

# CALL FOR EVIDENCE: REVIEW OF THE UK'S AML/CFT REGULATORY AND SUPERVISORY REGIME

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## INTRODUCTION

In this submission, Transparency International UK (TI-UK) provides a response to HM Treasury's call for evidence on the UK's anti-money laundering (AML) supervision regime.

We welcome this opportunity to inform HM Treasury's consideration of reform, which is long overdue. The UK's supervisory system for AML compliance is currently not fit for purpose. A radical overhaul is needed to stem the flow of corrupt wealth moving through our financial system and prevent UK service providers from being unwitting or complicit facilitators of money laundering. This requires a number of major changes in order to ensure the system meets the standards of good regulation.

In this call for evidence, we identify five key weaknesses in the current supervisory system:

- **Insufficient resources**, which provides threadbare, and in some cases near non-existent, oversight of private sector practices.
- **Conflicted governance** that undermines the effectiveness of some supervisors.
- **Poor application of risk assessments** to supervisory activities, leading to the inefficient allocation of resources.
- **Inadequate enforcement**, which fails to provide a credible deterrent against wrongdoing.
- **Statutory limitations** of the Office for Professional Body Anti-Money Laundering Supervisors (OPBAS), which inhibit its ability to increase performance across both professional and public body supervisors.

To address these we propose a new model built on the key principles of:

- **Consistency**: providing consistent advice and guidance, compliance monitoring and enforcement functions, that are free from conflicts of interest.
- **Proportionality**: targeting resources effectively and providing a credible deterrent against money laundering.
- **Transparency**: openness over policies, actions and costs to allow external scrutiny of performance.
- **Accountability**: subjecting performance to greater independent external scrutiny.

### Recommendation

We propose a radical re-design of the AML supervisory framework, with at most no more than two supervisors responsible for the regulated community – one for financial and another for non-financial businesses. This would best deliver the principles outlined at the start of this submission, and provide a more effective system for improving the UK's defences against dirty money.

## RESOURCES

Insufficient resources appear to be undermining the work of most supervisors, meaning they cannot effectively oversee their respective populations.

The Treasury Select Committee's findings in 2019 identified a lack of resources and high staff turnover as a key weakness for HMRC, which admitted their resources were not sufficient for their supervisory work.<sup>1</sup>

Resources may also be a limiting factor for the FCA's effectiveness at overseeing the full extent of their population. In the most recent HM Treasury supervision report, the FCA carried out just 111 on-site visits or desk based reviews of the 19,660 firms it supervises.<sup>2</sup> The UK's Mutual Evaluation Report by the Financial Action Task Force also raised concerns over the FCA's inadequate level of supervisory coverage across firms not subject to engagement cycles, suggesting many firms are likely receiving less attention than they should.<sup>3</sup>

The most damning evidence comes from the recent OPBAS report, which found that only 50 per cent of professional body anti-money laundering supervisors (PBS) were fully effective at resourcing their supervisory functions. This issue may be causing problems in hiring and retaining skilled supervisory staff. OPBAS's most recent report found only a *'third of supervisors assessed were effective in recruiting and retaining staff with relevant experience and providing support through ongoing professional development. On occasions, staff in key AML roles lacked sufficient expertise and knowledge. We expect PBSs to make this a priority as it will be key to improving effectiveness in all the areas identified in this report.'*<sup>4</sup>

It is clear that a substantial proportion of PBS' are struggling to recruit the requisite talent to carry out their supervisory duties.

## GOVERNANCE

There remain major governance concerns over a number of supervisors, which undermine how effectively they regulate their respective communities.

In HM Treasury's 2019 economic crime review, HMRC's primary role as a tax authority was raised as problematic due to the risk that supervisory activity became adjunct to its revenue raising activities.<sup>5</sup> It was noted that the HMRC Single Departmental Plan contained no standalone objective for its AML supervisory work.<sup>6</sup> This remains a concern because HMRC's 2021 outcome delivery plan contains no mention of money laundering supervision.<sup>7</sup> Given the huge range of businesses supervised by HMRC this is a major strategic flaw, which undermines the effectiveness of the entire supervisory system.

