



The Money Laundering Regulations Review
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Our ref

DX

Your ref

NI number

Review of the Money Laundering Regulations 2007: the Government response

Dear Sir,

HM Revenue and Customs (HMRC) are pleased to respond to your request for views on potential changes to the Regulations identified in your document *Review of the Money Laundering Regulations 2007: the Government response*.

My team or I would be happy to discuss any points we raise in our response.

Yours sincerely,

Head of the Money Laundering Regulations Team, HMRC

REVIEW OF THE MONEY LAUNDERING REGULATIONS 2007: THE GOVERNMENT RESPONSE

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INTRODUCTION

1. HM Revenue & Customs welcomes the opportunity to respond to potential changes to the Regulations identified in the HM Treasury document *Review of the Money Laundering Regulations 2007: the Government response*.

WHO WE ARE

2. HMRC is a non-ministerial department responsible for collecting and administering taxes and duties as well as paying and administering some forms of state support. We make sure that the money is available to fund the UK's public services, and we also help families and individuals with targeted financial support.
3. We are one of the 28 supervisors appointed by Treasury under the Money Laundering Regulations 2007 (MLRs). We are responsible for supervising Money Service Businesses (MSBs), High Value Dealers (HVDs) as well as Accountancy Service Providers (ASPs) and Trust or Company Service Providers (TCSPs) where businesses are not supervised by a professional body named in the Regulations or by the Financial Services Authority or another supervisory authority.

MAJOR POINTS

4. We welcome the Government's aim to strengthen the risk-based approach under the Money Laundering Regulations whilst reducing burdens on business to support its Plan for Growth.
5. As a supervisor under the MLRs using only powers granted to us by the Treasury, we welcome changes to the legislation to give all supervisors powers that some supervisors are able to use through their membership rules.
6. We think that the headline measures within the consultation - removal of the criminal sanction and exempting micro businesses - are an understandable response to what Government was told in the course of its original call for evidence. However we think that there are significant risks to both measures that are hard to mitigate.
7. The Consultation seeks views on ensuring that the right businesses are subject to supervision, giving supervisors proportionate powers to assist in their risk-based approach and achieving effective supervision whilst reducing burdens on business. This response uses feedback from customers and our experience as a supervisor as evidence for our responses to the proposals for change. Not all consultation questions posed by Treasury are relevant to HMRC.

PROPOSALS FOR CONSULTATION

Q1. Should the existing criminal sanctions be wholly or partly repealed?

8. We partially support this proposal.
9. The Consultation seeks views on whether the criminal sanctions should be partially or wholly abolished as they are perceived to cause a problem in preventing businesses from taking risk-based decisions due to fear of prosecution for minor failings.
10. We believe the abolition of criminal sanctions for regulatory breaches carries significant risk to our ability to
 - take robust action against criminally infiltrated MSBs
 - take advantage of the potential for sanctions as a behavioural tool in challenging wilfully non-compliant businesses.

