Money Service Businesses in the UK
Improving the Conditions for Effective Financial Crime Supervision and Investigations

Olivier Kraft
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187 years of independent thinking on defence and security

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Executive Summary

MONEY SERVICE BUSINESSES (MSBs) allow customers to remit money, to exchange currencies or to cash cheques without having to rely on a bank account. There are approximately 1,000 non-bank money remitters registered in the UK – more than four times the number registered in France, Germany, Italy, the Netherlands and Spain combined. Taken together with non-bank MSBs providing currency exchange or cheque-cashing services, the number of MSBs registered with HM Revenue and Customs (HMRC) – which are the focus of this paper – totals nearly 2,000. The significant size of the UK’s MSB sector is due to a range of factors, including the right of authorised payment institutions registered in the UK to offer services in any state that is a member of the EU or European Economic Area (EEA).

According to estimates of the National Crime Agency (NCA), at least £1.5 billion of criminal proceeds are laundered through MSB remittances from and to the UK each year. Repeated accounts of MSBs being used to launder several hundreds of millions of pounds confirm the NCA’s assessment that the actual figure is likely to be significantly higher. A country having a large MSB sector is not necessarily an indication of higher financial crime. However, when combined with other structural challenges to an effective supervision of the sector (such as a high fluidity and a low level of systematic transparency), a high number of MSBs can create an enabling environment for money laundering and terrorist financing.

The financial crime risks associated with the sector have been compounded by the fact that MSBs’ access to banking services has declined, and that MSBs therefore turn to alternative channels that lack statutory anti-money laundering/counterterrorist financing (AML/CTF) supervision, such as the freight transport of cash. In light of this fact, this paper seeks to support efforts to ensure the integration of legitimate MSB operations into the banking system, on the premise that such integration can succeed only if confidence in the sector is restored and the costs incurred by banks providing services to MSBs are reduced (actual risk mitigation costs, as well as potential reputational costs).

While acknowledging the international dimension of remittances, this paper focuses on the measures that can be taken at the UK level to strengthen the MSB sector’s AML oversight, and specifically to address the risk of criminally owned or complicit MSBs or agents operating unhindered in the UK. Based on a review of key challenges for the sector’s supervision, the paper identifies three key areas where improvements could be made:

- **Enforcement of existing rules**: Relevant UK authorities should assess to what extent the human and technological resources available within HMRC for the supervision of MSBs are commensurate with the number and specific characteristics of the payment institutions registered in the UK. The assessment should consider whether available resources are sufficient to verify institutions’ actual compliance with their obligation...
to report suspicious transactions (as opposed to their merely having adequate written policies and procedures).

• **Information sharing**: Consistent with broader trends in AML efforts, information sharing within and between the public and private sectors should be developed with respect to MSBs. Specifically, mechanisms should be considered to allow information on high-risk agents to be shared by MSBs with supervisors and/or within the sector. This would address the risk of the same agents moving from one MSB to another after having been found by their principal to be non-compliant. In addition, more detailed information about the supervision of the MSB sector should be made public and, in particular, shared with the banking sector in order to inform banks’ own risk assessments.

• **Transparency requirements**: The transparency of MSBs and their operations should be enhanced in order to create the conditions for a more effective supervision of the MSB sector, and specifically to provide supervisors with a comprehensive and accurate understanding of the sector’s composition and activities. Specific measures could, for instance, include: a requirement to file monthly or quarterly reports on the total volume and number of transactions completed; a requirement to list affiliated companies (especially other MSBs or dormant companies); or additional controls to be conducted by cash transport companies.

Without significantly increasing the regulatory burden on the sector, the measures listed above will contribute to broader efforts to enhance the MSB sector’s integrity and the integration of remittances into the financial system. To be fully effective in reducing money laundering risks, however, these measures would need to be complemented by further measures designed to detect businesses offering financial services without the required registration, to address new money laundering methods (such as through virtual currencies or mobile money), and to increase international cooperation, which remains indispensable to investigations into controller-led money laundering networks.
Introduction

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HIS REPORT IS predicated on the notion that money service businesses (MSBs) – that is, financial institutions providing money transmission services, cheque cashing or currency exchange – have a critical role to play in the global financial system. MSBs\(^1\) have been specifically recognised by the international community as a driver of financial inclusion,\(^2\) and as the main channel for remittances.\(^3\) This paper is therefore not meant to reassess in detail the various benefits of MSBs. Rather, it analyses measures that are required so those benefits can be achieved and sustained.

Summary of Financial Crime Risks Associated with MSBs

Like other financial institutions, MSBs present several specific money laundering (ML) and terrorist financing (TF) risk factors that are closely linked to their business model.

Relevance of Money Services in the Context of Financial Crime

The types of services offered by MSBs may serve several purposes for criminal or terrorist groups seeking to launder ill-gotten gains or to conceal the origin or destination of funds. In particular, currency exchange has been found to be a means to reduce the physical volume of cash by converting, for example, large amounts of low-denomination bank notes into a foreign currency with high-denomination notes (‘refining’), which are easier to smuggle.\(^4\) Money transmission services are of use for individuals or groups looking to transfer criminal proceeds across jurisdictions to undermine detection or confiscation efforts where the proceeds were generated, to purchase illegal goods, or to fund criminal or terrorist activities. Third-party cheque cashing may break the paper trail in instances where criminal proceeds are transferred by cheque.

Vulnerabilities

Certain features of MSBs pose specific challenges for the mitigation of ML/TF risks. First, MSBs do not necessarily maintain long-term business relationships with their customers, or formalise such relationships through customer accounts. The absence of a business relationship

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1. While MSB activities can be conducted by banks, the term ‘MSB’ should be understood throughout this paper to refer to non-bank MSBs.
between the MSB and its customers increases the difficulty of detecting unusual or suspicious transactions.\(^5\)

Second, and despite new internet-based transfer methods, a high proportion of transactions involving MSBs are still conducted in cash. Those transactions are more difficult to trace and sometimes irreversible,\(^6\) which limits the impact of any ex-post controls detecting suspicious patterns.

