (available here: <https://www.gov.uk/government/consultations/anti-money-laundering-supervisory-regime-response-and-call-for-further-information>); and

- The 4 week consultation, which was published on 20 July 2017 sought views on whether the draft regulations delivered on the government’s intent that OPBAS help and ensure SROs comply with their obligations, and evidence on the costs and benefits of this reform (available here: <https://www.gov.uk/government/consultations/anti-money-laundering-supervisory-review>).

8.2 These consultations received submissions from SROs, professional bodies and trade bodies, civil society and the general public, amongst others.

8.3 Responses to the consultation were broadly supportive of the government’s intention to strengthen oversight of the supervisory regime, but highlighted concerns around:

- the costs of the reform, which the FCA is seeking to address by developing an effective and efficient model for OPBAS; and
- the possibility that OPBAS’s focus on SROs may lead to a two-tier supervisory regime, especially in the accountancy sector where both HMRC and SROs are supervisors. To address this, HMRC intends to engage closely with OPBAS and to adopt OPBAS’s standards, where appropriate. In addition, HMRC will publish an annual report on its work as an AML supervisor, and this will set out how HMRC’s supervisory teams have drawn on OPBAS’s guidance as well as explain any deviations from it.

8.4 The government used the inputs received during the consultations to design the policy, including:

- OPBAS’s information gathering powers are clearly focused on SROs, because extending the power to request information from SROs’ members would duplicate and undermine SROs’ existing role;
- Failure by an SRO to comply with OPBAS’s requirements or their requirements under the MLRs can be sanctioned by public censure or a recommendation that the Treasury make regulations to remove the SRO from its role as a supervisor, to ensure the requirements are effective;
- The inappropriate disclosure of confidential information is a criminal offence, in line with similar legislation in the financial services area and to protect information for example handed over by SROs to OPBAS; and
- The Solicitors (Scotland) Act 1980 is amended to ensure, in particular, that the Law Society of Scotland is able to pay the OPBAS charge.

8.5 The government has published a response to the consultation at: <https://www.gov.uk/government/consultations/anti-money-laundering-supervisory-review>.

9. Guidance

9.1 The FCA will issue guidance shortly to accompany this instrument, and is consulting on how to best distribute the OPBAS charge.

9.2 The Regulations enable SROs that have followed relevant guidance published by the FCA or a European Supervisory Authority to have this taken into account when the FCA is deciding whether the body contravened a requirement under the MLRs.

9.3 Stakeholders should also take into account guidance issued by the European Supervisory Authorities (ESAs) which are as follows:

- Finalised ESA risk-based supervision guidelines:

<http://www.eba.europa.eu/documents/10180/1663861/Joint+Guidelines+on+Risk-Based+Supervision+%28ESAS+2016+72%29.pdf/7159758d-8337-499e-8b12-e34911f9b4b6>

9.5 Once operational, OPBAS will publish a sourcebook clarifying how SROs might demonstrate they have met their obligations.

10. Impact

10.1 The impact on business, charities or voluntary bodies is primarily in relation to SROs as supervisors, rather than on the firms regulated under the MLRs as relevant persons.

10.2 There will be a marginal cost to the public sector. In particular, the FCA will be impacted as it sets up and operates OPBAS.

10.3 The public and firms regulated under the MLRs will be impacted as OPBAS strengthens the supervisory regime and helps reduce economic crime.

10.4 An Impact Assessment is submitted with this memorandum and will be published alongside it on the legislation.gov.uk website.

11. Regulating small business

11.1 This instrument will affect those SROs that are also small businesses. The government, and the FCA, are seeking to minimise this impact where possible.

11.2 For example, most SROs supervise less than 6000 regulated persons and the FCA is currently consulting on capping the annual OPBAS fee for those SROs at £5000.

12. Monitoring and review

12.1 On 26 October 2017, the Treasury and the Home Office published the National Risk Assessment 2017 to identify, assess, and understand the risks of money laundering and terrorist financing affecting the United Kingdom, and how these are being mitigated. These risks will continue to be assessed in order to keep the findings up to date, including considering the impact of OPBAS on strengthening AML supervision.

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

12.3 Separately, the FCA will publish its objectives under this instrument annually, as well as performance against those objectives, its priorities for the coming year and emerging risks, in the FCA's Annual Report. This report will be complemented by information published on the internet.

12.4 In 2018, the UK's AML/CTF regime will be assessed during the UK's Mutual Evaluation carried out by FATF.

13. Contact

13.1 Katherine Newall at HM Treasury (Telephone: 020 7270 5803 or email: Katherine.Newall@hmtreasury.gsi.gov.uk) can answer any queries regarding the instrument.