11. The removal of all criminal sanctions would send out a message that financial reparation can offset sustained breaches of the Regulations. It is likely to encourage a climate of disrespect for the Regulations and a perception that compliance is of little importance.
12. Any fines levied (no matter what their value) are highly unlikely to be commensurate with the dividends reaped from actively facilitating or ignoring money laundering. A civil based penalty regime may also lead to accusations that HMRC generates additional revenue from regulated businesses rather than supervising them effectively. Although fines are an effective sanction against established businesses with concern for their reputation, this is not always the case with small operators. In the MSB sector there is evidence of businesses closing down to avoid payment of penalties only to re-open in another form and resume their non-compliant behaviour.
13. The role of some of the MSB sector as an enabler of criminal or terrorist financing is well documented and widely recognised but the criminal sanctions also act as a key deterrent in securing the compliance of non-criminally infiltrated MSBs. One large MSB for example has commented that the personal criminal liability under the Regulations is vital for large organisations as a lever to ensure continuing board level buy-in to a robust Anti-Money Laundering approach and to improving compliance procedures. Independent research carried out with our supervised sector found very little perception of a downside to non-compliance. We believe that this perception will change as we make more use the criminal sanctions: as we plan to do in this and future years. Use of the sanctions will create confidence in the market that serious non-compliance is being dealt with effectively. In this way the criminal sanctions available under the Regulations complement the UK's primary Anti-Money Laundering legislation (The Proceeds of Crime Act 2002), and support law enforcement action against those entities that facilitate or ignore the threat of criminal and terrorist finance.
14. We are committed to identifying and prosecuting businesses that are guilty of severe or sustained regulatory non-compliance. Prosecutions are one tool in our development of a refreshed compliance strategy based on understanding and using customer behaviour.
15. We are currently evaluating a number of potential cases for adoption by HMRC's Criminal Investigation team where there is intelligence or information to suggest serious breaches of the Regulations. Prosecutions will help disrupt criminal enablers within the regulated financial sector.
16. We accept that the fear of prosecution could cause legitimate firms to be unreasonably risk averse and hinder a step-change to an effective risk-based approach. For this reason, we advocate the retention of criminal sanctions for only the most significant regulatory breaches- in itself a risk-based approach. The following list focuses criminal sanctions in respect of breaches that go to the central purpose of the Regulations – prevention and detection of money laundering. This would counter the perception that prosecutions would be taken against cases of minor non-compliance with the Regulations. We suggest existing criminal sanctions are applied to the following Regulations:
 - Regulation 7(1)-(3)- Application of customer due diligence measures
 - Regulation 8(1) and (3)- Ongoing Monitoring
 - Regulation 11 (1a-c)- Requirement to cease transactions
 - Regulation 14 (1)- Enhanced customer due diligence and ongoing monitoring
 - Regulation 19 (1,4, 5 and 6)- Record Keeping
 - Regulation 26- Requirement to be registered
 - Regulation 33- Requirement to be registered.

17. The remainder can be repealed and breaches best dealt with using appropriate, proportionate and behaviourally-based civil penalties. Taking this line reduces the number of criminal sanctions by approximately 55%.

Q2. Should new powers be granted to supervisors allowing them to order or require actions by businesses to mitigate the potential negative impacts from the loss of criminal sanctions?

18. We oppose the removal of all criminal sanctions. If those sanctions are removed we would need to obtain alternative powers.

19. We feel that the removal of our ability to prosecute for the most serious instances of non-compliance will remove a key plank in our supervisory approach, though of course we do understand the reasoning behind it.

20. If the Government is minded to remove all the sanctions then we would need powers that although never capable of replicating the threat of prosecution will go some way to support our effective supervision of all of our sectors and allow us to take assertive action against those who wilfully do not comply with their obligations.

21. The current penalty framework provides for unlimited financial penalties to be levied but for those committed to non-compliance these can be seen as a financial overhead. Customer insight research completed on our behalf has shown that many businesses across all the sectors we supervise consider their registration as a “licence to trade”. The registration with HMRC is not a licence to trade, especially given the limited powers to check fit and proper status of individuals within HVDs and ASPs. But the perception that they have or do not have a licence to trade is a powerful motivator for our businesses. We believe that powers to cancel the registration of non-compliant businesses, where we can demonstrate we are unlikely to change the behaviour, could be an important step to mitigating our inability to prosecute. Indeed we think this would be a valuable amendment to the Regulations irrespective of any changes to the scope of criminal sanctions.

Q3. Do you agree that the current distinction between Parts 1 and 2 of Schedule 3, e.g. for reliance purposes, should now be removed?

22. We support this change.

23. The proposal is to remove the distinction between Part 1 and 2 of Schedule 3 of the Regulations. Since taking on responsibility for supervising their members, all professional bodies in Schedule 3 have accounted for their risk-based approach to Treasury. This negates the need for a distinction. We believe that this proposal would put all members of accountancy professional bodies on a similar footing when it coming to accessing reliance provisions under regulation 17.

Q5. Should there be a general de-minimis exclusion for very small businesses (for example those with below €15,000 VAT-exclusive turnover per annum), or a reduction in the requirements placed on such businesses?

24. We oppose this change.

25. The Consultation document seeks views on how the burden placed upon small businesses by the requirements of the Money Laundering Regulations can be reduced either through a reduction in requirements or a de-minimis level at which a business may not be subject to the requirements of the Regulations at all.