Third, MSBs often rely on large networks of agents who conduct transactions on their behalf.\(^7\) Notwithstanding measures that must be taken by MSBs to ensure appropriate preventive measures at the agent level, the involvement of agents inevitably limits MSBs’ visibility over transactions and may impede the detection of suspicious patterns.

In addition, in order to avoid charges and be profitable, MSBs accepting payments generally do not immediately wire the relevant amount to the business at the receiving end, but rather rely on settlements of accounts over variable periods of time, often including third parties.\(^8\) This modus operandi, particularly common in traditional forms of money transmission, represents another challenge in tracing financial flows, and contributes to the risk of trade-based money laundering.\(^9\)

**Threats**

In light of the above, the predicate crimes most likely to lead to money laundering through MSBs are those generating high volumes of cash, such as drug trafficking\(^10\) or human trafficking.\(^11\) The same MSBs are generally used to launder proceeds originating from various types of criminality. According to an estimate of the National Crime Agency (NCA), the amount of criminal proceeds laundered through MSB remittances from or to the UK is likely to exceed £1.5 billion per year.\(^12\)

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This is confirmed by repeated accounts of cases involving the laundering of several hundreds of millions of pounds through individual MSBs.\textsuperscript{13}

In addition, the fact that certain MSBs operate in countries with high levels of terrorism, while critical in order to maintain financial corridors to those countries, also increases the risk of abuse by terrorists or terrorist groups.\textsuperscript{14} Other threats relate to specific offences under national legislation. For example, MSBs offering cheque cashing services face a threat of being misused to circumvent the provisions of the Scrap Metal Dealers Act 2013,\textsuperscript{15} which bans scrap metal dealers in England and Wales from paying for scrap metal in cash.\textsuperscript{16}

**External versus Internal Risks**

As the UK’s 2015 National Risk Assessment (NRA) acknowledges, the factors creating ML/TF risks in the MSB sector vary.\textsuperscript{17} On the one hand, MSBs may unwittingly be abused by criminal groups seeking to launder funds or fund terrorist activities (external risk). On the other, a complicit MSB owner, staff or agent may deliberately divert a business for criminal purposes (internal risk). The boundaries between the various degrees of awareness are not clear-cut, and ML/TF cases may involve MSBs with different degrees of awareness (such as a complicit MSB using the services of a negligent MSB as part of a ML scheme).

**Impact of Concerns about Financial Crime Risks**

Alongside other sectors, MSBs have in the past ten years faced growing difficulties in accessing or maintaining the banking services on which their operations rely.\textsuperscript{18} Among other factors underlying this trend,\textsuperscript{19} concerns about the risks described above have informed banks’ decisions to exit or decline business relationships with MSBs. This is due not only to the potential reputational or regulatory risks to the banks if they are found to be facilitating ML/TF, but also to the costs of mitigating those risks. Concerns about financial crime have been compounded by the lack of confidence in the supervision of the sector. A G20 survey revealed in 2015 that

\textsuperscript{13} See HM Treasury and Home Office, *National Risk Assessment of Money Laundering and Terrorist Financing 2017*, p. 70, Box 11.A (describing the case of an MSB that ‘moved around £1 billion to China, around £300 million of which was assessed to be criminal money’).

\textsuperscript{14} FATF, ‘Guidance for a Risk-Based Approach – Money or Value Transfer Services’, February 2016, p. 20.

\textsuperscript{15} HMRC, ‘Money Laundering Supervision: Guidance for Money Service Businesses’, last updated 26 June 2017.

\textsuperscript{16} ‘Scrap Metal Dealers Act 2013 (UK)’, Chapter 12.

\textsuperscript{17} HM Treasury and Home Office, *UK National Risk Assessment of Money Laundering and Terrorist Financing*, 2015, p. 49.


'Only 52 percent of bank respondents judged that the [money transfer operators (MTO)] sector is sufficiently supervised and only 48 percent of bank respondents felt that they can rely on the supervision of the MTO sector to inform risk-based decisions on opening/maintaining accounts for MTO customers.'

An MSB without access to a bank account may not be able to operate effectively despite being registered with the statutory supervisor(s), such as HMRC and/or the Financial Conduct Authority (FCA). As a result, banks have, de facto, taken a supplementary role in regulating access to the MSB market. In addition, new restrictions on market access may have the unintended consequence of driving cash transactions (previously conducted through MSBs) into the underground economy. This is particularly true given that the amount of cash in circulation in the UK continues to increase both in absolute terms and in relation to GDP (see Figure 1).

**Figure 1:** Ratio of Value of Banknotes in Circulation to GDP in the UK, 2004–16

![Figure 1: Ratio of Value of Banknotes in Circulation to GDP in the UK, 2004–16](image)


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Objective and Focus of this Paper

A sustained demand for cash highlights the need to allow cash flows to circulate in a regulated market where they can be monitored. With a declining MSB access to the banking system, cash flows (including legitimate cash flows) are likely to shift to other – less regulated – channels, such as freight shipments. This explains in part why the money laundering risks associated with MSBs were re-evaluated from medium to high in the UK’s latest NRA. Conversely, the integration of cash received by MSBs into the banking system allows for a stronger monitoring of financial flows. Maintaining or increasing such an integration will be possible, however, only if the banking sector’s confidence in the MSBs sector is restored, including through effective oversight by the authorities. In line with this, G7 finance ministers agreed in May 2017 to ‘continue to improve the effective supervision and monitoring of the MVTS [money and value transfer service] sector including their agents, on a risk-based approach’.