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<sup>1</sup> <https://publications.parliament.uk/pa/cm201719/cmselect/cmtreasy/2010/2010.pdf> page 28 and 29 [Accessed 13 October 2021]

<sup>2</sup>

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/920209/200922\\_Su pervision\\_report\\_18-19.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/920209/200922_Su pervision_report_18-19.pdf) Page 13 [Accessed 13 October 2021]

<sup>3</sup> <https://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-United-Kingdom-2018.pdf> Page 132 [Accessed 13 October 2021]

<sup>4</sup> <https://www.fca.org.uk/publication/opbas/supervisory-assessments-progress-themes-2020-21.pdf> Page 8 [Accessed 13 October 2021]

<sup>5</sup> <https://publications.parliament.uk/pa/cm201719/cmselect/cmtreasy/2010/2010.pdf> Pages 27 and 28 [Accessed 13 October 2021]

<sup>6</sup> <https://www.gov.uk/government/publications/hm-revenue-and-customs-single-departmental-plan/single-departmental-plan#maximise-revenues-due-and-bear-down-on-avoidance-and-evasion> [Accessed 13 October 2021]

<sup>7</sup> <https://www.gov.uk/government/publications/hm-revenue-and-customs-hmrc-outcome-delivery-plan/hm-revenue-and-customs-outcome-delivery-plan-2021-to-2022--2> [Accessed 13 October 2021]

There are also significant governance concerns relating to PBSs, many of whom still do not have adequate division of advocacy and supervisory functions. This issue was raised by OPBAS in September 2021:

*'A third of PBSs did not have an effective separation of their advocacy and regulatory functions, presenting a clear risk of conflict of interest. PBSs in the accountancy sector were more effective in handling conflicts of interest appropriately than those in the legal sector.'*<sup>8</sup>

This issue severely undermines PBS' ability to effectively supervise their communities. In 2018, OPBAS found 92 per cent of accountancy supervisors expressed concerns about taking robust action if this would damage their ability to attract or retain members.<sup>9</sup> This risk will remain as long as conflicts of interest are not adequately handled.

## RISK BASED APPROACH

Flawed risk-based approaches across supervisors are undermining the effectiveness of their oversight functions. Although the approach by the FCA appears by far the most advanced, it still has room for improvement. There seem to be far more serious issues with the approaches taken by HMRC and PBSs. And overall the application of risk assessments to supervisory functions lacks consistency.

There is no single approach to developing a risk-based approach across supervisors, whilst this in part due to the difference in sectors and activities supervisors oversee, the mix of statutory and self-regulatory bodies in the UK supervisory landscape leads to uneven access to high-quality intelligence, exacerbating the differing approaches to risk.

The FCA's risk-based approach to conducting criminal background checks to those seeking to own or control a financial institution is problematic, with these checks only being carried out after concerns are raised. Research by TI-UK has identified this is resulting in those with questionable pasts gaining control of authorised firms.<sup>10</sup> The FCA's approach to inspecting firms it deems high risk every four years was highlighted in the UK's FATF mutual evaluation, raising the question of whether this should be more frequent.<sup>11</sup> The breadth of the FCA's oversight was also called into question in this review with FATF calling for the FCA to ensure appropriate intensity of supervision for all the different categories of its supervisory population from low risk to high risk.<sup>12</sup>

We are concerned about HMRC's risk-based approach due to its limited activity in relation to the UK's company formation industry, which is viewed by the HM Treasury as high-risk.<sup>13</sup> Thousands of firms formed and administered by businesses regulated by HMRC go on to be used in money laundering schemes, however there has been limited action to address this based on publicly available information.<sup>14</sup>

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<sup>8</sup> <https://www.fca.org.uk/publication/opbas/supervisory-assessments-progress-themes-2020-21.pdf> Page 6 [Accessed 13 October 2021]

<sup>9</sup> <https://www.fca.org.uk/publication/opbas/themes-2018-opbas-anti-money-laundering-supervisory-assessments.pdf> Page 5 [Accessed 13 October 2021]

<sup>10</sup> Research Report due for publication December 2021

<sup>11</sup> <https://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-United-Kingdom-2018.pdf> Page 131 [Accessed 13 October 2021]

<sup>12</sup> <https://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-United-Kingdom-2018.pdf> Page 132 [Accessed 13 October 2021]

<sup>13</sup>

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/945411/NRA\\_2020\\_v1.2\\_FOR\\_PUBLICATION.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/945411/NRA_2020_v1.2_FOR_PUBLICATION.pdf) [Accessed 13 October 2021]

<sup>14</sup> See the following Transparency International UK publications: Hiding in Plain Sight: How UK Companies Are Used To Launder Corrupt Wealth <https://www.transparency.org.uk/publications/hiding-in-plain-sight> and At Your Service: Investigating how UK businesses and institutions help corrupt individuals and regimes launder their money and reputations <https://www.transparency.org.uk/publications/at-your-service>

Perhaps most problematic are findings from the most recent OPBAS report, which stated that the vast majority (over 80 per cent) of PBSs have failed to implement effective risk-based approaches. This has a direct impact on their ability to effectively supervise their regulated communities with just under half had effective tools in place to oversee their members.