26. Overall we would be very concerned at any general de-minimis exclusion for small businesses as we do not accept that all such businesses are low risk. Money

Transmitters operating to small commission margins may have a modest turnover (the amount they take for themselves) but very significant throughput of money. The risks posed by MSBs in respect of the movement of terrorist funds are well documented. We also believe that any indicator used to differentiate the 'micro' business would be very difficult to police effectively.

27. We have recently sponsored some research by Quadrangle Group on customer insight and customer segmentation. Based on their research they tell us that the survey results from businesses with less than £15k turnover shows a group which is potentially vulnerable, particularly to use by small-scale money launderers and for terrorist finance. If the decision is made to de-scope businesses we feel that the proxy suggested in the consultation is not sufficient and would need to have additional proxies put in place to reduce the risk of vulnerable businesses falling out of scope. (For example stipulating a maximum number of customers over a prescribed period – to ensure all money transmitters remained in scope).
28. We appreciate that a proposal to limit the scope of the Regulations is attractive in terms of the Government's agenda for micro businesses. By including small ASPs it would also remove a vociferous body of complainants. However we would strongly oppose this approach because:
 - a threshold based on turnover or any other indicator would create a loophole which could be actively exploited, allowing money launderers to operate below the radar by using a business that is exempt from the Regulations, or presents itself as being exempt
 - a blanket exemption for all small businesses would have the unintended consequence of covering all small businesses irrespective of the risk and this would include some MSBs: based on a turnover of £15,000 research indicates there are 240 MSBs that would be out of scope
 - we cannot be confident at this stage that there is minimal risk or opportunity for money laundering/terrorist financing through low activity ASPs. It's quite possible that low turnover in this sector equates to low risk but at present we have no evidence of that or conversely of any specific risks attached to such businesses. Our knowledge of the sector is still developing but HMRC's experience and history of dealing with tax agents (for example, in a 'deliberate defaulters' programme) has been instructive in showing that the whole of the ASP sector is not low risk
 - any reduction of the burdens imposed by the Regulations would not remove ASPs from the regulated sector under schedule 9 of Proceeds of Crime Act and they would still need to report suspicious activity
 - small businesses can charge small amounts of fees for activity that could support significant money laundering, Money Transmitters for example may charge less than 0.001% per transaction

29. HMRC's experience of operating thresholds, for example:

- the Self Assessment three-line account requirement currently set at the VAT threshold of £73,000 but having previously been set around £15,000
- the Stamp Duty threshold
- Small Companies Relief

shows that the creation of any threshold will be manipulated by businesses. Although an exemption based on turnover would lift the compliance burden on some businesses it could potentially cause market distortion and disadvantage businesses trading slightly above the limit.

30. Reduction of burdens is a key stimulus to growth but there is a danger in this case of it becoming a perverse incentive. Introduction of a turnover-based threshold may inhibit

business growth by discouraging businesses from developing beyond the threshold to avoid the additional burdens imposed by the Money Laundering Regulations.

31. There would also be very significant practical difficulties in policing an exemption based on turnover. Reliable data on the turnover of registered businesses could not be updated using tax information because the time lag in submitting Tax Returns means data is not contemporaneous. We would therefore have to consider the extent to which we would be able to actively police the threshold (and the potential resource implications, particularly given the resulting reduction in fee income) whilst being aware of the risk implications of allowing the threshold to be self-policed.
32. There is also a danger in exempting these businesses on the grounds that “they are not adjudged to be in business”. The Regulations do not require businesses to be registered if they are not doing the activity “by way of business”. This test aligns to settled case law in the Income Tax sphere as to what defines a business; any change of this definition under the Money Laundering Regulations would sit uncomfortably with our tax treatment of micro businesses which are not exempted from direct tax responsibilities.

Q9. Do you agree that all previous criminal conduct should be considered under the fit and proper test for MSB's?