This paper discusses how the supervision of the non-bank MSB sector in the UK may be strengthened as part of a broader strategy to promote MSBs’ access to banking services and ensure the traceability of cash flows. Considering ongoing efforts to help MSBs comply with their obligations to mitigate external ML/TF risks (see Chapter I), the primary objective is to determine how internal risks relating to complicit or criminally owned MSBs or agents may be more effectively prevented, detected and addressed.

It is understood that, in the context of remittance activities by MSBs, there may be risks at each stage of the process. This paper focuses on those stages that take place in the UK, such as the ‘first mile’ for outward remittances and the ‘last mile’ for inward remittances. Ensuring the integrity of the MSB sector in the UK is a necessary condition – albeit not a sufficient one – to effectively address ML/TF risks throughout the chain. Also, while addressing other ML/TF risks associated with remittances requires international cooperation, several steps could be taken by the authorities and the industry in the UK to mitigate risks specific to the national context.

Approach

Chapter I provides an overview of the MSB sector in the UK, specifically the various types of services offered, the market structure, and the applicable AML/CTF regulatory and supervisory framework.

23. For a more detailed discussion of the various stages of the remittance process, see, for example, Thompson et al., ‘Safer Corridors – Rapid Assessment’, p. 28.
Chapter II analyses the main challenges relating to the oversight of the sector, both by supervisors and law enforcement agencies. In addition to deliberate circumvention techniques used by criminal groups, the analysis reviews contextual or structural factors that do not involve any misconduct but may nonetheless impede the effective supervision of MSBs.

Chapter III outlines recommendations on ways to strengthen the supervision and the integrity of the sector, focusing specifically on: the enforcement of existing AML/CTF regulations; information sharing within and between the public and private sectors; and transparency requirements for MSBs.

Methodology

The report is based on a desk-based review of publicly available information, as well as on information provided during and following interviews with a range of stakeholders in the UK and internationally.

The publicly available information reviewed for this project includes, but is not limited to, risk assessments and guidance issued by public authorities in the UK and other jurisdictions; ML/TF typology reports published by international organisations such as the FATF (the global standard-setter for AML/CTF) or Europol; literature on the operations and role of MSBs; and data on the UK sector. Primary data on more than 100 MSBs was extracted from public databases maintained by HMRC, FCA and Companies House.

Following the desk-based review, more than 30 in-person or phone interviews were conducted with representatives from law enforcement, government, supervisory bodies and the private sector.

I. Legal and Regulatory Framework

As a basis for the analysis, this Chapter summarises the framework in which MSBs operate in the UK. The objective is to specifically distinguish between the various types of businesses falling within the MSB definition, and to clarify the sector’s current regulatory and supervisory regime. While this section refers to the Money Laundering Regulations (MLRs) in effect at the time of writing (MLRs 2017), it should be noted that these regulations took effect only in June 2017 and the practice referred to in this paper is therefore mostly based on the previous version of the MLRs (that is, ‘MLRs 2007’).

Activities of MSBs

An MSB is defined in the MLRs as an ‘undertaking which by way of business operates a currency exchange office, transmits money (or any representation of monetary value) by any means or cashes cheques which are made payable to customers’. The term ‘MSB’ was introduced primarily for purposes of AML supervision. Outside that context, there is no uniform business category of MSBs subject to a single legal regime. This means that the range of a firm’s authorised activities cannot be inferred directly from its status as an MSB. Rather, the various activities listed in the Money Laundering Regulations’ definition of MSBs are subject to different legal regimes.

Money Remittance

The EU’s Payment Services Directive (PSD) defines money remittance as

a payment service where funds are received from a payer, without any payment accounts being created in the name of the payer or the payee, for the sole purpose of transferring a corresponding amount to a payee or to another payment service provider acting on behalf of the payee, and/or where such funds are received on behalf of and made available to the payee.

1. ‘The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (UK)’ [MLRs 2017], Chapter 3.
Consistent with PSD, money remittance is deemed a payment service in the UK under the 2009 Payment Services Regulations when carried out as a regular occupation or business activity.\(^3\) As a payment service, money remittance can be provided only by businesses registered by the FCA, for example as payment institutions.

Two types of applications to the FCA are possible for payment institutions depending on the projected turnover. If the projected monthly average of payment transactions does not exceed €3 million, a firm or individual may apply for a status as a small payment institution (SPI).\(^4\) Above that threshold, an application as an authorised payment institution (API) is required. The distinction between SPIs and APIs is based on an optional provision under PSD, which allows member countries to exempt smaller payment institutions from certain obligations applicable to larger ones.\(^5\) SPIs are not allowed to make use of passporting provisions to offer services in other European Economic Area (EEA) states. As of 2011, fifteen EEA states, including the UK, had made use of this exemption in their national legislation,\(^6\) whereas other states apply the same registration and supervision regime, namely the API regime, to all payment institutions regardless of turnover.

**Currency Exchange and Third-Party Cheque Cashing**

Unlike money remittance, currency exchange and third-party cheque cashing are excluded from the scope of PSD.\(^7\) Providing these services in the UK therefore does not require an application to the FCA and is not subject to any capital requirements.

**Other Activities**

The definition of MSB in the Money Laundering Regulations does not preclude the possibility of additional activities. In fact, most MSBs pursue other business lines, whether financial (subject to appropriate authorisations) or non-financial, for example retail or travel services.

**Taxonomies**

Besides the differences in the types of activities offered, MSBs also vary depending on a range of other criteria, including:

- **Involvement of agents:** Certain MSBs rely on large networks of agents who conduct transactions on their behalf. Agents may or may not be registered separately as an MSB

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5. PSD, Article 26. A similar exemption is foreseen under PSD2, Article 32, with the difference that member states have the possibility to set a lower threshold than €3 million.
7. PSD, Section 3. PSD2 states a similar exclusion at Section 3.
with HMRC. Those who are may have sub-agents. Any given agent may have agreements with multiple MSBs, referred to as principals.\(^8\)

- **Size of transactions:** Depending on their business model, MSBs may offer retail services to individual customers (for example, migrants remitting money to their country of origin or tourists seeking to exchange a currency), provide wholesale services to smaller MSBs or act as Foreign Exchange (FX) brokers and conduct high-volume transactions.\(^9\)

- **Links with traditional business models:** Certain MSBs rely on traditional business models to transmit money. While there is no single definition of these business models, sometimes referred to as *hawala* or informal value transfer services (IVTS), one of their characteristics is considered to be the use of settlement methods outside the banking system, including trade, cash and long-term net settlement.\(^10\) Subject to their registration with HMRC and the FCA, IVTS can operate legally in the UK.