## ENFORCEMENT

We note that the UK continues to have an inconsistent approach to enforcement amongst supervisors, even within the same sector. For example, only the FCA and HMRC continue to have civil penalties provided for under the Money Laundering Regulations 2017 and are the only bodies who are required to publish the details of the use of these powers. Similarly, the UK Government has not sought to standardise the sanctions other supervisors would have at their disposal, despite industry supporting such a measure to improve legal certainty.<sup>15</sup>

This inconsistency is exacerbated by the fact that there is no requirement for PBSs to have published enforcement or sanctions policies. These are crucial parts of regulatory governance that provide certainty to the regulated community over how investigations into alleged breaches of the rules are managed and what criteria informs sanctioning decisions. These signals from these policy statements are a core part of providing strong incentives towards good business behaviour.

The most recent report from OPBAS found around two thirds of PBSs didn't have effective enforcement frameworks.<sup>16</sup> For example, some PBSs could not explain their criteria for taking enforcement action and which tools would be used. It also found only a quarter of PBSs used their enforcement tools effectively. Some legal sector PBSs continue to face statutory limitations to the exercise of their powers, requiring them to refer matters to the independent Solicitors Disciplinary Tribunal for larger fines.

There also appears to be large discrepancies between the fines issued to different sectors overseen by HMRC. While there have been record one-off fines in the estate agent and money service business sectors, the trust and company formation sector rarely sees fines exceeding £1,000.<sup>17</sup> This does not create a credible deterrent to those in the sector with weak money laundering defences.

Beyond civil penalties, there is an unresolved issue about the pursuit of criminal prosecutions for egregious breaches of the rules. Although we note that such action should be reserved for the most serious cases in this regulatory context, the prospect of action through the criminal courts is still necessary to providing a credible deterrent even if it is not frequent. Currently, only the FCA, HMRC and Gambling Commission appear capable of pursuing these cases in practice, with the FCA remaining the only supervisor to have done so. This provides an enforcement gap, with no clear route to investigation or prosecution for those regulated businesses outside of the purview of public sector supervisory bodies.

## STATUTORY LIMITATIONS OF OPBAS

Whilst the introduction of OPBAS was a step in the right direction in terms of trying to bring higher levels of consistency to PBSs, its own reports show it is a long way from achieving this objective.

### *Limits in scope*

OPBAS only has the responsibility for monitoring and ensuring greater consistency across PBSs, which does not include HMRC, the FCA or the Gambling Commission. This has created a two-tier approach with PBSs overseen by OPBAS, while public sector supervisors would be subject to direct oversight from HM Treasury.

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<sup>15</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/600340/Anti-Money-Laundering-Supervisory-Regime-response-call-for-further-information.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/600340/Anti-Money-Laundering-Supervisory-Regime-response-call-for-further-information.pdf) [Accessed 13 October 2021]

<sup>16</sup> <https://www.fca.org.uk/publication/opbas/supervisory-assessments-progress-themes-2020-21.pdf> [Accessed 13 October 2021]

<sup>17</sup> <https://www.gov.uk/government/publications/businesses-not-complying-with-money-laundering-regulations-in-2018-to-2019/list-of-businesses-for-tax-year-2019-to-2020-that-have-not-complied-with-the-2017-money-laundering-regulations> [Accessed 13 October 2021]

This system does not deliver sufficient levels of accountability or oversight over public body supervisors, who we have shown to have differing levels of effectiveness in carrying out their roles.

#### *Insufficient powers*

OPBAS is not empowered to compel supervisors to adopt certain standards, only having the power to 'encourage' them to do so. Similarly, the guidelines released by OPBAS are not binding and therefore cannot guarantee consistency.

While OPBAS has certain powers that allows it to monitor supervisors' compliance with their responsibilities, it does not currently have powers to directly interview those from the regulated sector. This means that OPBAS may be missing out on different insights into the performance of supervisors provided by the regulated sector, this weakens OPBAS' guidance to supervisors.