33. We support the proposal that we should be able to consider all previous criminal conduct under the Fit and Proper Test.
34. This could be achieved by either listing all relevant criminal conduct as an extension of the offences currently in Regulation 28(2) (a)-(g) or by an extension of the meaning of Regulation 28(2) (h) which considers the risk of money laundering or terrorist financing presented by an individual. We think that the best response would be to grant discretion about previous criminal conduct in addition to the offences already listed. We think that this discretionary power to fail an applicant for previous criminal conduct would be more proportionate than a blanket restriction, allowing us to take in to account the age (if not spent) and seriousness of a previous criminal conviction and to discount convictions unlikely to raise the risk of money laundering or terrorist financing. A simple amendment to regulation 28(2) (h) would be needed to achieve this along the following lines: ‘is otherwise not a fit and proper person with regard to the risk of money laundering or terrorist financing including but not restricted to any previous criminal conduct’.
35. This amendment would partly respond to the concerns raised in the review by explicitly broadening the scope of the test. It would not however address circumstances concerning businesses that are implicated in money laundering or terrorist financing activity but who have not (yet) been convicted. We have been subject to criticism where there appears to be a divergence of treatment between ourselves and an investigating authority. To remedy this shortcoming our previously rigid policy interpretation of 28(2)(h) (which was limited to only considering overseas convictions for money laundering or terrorist financing and breaches of financial sanctions as causes for Fit and Proper failure) will be made more flexible. This will be complemented by law enforcement agencies promptly providing the evidence to justify a decision to cancel a registration. There can be difficulties in disclosing evidence to a business whilst there are ongoing investigations. The Regulations oblige us to notify the reasons for any cancellation so delays in notifying a cancellation will occur from time to time. We are optimistic that the issue can be largely overcome without the need for further amendment to the text of Regulation 28.
36. A further issue has arisen since the introduction of the Regulations in relation to fitness and propriety to act as a Money Transmitter. In order to operate legally under the Payment Services Regulations 2009 a Money Transmitter must be registered with both HMRC and the Financial Services Authority (FSA). A pre-requisite of FSA registration is to be registered with HMRC. Both supervisors operate a Fit and Proper Test but the test criteria are different. It is possible for a business to pass the HMRC test and obtain

HMRC registration, then fail the FSA Fit and Proper Test. Failure to be registered with the FSA is not currently part of the HMRC test. The outcome is that businesses can be registered with HMRC yet not be allowed to operate. We have requested the ability elsewhere in this response to remedy this but we also encourage Treasury, responsible for both the Money Laundering Regulations and the Payment Services Regulations, to see if a common Fit and Proper Test is practicable.

Q10. Do you agree a right of appeal should be introduced for decisions under the fit and proper test by HMRC?

37. We support this change.

38. The Regulations set out the right of appeal where we take a decision to either fail a new application for registration or cancel an existing one as a result of one or more people in the business being adjudged to be not fit and proper. However this right of appeal is vested in the business applying for registration or being on our register and whilst for sole proprietors the failed fit and proper person and the business will be one and the same for larger business this is not the case. We believe that the ability of individuals to appeal against a failed Fit and Proper Test is an essential counter balance to the proposed increased flexible use of “otherwise unfit and proper” as outlined above.

Q11. Should supervisors be given new powers to impose penalties for the unreasonable failure to allow a supervisor to enter their businesses premises?

39. We support the proposal that supervisors should be given new powers to impose penalties for the unreasonable failure to allow a supervisor to enter their business premises.

40. Under the Money Laundering Regulations 2003 supervisors had powers to impose penalties on businesses that refused entry to their premises, inspection of the premises and inspection of recorded information. Officers frequently used the powers in respect of entry to premises, often with the threat of a penalty being sufficient to leverage behaviour but we did issue four financial penalties where the warning had had no effect. This was very effective in reducing the time spent by officers having to make return visits.

41. The position under the Money Laundering Regulations 2007 requires officers to seek a Court Order to gain access to premises. This procedure is clumsy, time-consuming and slow. It places additional administrative burdens on the supervisor which in turn imposes a financial burden on compliant businesses who fund the regime via the fees they pay. It also imposes arguably unnecessary burdens on the civil courts that have to consider each case and issue the relevant Orders at a time when the pressures on civil courts are high.

Q12. Should there be penalties for the unreasonable failure to provide information?

42. We support the proposal that there should be penalties for the unreasonable failure to provide information.

43. As with the powers above we feel that this is another situation where the penalty provisions available to us under the 2003 Regulations were not fully transposed to the 2007 Regulations. Currently, as with refusal to allow an entry into premises, if a business is registered with HMRC we are required to go to a court to get an Order to allow us to obtain information. However, this is a time-consuming process. Evidence from our operation of the 2003 Regulations suggests the threat of a penalty would speed up and simplify the process. This would benefit compliant businesses by virtue of a reduction in the resources we need to supervise less compliant businesses.