- **Acceptance of cash:** Building on new technologies, MSBs have progressively developed online services allowing customers to transmit funds without visiting the MSB’s physical premises. While some MSBs using online tools still allow customers to provide funds in cash, others accept only bank transfers.

- **Country of registration and operation:** European ‘passporting rules’ allow authorised payment institutions registered in an EEA state to offer services in any other EEA state under a single market directive. Among MSBs operating in Britain, most are registered in the country whereas others may offer services to UK-based customers while being registered in another country.

Money remittance, currency exchange and cheque-cashing services are also offered illegally by businesses without the required registration. For purposes of this paper, these businesses are referred to as unregistered businesses, and not included in the category of MSBs.

According to HMRC guidance, businesses that conduct MSB activities only occasionally (and not by way of businesses) are not required to register.\(^11\)

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8. The term ‘principal’ describes an MSB’s status in the context of a given agency arrangement. Accordingly, the same MSB may be a principal in one arrangement, but an agent in another.

9. Depending on their activities, FX brokers may be registered either as an MSB or as regulated institutions supervised by the FCA.


AML/CTF Regulatory and Supervisory Framework

Consistent with international requirements, a range of measures have been taken to mitigate the AML/CTF risks summarised in the Introduction. In recent years, statutory requirements have been strengthened and complemented by targeted initiatives of supervisors and law enforcement agencies.

**Preventive Measures to be Applied by MSBs**

MSBs are subject to the full range of AML/CTF obligations set out in the MLRs, including customer due diligence obligations for the transmission of funds above €1,000, reporting obligations and record-keeping requirements. In addition, since 26 June 2017, MSBs are required to verify the payer’s identity for any transfer of funds in cash, regardless of the amount. HMRC issues specific guidance for MSBs regarding their obligations under the MLRs. For instance, based on past experience, the guidance clarifies that MSBs should apply enhanced due diligence when accepting funds from another MSB that is not acting as their agent.

Specific obligations apply to MSBs that provide services via agents. The MLRs adopted in June 2017 specifically clarify that principals must have policies, controls and procedures assessing whether agents would pass a fit-and-proper test and assessing the extent of the risk that the agent may be used for money laundering or terrorist financing. In addition, the principal is required to include the full name and address of all agents when applying for a registration as MSB with HMRC, and to notify HMRC of any subsequent changes.

**Supervision**

The responsibility for the AML supervision of firms providing money services is shared between the FCA and HMRC. The FCA supervises those firms that have the status of entities authorised for purposes of the Financial Services and Markets Act 2000, also referred to as ‘regulated entities’ (for example, credit institutions that also offer any of the activities listed in the MLRs’ definition of MSBs). HMRC supervises all other firms providing money services. The overall
mandate of AML supervisors is to take necessary measures to monitor and secure compliance of supervised persons with the MLRs. To that end, the FCA and HMRC are expected to review the adequacy of the policies, controls and procedures adopted by the firms under their respective supervision, based on a risk-based approach.

Unlike AML supervision, prudential and conduct supervision is carried out by the FCA for any payment institution, including all businesses offering money transmission services (see Table 1). As a result, a given MSB may be supervised by HMRC for compliance with the MLRs and by the FCA for compliance with other requirements, as illustrated below.

**Table 1: Authorities in Charge of MSB Supervision**

<table>
<thead>
<tr>
<th>Type of supervision</th>
<th>Type of MSB</th>
<th>Other MSBs</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Entities authorised for purposes of the Financial Services and Markets Act 2000</td>
<td>Offering money transmission</td>
</tr>
<tr>
<td>AML</td>
<td>FCA</td>
<td>HMRC</td>
</tr>
<tr>
<td>Prudential and conduct</td>
<td>FCA</td>
<td>FCA</td>
</tr>
</tbody>
</table>

As part of their supervisory responsibilities, both HMRC and the FCA hold registers of entities subject to their supervision, whether for MLRs or prudential purposes. In addition, HMRC’s register includes all premises in the UK from which MSBs provide services (whether the relevant MSB is registered in the UK or operates in the UK under European passporting rules); whereas the FCA’s register lists all agents of payment institutions registered in the UK (whether the relevant agents are based in the UK or not, so long as the principal is registered in the UK).

The registration process for both HMRC and the FCA is subject to controls designed to mitigate integrity risks. Consistent with international standards, the MLRs specifically require that MSBs undergo a fit-and-proper test prior to their registration. The test also applies to any officer or manager, to the beneficial owner, as well as – since 2017 – to any agent, and to any officer, manager or beneficial owner of the agent. The fit-and-proper status may be reassessed at any point after the registration, with a suspension or cancellation of the status preventing the MSB from continuing to operate.

If an MSB registered in the UK offers services on the territory of another EEA state (hereafter ‘State A’) under passporting rules, HMRC or the FCA (as the home supervisor) will cooperate

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18. MLRs 2017, Regulation 46.  
19. See, for example, FATF Recommendation 26 (‘Regulation and Supervision of Financial Institutions’).  
20. MLRs 2017, Regulation 60.
with their counterparts in State A (as the host supervisor) for the purposes of supervision.\textsuperscript{21} The EU’s Fourth Anti-Money Laundering Directive also introduced the possibility for State A to require such MSBs to appoint a central contact point for AML/CFT matters in State A’s territory.\textsuperscript{22} In addition, the 2017 MLRs provide that such businesses will be regarded as carrying on business in the UK for the purposes of the 2017 MLRs, even if they would not otherwise be regarded as doing so.\textsuperscript{23}

**Risk-Mitigation Initiatives**

Building on and complementing the framework set out above, a range of risk-mitigation initiatives have been taken by HMRC and other relevant agencies to further mitigate financial crime risks in the MSB sector. Such initiatives have taken into account the range of relevant risks, and the scale of compliance within the MSB sector.