OPBAS itself does not have the power to remove supervisory role from PBSs that are falling short in their regulatory duties, only the power to recommend to HM Treasury such action. This has resulted in no PBSs having their duties removed from them despite OPBAS repeatedly finding these supervisors failing to live up to the minimum expected standards for this role.

#### OPTIONS FOR REFORM – SUPER SUPERVISOR MAX

In our previous submission to HM Treasury's call for information in June 2016, we provided three broad options for reform, which are included in the Annex below for information. Subsequent to that call for information the UK Government pursued changes similar to Option 2, with OPBAS becoming the super-supervisor seeking to improve standards across PBSs. We have laid out the numerous weaknesses across this current approach above. In its current form, OPBAS is unable to adequately address these on its own.

Given the issues we identified half a decade ago persist, we are now more inclined to pursue a more radical re-design of the AML supervisory framework, with at most no more than two supervisors responsible for the regulated community – one for financial and another for non-financial businesses. This would best deliver the principles outlined at the start of this submission, and provide a more effective system for improving the UK's defences against dirty money.

Consideration should be given to how best to transition to this system without losing from existing supervisors. Given the weaknesses we have identified with its money laundering supervision, HMRC should not be given the role of non-financial supervisor.

Pending these changes, there are a number of smaller tweaks to make the system work better. We have provided comments on technical changes to the MLRs in our submission to HM Treasury's parallel consultation on MLR reform. There is also scope to provide greater powers to OPBAS; for example, providing a greater role in receiving and disseminating intelligence across supervisory bodies. And HM Treasury can start taking more decisive action against those PBS' that are falling below the standards expected of them, as part of a gradual move towards consolidation of AML supervisory responsibilities akin to those we envisage under Option 3. We would be happy to provide more detailed thinking on interim measures when the government provides a clearer steer about its ambition and pace of reform in this area.

#### CONTACT

Rachel Davies Teka, Head of Advocacy [rachel.davies@transparency.org.uk](mailto:rachel.davies@transparency.org.uk)  
Ben Cowdock, Investigative Lead, [ben.cowdock@transparency.org.uk](mailto:ben.cowdock@transparency.org.uk)

## ANNEX: OPTIONS FOR REFORM (FIRST PROPOSED BY TI-UK TO HM TREASURY IN JUNE 2016)

### Option 1: consolidate into independent thematic supervisors

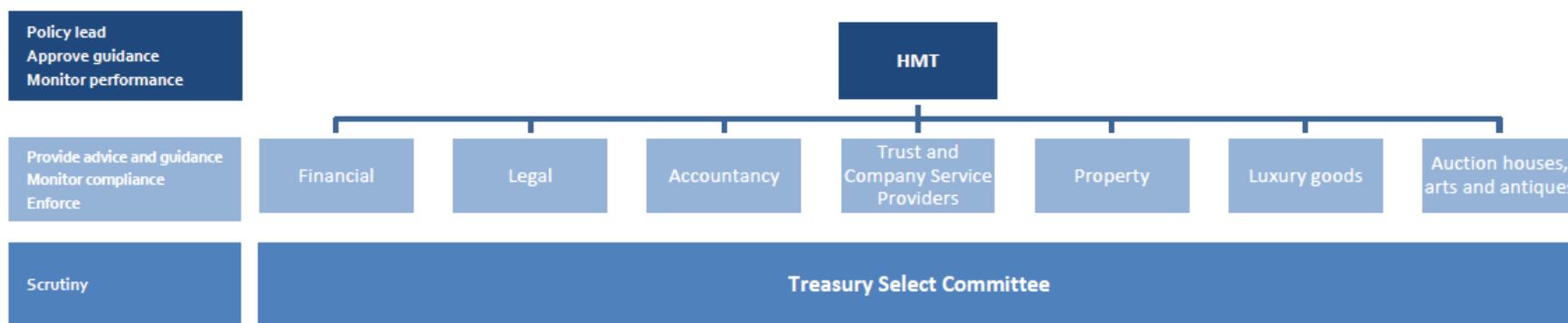
This would involve consolidating the existing supervisory functions into thematic bodies that are separate from the lobbying arms of existing industry organisations. The themes could be based around the model outlined below.