44. Having the power to issue penalties for the unreasonable failure to provide information would result in:
- a quicker and simpler process
 - the ability to be more effective in supervising registered businesses and any unregistered businesses who we believe should be registered with us
 - the provision of fairer treatment of compliant and non compliant businesses throughout our supervision
 - the provision of sufficient powers to enable us to discharge our duties as supervisor more effectively and proportionately.
45. In the cause of consistency and transparency the Government may wish to consider penalties for failure to provide information along the lines of Schedule 36 of the Finance Act 2008 (Part 7 Penalties) issuing an initial fixed penalty for failure to comply, along with possible daily penalties. This would result in a level playing field and a consistent approach with other areas in HMRC.
46. The Government may also wish to consider an accompanying penalty for inaccuracies; otherwise a person could comply with the letter of law but not give us the information we need. This power would complement our penalty powers under Regulation 27 (which is restricted to information about registration matters).
47. We are currently trialling an annual return to gain accurate and up-to-date information about our businesses, helping us identify the riskiest businesses. If the trial is successful in demonstrating benefits above the burden on business, we would wish to have an amendment to the legislation to meet the policy intent to allow us to seek information from all businesses on a periodic basis. The annual return whilst being a burden will reduce unnecessary visits to low risk businesses.

Q13. Should supervisors be given additional powers to enforce the payment of fees or charges payable under a supervisory arrangement, for example by ensuring all supervisors have powers to de-register a business where there is sustained non-payment?

48. We support the proposal that supervisors be given additional powers to enforce the payment of fees or charges payable under a supervisory arrangement, including the powers to de-register a business where there is sustained non-payment.
49. HMRC as well as other supervisors such as the Office of Fair Trading operate a discrete Anti-Money Laundering team which is funded by the fees that all businesses must pay us for being supervised under the legislation. We try and keep the fees as low as we can but are faced with cases where people are unwilling to pay us for the supervision. In 2010 10% of our entire register failed to pay after being chased and outstanding fees are over £20,000 which we currently cannot reinvest back into our supervisory effort or into making efficiencies to allow us to maintain or reduce the fee level.
50. Allowing businesses not to pay, along with the cost of the resource to chase those payments, is unfair to other businesses that pay us on time. Our businesses expect us to be fair to them all and at the moment the legislation limits our ability to meet that expectation.
51. There are two areas where minor changes to the legislation will assist us and other supervisors facing the same issue:
- a. the power to impose penalties for non-payment of either the initial fee payable upon registration, or the annual fee payable thereafter** - at the moment there is no sanction for not paying us and businesses do not feel

they need to rush to pay us because there is no downside. Under the 2003 Regulations we had this power and levied 123 penalties in the period 2004-07 although the threat of additional sanctions alone will have led others to pay before the penalty was levied

- b. the power to remove a business from our register if they do not pay -** our solicitors tell us that Regulation 30(2) does not permit us to remove a business from our register if they continue to not pay their registration fees. If the financial sanction above does not succeed in changing behaviour then we would like to remove that business from our register.

52. The requirement of both powers – charging a penalty and de-registering a business – centres around the need for a range of sanctions to deal proportionately with those businesses who persist in not paying the fees and show potential to be criminally minded. For criminally minded non-paying businesses, a financial penalty would not be proportionate in addressing the money laundering or terrorist financing risk attached to them. Removal from the register is the appropriate response in such cases.

Q14. Should supervisors be given strengthened powers to de-register a business, where a registration has been obtained by other than bona fide means, or no longer serves the public interest?

53. We support the proposal that supervisors be given enhanced powers to protect the integrity of their register of supervision and that where businesses have failed to meet obligations placed upon them or have dishonestly obtained their registration they should be removed from a supervisory regime and told that they cannot legally trade.

54. We think that changes to the current legislation in Regulation 30(2) and matching powers under Regulation 30(4) will suffice to deal with following situations:

- Regulation 30(2) only allows us to consider facts at the point of registration that would have given us grounds to refuse an application for registration - we think that this power should be extended to allow us to consider any material facts that come in to existence following our decision to register the business
- Money Transmitters who must be registered or authorised as payment institutions by the FSA but have failed to do so are committing a criminal offence by continuing to trade - as such they should not remain on our register but we do not have the power to remove them.