For example, efforts to promote a better risk understanding and higher compliance within the sector, such as through Project Quaver\textsuperscript{24} or through HMRC webinars explaining the MLRs’ requirements, are critical in order to reduce the risks of unwitting involvement of MSBs in ML/TF. Other initiatives, such as the Safer Corridor Initiative, are designed to reduce TF risks and protect remittances on corridors considered as high-risk. The *Money Service Business Action Plan* issued by HMRC in September 2008 reflects the range of measures required to effectively mitigate financial crime risks in the sector.\textsuperscript{25}

\textsuperscript{21} PSD, Article 25; PSD2, Article 29.


\textsuperscript{23} MLRs 2017, Regulation 9.

\textsuperscript{24} Project Quaver was a joint initiative of law enforcement and regulatory bodies designed to improve the risk understanding in the MSB sector and promote compliance with AML/CTF requirements (see FATF, ‘The Role of Hawala and Other Similar Service Providers in Money Laundering and Terrorist Financing’, p. 63).

II. Key Challenges for Financial Crime Supervision and Investigations

Discussions with a range of stakeholders from law enforcement, regulators, supervisors and the industry pointed to several ongoing challenges in tackling criminal involvement in the MSB sector. For clarity, the challenges may be grouped in three main categories depending on whether they derive from the deliberate circumvention of AML rules, the size and composition of the sector, or the level of transparency of MSB operations. The first category relates to criminal attempts to avoid supervisory scrutiny or undermine investigations. By contrast, the other types – the focus of this paper – relate to the entire MSB sector, including legitimate businesses, and may therefore be considered as structural. While these structural factors do not involve criminal conduct, they contribute to making the MSB sector attractive for groups seeking to launder funds and should therefore be considered when evaluating opportunities to strengthen oversight.

Deliberate Circumvention of AML Rules

This chapter will give an overview of common techniques used to circumvent AML rules and posing challenges to MSB oversight. Note that the focus of this paper is on structural challenges, as opposed to criminal ones. Further details of specific typologies have been set out in public reports of relevant bodies, and continue to be analysed by law enforcement and intelligence services in the context of ongoing investigations.

Falsification of Transaction Data

Transaction monitoring constitutes a core part of AML efforts. As a result, the falsification of transaction data is a common technique used to undermine those efforts. As with individuals who break high amounts of money into smaller transactions, complicit MSBs accepting criminal proceeds have been found to create false records to justify a high turnover. For instance, an MSB accepting £100,000 from an organised crime group (OCG) may record 50 transactions of £2,000 each, and attribute those transactions to fictitious customers (using forged IDs) or to individuals with no involvement in the transaction. These could include past customers whose

personal details have been stored, individuals whose personal details were obtained through other means, or individuals listed in the telephone book.\(^3\)

Authorities’ ability to detect falsification depends on the level of sophistication involved: while a high number of transactions with the exact same amount, or of customers living at the same address, may point to falsification, detecting and demonstrating more sophisticated cases may require significant resources and analytical capabilities.

Complicit MSBs seeking to circumvent transaction monitoring mechanisms may also artificially increase the amount of small remittances to transfer additional funds. A customer seeking to transfer £300 may be asked to indicate a higher amount (for example £2,000), on the understanding that the recipient will receive the agreed amount and the remaining funds will be paid out to another individual.

The falsification of records may also involve the deliberate omission of transactions conducted by the MSB through a separate channel, for instance through undeclared bank accounts or mobile money.

**Shadow Banking**

While the described techniques involve a transfer of funds or currency exchange, other forms of circumvention rely on the transfer of control without movement of funds. Using this mechanism, with MSBs providing de facto deposit accounts to OCGs, financial transactions can be conducted with limited opportunities for oversight (see Box 1 and Figure 2). Such a system presupposes the existence of connected pools of cash controlled by professional money laundering networks across various jurisdictions.

**Box 1: Informal Transfer of Control**

Legitimate customers pay a total of £100,000 in cash to an MSB in the UK with a request to transfer the full amount to recipients in country A. An OCG provides an equivalent amount of local currency to an MSB in country A. The local currency is passed on to the recipients designated by the legitimate customers. The two MSBs may be in direct communication. In most cases, however, they both follow instructions of a third party, referred to as the controller.

The original money paid by the legitimate customer does not leave the UK, but is held by the UK MSB (or the controller) on behalf of the OCG. The control over the deposit – or part of it – may later be transferred informally to another group without any physical movement of money. For an illustration of this process, see Figure 2.

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3. For a specific example, see Europol, *Why is Cash Still King?*, p. 32.
As explained above, non-bank MSBs must register with HMRC (and, in the case of money remitters, with the FCA) before operating. Most stakeholders interviewed for this paper agreed that unregistered businesses had not been seen as a common problem until recently. This may be due to the relatively low requirements for registering as an MSB.\(^4\)

However, anecdotal evidence suggests that the number of businesses offering money services without formal registration may be increasing. Various factors may explain this trend. Specifically, the difficulties for registered MSBs to secure banking services may have the unintended consequence of deterring businesses from disclosing their activity to public authorities and banks. Unregistered businesses may also be more frequent for corridors on which MSBs at the receiving end are subject to strict licensing requirements, because businesses that do not

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Money Service Businesses in the UK

comply with those requirements may seek to avoid detection by engaging with unregistered businesses in the UK.