#### Potential benefits:

- Improved consistency of AML advice and guidance within sectors
- Improved coordination of AML activities within sectors
- Improved pooling of AML expertise and resources that can be prioritised based on sector-specific risks
- Continued sector expertise in supervisory bodies
- Continued consistency checks on guidance from HM Treasury

#### Potential disadvantages:

- AML expertise is still fragmented across different supervisory bodies
- Continued reliance on the AML supervisors' forum as the main coordinating body across sectors



**Option 2: Super-supervisor light**

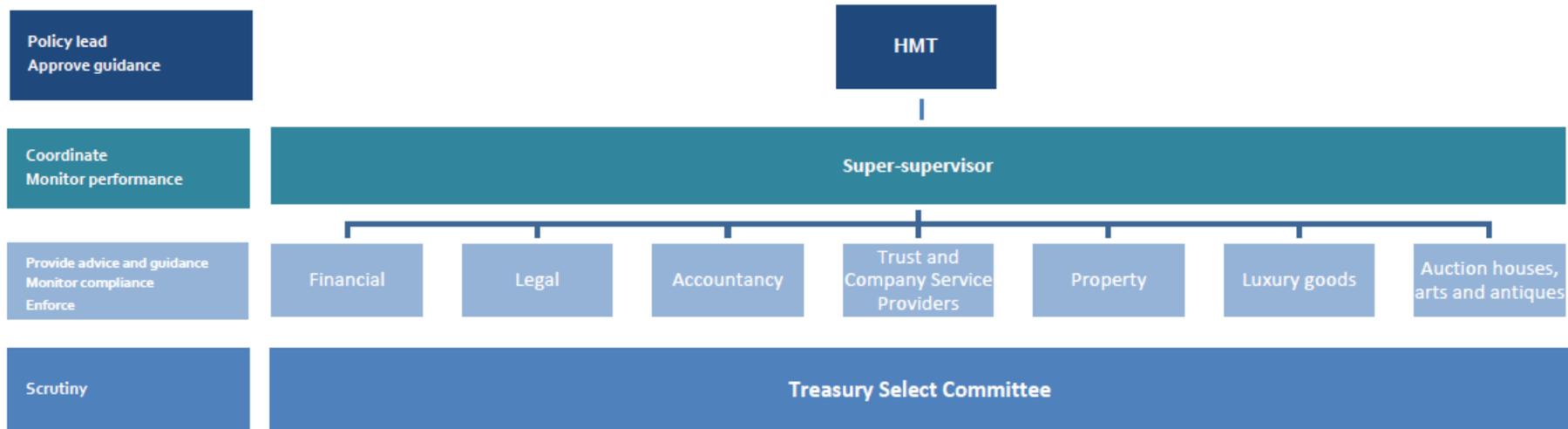
This would involve consolidating the existing supervisory functions into thematic bodies and introducing a super-supervisor that would work with sector supervisors on an operational level, for example, in the development of risk assessments and guidance, and providing a forum for coordination and information sharing. The super-supervisor would need some powers of direction to ensure sector supervisors comply with the principles we have outlined above. For example, it may need to require them to submit annual performance reports in order for them to be accountable. HM Treasury would remain the departmental policy lead in government and continue to approve guidance.

**Potential benefits:**

- Improved consistency of AML advice and guidance across sectors
- Improved coordination of AML activities across sectors
- Improved pooling of AML expertise and resources that can be prioritised based on sector-specific risks
- Continued sector expertise in supervisory bodies
- Reduced HM Treasury resources needed for approving guidance

**Potential disadvantages:**

- AML expertise and resource cannot be prioritised based on cross-sector risks



### Option 3: Super-supervisor max

This would involve consolidating the existing supervisory functions into one single AML supervisor that would contain both AML specialist and sector-specific expertise that leads on operational AML supervision, for example, the development of risk assessments and guidance. HM Treasury would remain the departmental policy lead in government and continue to approve guidance.

#### Potential Benefits:

- Highest level of consistency of AML advice and guidance across sectors
- Highest level of coordination of AML activities across sectors
- A single enforcement policy which could be applied across the regulated sector
- Single point of contact for AML issues for any companies working across different sectors
- Pooled AML resources and expertise in one body that can be allocated based on cross-sector risks
- Dedicated, centralised intelligence function to help share information on money laundering risk from across the regulated sector with Government and law enforcement
- Reduced HM Treasury resources needed for approving guidance

#### Potential disadvantages:

- Potential to lose sector-specific expertise if it is not prioritised when setting-up the super-supervisor