55. These changes will remove ambiguity from the Regulations and allow us to supervise businesses effectively.

56. Any additional powers to deregister must of course be counterbalanced by a right of appeal.

Q15. Should supervisors have clear powers to make enquiries of persons who reasonably appear to be relevant persons?

57. We support the proposal for supervisors having clear powers to make enquiries of persons who reasonably appear to be relevant persons.

58. An amendment to the Regulations would remove the present uncertainty by supervisors about their ability to make enquiries of persons who reasonably appear to be relevant persons. What we mean is that we do not have powers to make enquiries of persons who we have reason to believe ought to be subject to supervision but are not currently on our register. This hampers our ability to effectively check that all businesses that

ought to be supervised by HMRC are brought in to supervision or their non-compliance dealt with in an effective manner.

59. Regulation 37 (1) is to be used against “relevant persons”. A relevant person as defined in the Regulations includes someone who runs a supervised business, for example an MSB. The Regulation is explicit in that it relates to someone who as a matter of fact runs an MSB. It is not a power that can be used against someone whom HMRC suspects (however reasonable that suspicion) runs an MSB. The power cannot be used to obtain proof that a person should be registered. 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.
60. One example is a project undertaken by visiting officers to unregistered businesses between April and July 2010. Previously officers had attempted to enter premises in order to obtain information from unregistered businesses but were refused on the grounds that the persons concerned were not running an MSB from those premises. Officers successfully used an Information Notice to get some records and interview the unregistered person. However, the project stalled following legal advice. This weakness has unfortunately enabled unregistered businesses to continue to operate without being effectively supervised.

Q16. Should the ability of supervisors to exchange information with each other for the purposes of discharging their AML supervisory functions be strengthened, if necessary by the creation of new ‘gateways’ to allow for the exchange of information?

61. We support this change.
62. The current situation hampers effective supervision of ASPs as well as any business who may undertake activities which are supervised by more than one supervisor including HMRC. We can share information with other ASP supervisors within the limited circumstances outlined in section 18(2) (a) of the Commissioners of Revenue and Customs Act 2005 (CRCA).
63. By creating a gateway within the Money Laundering Regulations, we will be able to effectively target ASPs who are not members of professional accountancy bodies, ASP supervisors will be able to avoid regulatory arbitrage because they can pass information between each other to stop firms playing one supervisor off against each other or avoiding regulatory oversight by switching professional body. One accountancy body has several examples of ASPs resigning to avoid oversight by their body and effective information sharing based through a bespoke gateway will improve our effectiveness in picking these up. In addition, the ability to discuss cases where there are supervisory overlaps will lead to quick and common sense decisions being made for businesses to give them certainty and avoid being burdened by two supervisory authorities.
64. It is important though that the gateway is clear that any sharing of information is limited to information collected for and shared in relation to supervision under the Money Laundering Regulations and not for other purposes and that there are clear provisions relating to respecting HMRC’s strict duty of confidentiality under section 18 of CRCA in relation to any information shared with other supervisors.

Q17. Should HMRC or other supervisors have powers to limit or prescribe the language used by regulated businesses to describe their relationship with their AML supervisor (for example to make it clear that supervision applies only to money laundering compliance)?

65. We support the proposal to clamp down on misleading information on business promotional material although this has not been a significant problem for us.

66. HMRC has seen businesses misrepresenting their supervision by HMRC as a means of giving the consumer confidence in using the business, to an extent that goes beyond the intent of the Money Laundering Regulations, to protect businesses from customers who wish to launder money. This is particularly the case for ASPs where the fact that they are registered with HMRC can act as an enticement to a consumer and an assumed indication of the quality of the service being offered. In one example the words “Approved and supervised by HMRC” was used on a business letterhead.
67. We welcome the possibility of an additional power to avoid the situation above occurring by prescribing in legislation the way businesses describe their relationship with HMRC. We suggest businesses that wish to refer to their relationship with HMRC use only the following text; “Registered for supervision by HM Revenue and Customs (HMRC) under the Money Laundering Regulations. Being supervised by HMRC is not in itself an endorsement of a company”. To enforce compliance we would urge the Government to consider making any breach of this requirement subject to a penalty under Regulation 42.