Impact of Circumvention Techniques

Generally, preventive measures imposed by AML rules, including the MLRs, assume the obliged entities’ good faith. The focus is on external risks relating to, for example, high-risk customers or countries. Supervisory measures are therefore meant, first and foremost, to verify to what extent financial institutions such as MSBs mitigate the risks to which they are exposed.

By contrast, circumvention techniques are meant to undermine the purpose of preventive measures. An MSB that falsifies records may have strong AML policies on paper as well as well-trained compliance staff. Supervisory measures designed to identify non-compliance with regulatory requirements may therefore not necessarily detect more sophisticated forms of criminal conduct. The ability of supervisors and law enforcement to address the challenges posed by circumvention techniques depends on several contextual factors, including the composition of the sector and the applicable regulatory requirements.

Composition of Sector

As explained above, the MSB sector includes businesses with different legal statuses and authorised activities. The figures below, in Tables 2 and 3, reflect the breakdown of relevant companies registered in the UK as of March 2017.

Table 2: Entities registered with HMRC, as of March 2017

<table>
<thead>
<tr>
<th>Total Number of MSBs Registered with HMRC and Type of Service Offered:</th>
<th>1,947</th>
</tr>
</thead>
<tbody>
<tr>
<td>Currency exchange</td>
<td>1,223</td>
</tr>
<tr>
<td>Money transmission</td>
<td>1,039</td>
</tr>
<tr>
<td>Cheque cashing</td>
<td>478</td>
</tr>
</tbody>
</table>

Number of MSB premises (premises of UK-based MSBs and of any agent operating in the UK, including agents of MSBs registered in another EEA state) 44,969

Note: A given MSB may offer one or more of the three types of services listed.

Source: Data provided to the author by HMRC.

Table 3: Entities registered with the FCA, as of May 2017

| Total Number of Payment Institutions Registered with FCA and Type of Institution: | 1,087 |
| Small payment institutions | 715 |
| Authorised payment institutions | 372 |

Source: Data presented by the FCA at a conference attended by the author in May 2017.

The figures above should be considered in light of historic data, as shown in Figure 3.

Figure 3: Number of Registered MSBs, 2011–17 (as available)

Source: Data provided to the author by HMRC.

The numbers reflect a decrease in the number of principal MSBs over the past years. However, as recognised in the UK’s 2017 ML/TF NRA, this does not necessarily reflect a reduction in
the number of businesses carrying out MSB activities.\textsuperscript{6} Rather, a number of businesses that used to operate in their own name are now registered as agents of larger networks. Besides considerations of profitability, such a consolidation may be linked to the increasing difficulties of MSBs to access and retain banking services.\textsuperscript{7} As a result, the number of MSB premises has remained stable between 2011 and 2017 (see Figure 4 below).

\textbf{Figure 4:} Number of MSB premises, January 2011–July 2017

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{figure4.png}
\caption{Number of MSB premises, January 2011–July 2017}
\end{figure}

\textit{Source: Data provided to the author by HMRC.}

Also, notwithstanding a recent decrease, the overall number of payment institutions registered in the UK (1,087) remains significantly higher than in the other five EU countries that registered the highest levels of outward personal transfers in 2014, as reflected in Table 5 below.\textsuperscript{8}

\begin{table}[h]
\centering
\begin{tabular}{|c|c|c|c|c|c|c|}
\hline
Country & Amount of outward personal transfers (in millions of US dollars) & \hline
France & 12,463 & \hline
the UK & 9,021 & \hline
Italy & 8,646 & \hline
Spain & 8,462 & \hline
Germany & 4,617 & \hline
the Netherlands & 2,461 & \hline
\end{tabular}
\caption{Amount of outward personal transfers in 2014}
\end{table}

\textsuperscript{7} \textit{Ibid.}, p. 69.
\textsuperscript{8} Based on data from the World Bank. Amount of outward personal transfers in 2014 (in millions of US dollars): France, 12,463; the UK, 9,021; Italy, 8,646; Spain, 8,462; Germany, 4,617; and the Netherlands, 2,461. See World Bank, 'Migration and Remittances Factbook 2016', 3\textsuperscript{rd} edition, May 2016.
Table 5: Number of Payment Institutions Licensed or Registered in Selected EU Countries, 2017

<table>
<thead>
<tr>
<th>Country</th>
<th>Number of Payment Institutions Licensed or Registered</th>
</tr>
</thead>
<tbody>
<tr>
<td>France</td>
<td>47 (as of 1 January 2017)</td>
</tr>
<tr>
<td>Italy</td>
<td>39 (as of 1 January 2017)</td>
</tr>
<tr>
<td>Spain</td>
<td>43 (as of 18 August 2017)</td>
</tr>
<tr>
<td>Germany</td>
<td>55 (as of 18 August 2017)</td>
</tr>
<tr>
<td>The Netherlands</td>
<td>37 (as of 22 September 2017)</td>
</tr>
</tbody>
</table>

Note: Not all payment institutions offer remittance services.


Under EEA passporting rules, authorised payment institutions registered in the UK have the right to operate via agents in any other EEA state, subject to a prior notification to the FCA. Registers of agents published by other countries confirm that agents of UK-based payment institutions constitute a large percentage of the money remittance sector on the continent.9

The distribution of payment institutions among EEA states is likely due to several reasons, including tax considerations and the fact that not all countries have adopted a simplified regime for small payment institutions.10 The higher number of payment institutions registered in the UK therefore does not in itself point to a higher money laundering risk. However, irrespective of the reasons for the high concentration of payment institutions and agents in the UK, the resulting challenges should be recognised and inform any risk-mitigation strategy.


10. See Chapter I for an explanation of the difference between authorised and small payment institutions.
Intensity of Supervision

EEA passporting rules, which allow a payment institution registered in a member country to operate in any other member country, place the primary supervisory responsibility on the home supervisor of passporting institutions. The high concentration of payment institutions in any given country should therefore generally be matched by commensurate supervisory resources. In the absence of such resources, the size of a supervised sector is likely to have an impact on supervisors’ ability to carry out the controls that are required to prevent and detect financial crime. This is particularly true where a high number of agents are located outside of the national territory.

The challenge of supervising all agents of MSBs registered in the UK explains the role of principal MSBs in ensuring the implementation of the MLRs with respect to agents. As explained above, the new MLRs were meant to introduce the responsibility for HMRC to verify that all MSB agents are fit and proper. In particular, it was indicated that one of the key decisions that had emerged from the consultation was an ‘extension of the fit and proper test to agents of money service businesses (MSBs), which will be carried out by HMRC’.11 Unlike the initial draft circulated for consultation in March 2017, however, the final version of the MLRs specifies that, in conducting this verification, HMRC may take account of the opinion of the agent’s principal as to whether the agent is fit and proper.12 The level to which HMRC may defer to a principal’s opinion will be further clarified through practice, but is likely to be significant in the case of large MSB networks.

Clarity on the Composition of the Sector

As explained above, HMRC and the FCA each maintain registers of those MSBs and agents falling within their area of supervision. The coexistence of two registers reflects the fact that each serves its own purpose and has its own legal basis: HMRC is required under the MLRs to hold a register of all entities it supervises for AML purposes, whereas the FCA’s register is required to list all payment institutions under PSD.

However, despite efforts to exchange information between HMRC and the FCA, the coexistence of two registers with partial overlap creates room for inconsistencies. For example, certain MSBs registered with HMRC as stand-alone money remitters, who should legally be registered as payment institutions, are not listed by the FCA. While such inconsistencies are unavoidable given the number of entries, they blur the picture of the sector and cause uncertainty about the authorised activities of relevant businesses, including among public authorities from other EEA states that host agents.

12. MLRs 2017, Regulation 58.5.
Law Enforcement Ability to Trace Financial Flows

Like supervisory resources, law enforcement needs are a function of the number of actors operating in any given sector. However, in addition to a purely quantitative correlation – that is, more MSBs requiring more law enforcement resources – a high number and concentration of MSBs also creates additional challenges that may not exist in other jurisdictions.

For example, one technique that allows authorities to identify MSBs associated with money laundering is to establish a discrepancy between a high amount of declared transactions on the one hand, and a low number of customers entering a business on the other. This might point to the falsification of records. Considering that this technique generally requires the surveillance of the premises of a specific MSB, its application becomes particularly complex in a situation in which a principal has several agents operating within a small geographic area. If confronted over a low number of customers, the principal may argue that most funds were collected by agents rather than at its own premises. Unless the premises of the relevant agents were also placed under surveillance, the evidentiary weight of the apparent discrepancy is significantly reduced.

Low Profitability

The size of the MSB sector makes it highly competitive. In order to attract customers, money remitters and bureaux de change have lowered commissions, meaning that their profitability relies more on the aggregate volume of transactions than on high margins. A review of publicly available accounts of MSBs confirms that a significant proportion have registered losses for several consecutive years.

While competition is generally considered to keep prices for consumers down, it may also have unintended consequences. The World Bank noted, for example, that

> it is possible that the potential benefits of permitting retail businesses and individuals to act as principal [money transfer businesses] in a specific country may not outweigh the potential costs of oversight and of the risk factors, or of effective risk mitigation techniques with respect to money laundering and terrorist financing risks and other risks.

Along similar lines, in the context of discussions on the regulation of the banking sector, a member of the European Central Bank’s executive board noted that an ‘oversized financial sector can reflect increased risk-taking’.

13. While the costs of remittances may be higher (especially on certain corridors), these are not necessarily linked to a high commission at the first mile.
interviewed while researching this paper pointed out that the negligible margins resulting from the high number of actors might encourage certain MSBs to accept funds from organised crime groups that are generally willing to pay higher commissions in the course of the money laundering process.  

**Other Factors Compounding the Challenges Related to the Size of the Sector**

A review of publicly available information on MSBs held by HMRC, the FCA and Companies House reveals several features of the sector that, while legal, may further impede the oversight of MSBs.

**Fluidity**

Company accounts suggest that the MSB sector is characterised by a high fluidity. Company records indicate several recurring patterns in the sector, including businesses operating only for a year or less, maintaining short agency agreements with various principals, or changing their address on a yearly basis. In the absence of historic data about MSBs registered with HMRC, the fluidity of the sector could not be measured with precision. Yet gathering and processing data on the turnover of MSBs and agents would be an important step towards remedying this.

**Multi-Layered Agency Arrangements**

A review of primary data confirms that current rules allow for chains of MSBs linked through multiple agency arrangements. Such an arrangement limits the visibility of the principal MSB over the origin of funds. It also allows an individual to use separate channels for sending money from a single counter.

For example, in the figure below MSB 1 is registered with the FCA as an authorised payment institution and with HMRC as a money transmitter. In addition to being able to remit money in its own name, MSB 1 is also the agent of two money remitters (MSBs 2 and 3). In turn, MSB 1 has 60 agents itself, including MSB 4, who is an agent for MSB 3 among other principals, and is also registered as an authorised payment institution and may therefore offer money remittance in its own name or through agents. As a result, a customer entering the premises of MSB 4 may

17. Author’s interviews with law enforcement officials in London, May–June 2017.
20. While company accounts and past FCA authorisations remain available after a company has been dissolved, HMRC’s register reflects only information current as of the date of a search. Accordingly, publicly available information will not confirm whether a dissolved company used to provide currency exchange or cheque cashing services. For the purpose of this paper, businesses were assumed to have provided such services where their name included unambiguous terms, such as ‘currency exchange’, and their activity on Companies House’s register was described as ‘financial intermediation’.
send money using the services of MSBs 1 to 4 in any combination. For example, a customer could send 20% directly through MSB 4, 50% through MSB 3 and 30% through MSB 1, who may decide to remit all or part of the funds through MSB 2 or 3 (also taking into account the applicable fees on the relevant corridor).

**Figure 5: Example of a Multi-Layered Agency Arrangement**

![Diagram of MSB networks](image)

*Note: While the names of all businesses have been redacted, this example is based on real MSBs.*

**MSB networks**

The desk-based review also revealed the existence of multiple MSBs that are connected through directors or company secretaries holding simultaneous or successive positions in different companies with the same address and/or nearly identical names, including dormant companies. Similar to other patterns described above, the rotation in question is not illegal per se, but

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21. In this context, the term ‘secretary’ does not refer to a clerical role. Under the UK Code of Corporate Governance, the company secretary ‘should be responsible for advising the board through the chairman on all governance matters’. See Financial Reporting Council, ‘The UK Corporate Governance Code’, September 2012, Section B.5.
complicates the structure of the sector and does not seem to respond to a clear economic need. It may also allow certain actors to process transactions using the bank account of a different entity.

In Figure 6 below, which is based on publicly available information from 25 August 2017, ‘A’ and ‘B’ refer to slight variations of the same terms or expressions; and D1 and D2 refer to individuals with the same last name holding director positions.

**Figure 6: Example of MSB Network**

![Figure 6: Example of MSB Network](image)

Association with Companies Processing Customer IDs

The review of MSB profiles also confirmed that many businesses are associated with travel companies through a common director. While such an association may be explained by the fact that travel and currency exchange services are often used together, it can also be misused by MSBs seeking to collect legitimate IDs that may be used at a later date without the owner’s knowledge.

Figure 7 (below), which is based on publicly available information from 20 October 2017, provides an example of a company network involving existing and past MSBs.
Figure 7: A Company Network Involving Existing and Past MSBs

Key:
- MSB
- Registered company
- Dissolved company
- Dissolved company previously involved in monetary or other financial intermediation according to Company House records
- Dissolved company formerly dormant according to Company House records

Director
- Former director
- Secretary
- Former secretary
As explained above, the characteristics of the MSB sector described are not in themselves indications of financial misconduct that would automatically warrant further investigations. However, they do contribute to the sector’s opacity and pose significant challenges to effective oversight.

**Transparency of Operations**

Another contextual element determining the sector’s oversight is the ability of law enforcement and supervisors to review and understand the details of any business’s activities. Besides inherent challenges relating to long-term settlements, several other factors contribute to the high complexity of investigations into MSBs, which generally last several years before leading to any sentence.

**Records and Accounts**

One of the main reasons for the high complexity and cost of investigating MSBs is their volume and format, with various methods used to keep records of transactions, such as paper, general software applications or dedicated IT tools. In most cases, the processing of such data by law enforcement requires significant technical capabilities and staff resources. In addition, several law enforcement representatives pointed out that the probability of incomplete or inaccurate records tends to be higher in the case of MSBs than with other financial institutions that are subject to higher regulatory standards.

While payment institutions have an obligation to file annual activity reports with the FCA, MSBs in the UK are not subject to more frequent and detailed reporting requirements that have been introduced by other countries with large volumes of remittances and that provide authorities with more comprehensive and structured data. For example, money remitters operating in Spain have an obligation to provide monthly reports to the FIU/supervisor (SEPBLAC) specifying: the aggregate volume and the number of incoming and outgoing transactions during the relevant period *broken down by corridor*; the aggregate volume and the number of incoming and outgoing transactions *broken down by agent*; and, for the five corridors with the highest volume of transfers, the aggregate volume and number of incoming and outgoing transactions for each of the money remitter’s 20 agents with the highest turnover on each of the corridors.

Other examples and the potential benefits of such reporting systems will be discussed further below in Chapter III.

Another limitation on transparency requirements for MSBs stems from the accounting regime applicable to small or micro companies. Under the Companies Act 2006, small companies benefit from an audit exemption under certain conditions. While this exemption does not

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22. See Introduction.
24. See Chapter III.
25. Author’s phone interview with SEPBLAC representative, July 2017.
apply to businesses providing services as an insurance company, banking company or e-money issuer, it does apply to MSBs. A review of company accounts confirms that, consistent with this exemption, a high proportion of MSB accounts are unaudited.

**Internal Organisation of MSBs**

A recurrent challenge in investigations of complicit MSBs concerns the difficulties in demonstrating the personal accountability of a specific individual when criminal funds have transited through a business. While this may also happen in other financial institutions, it is compounded by the fact that many MSBs and agents tend to operate in a setting with less clearly defined roles.

In addition to difficulties in obtaining a conviction or removing a fit-and-proper status, the lack of clarity over an MSB’s internal operations also has an impact on the application and value of the initial tests conducted by HMRC or MSB principals, given that these can be effective only if they cover a business’s genuine director and officers.

**Regulatory Framework for Cash Transport and Export**

While transactions conducted by MSBs through the banking system may be monitored and traced for supervisory or investigative purposes, other channels – legitimate or not – are not currently subject to equivalent controls.

Consistent with international standards, passengers travelling to the UK from a non-EU country or vice versa are required to declare any cash amount above €10,000. By contrast, cash movements within the national territory are not subject to AML regulations. Specifically, while certain companies transporting cash on behalf of third parties may in some instances notify authorities of money laundering suspicions, they are not legally required to do so. There is therefore a high risk that supervisors or law enforcement will lose sight of transactions involving the physical movement of bulk cash.

The risk is further compounded because, unlike the transport of cash by individual passengers, freight movements of cash are not subject to uniform disclosure requirements. Freight companies might declare the value of the physical paper and ink, rather than the amount of cash.

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26. For a detailed overview of money laundering risks associated with the physical transportation of cash, see FATF, ‘Money Laundering Through the Physical Transportation of Cash’, October 2015.
27. See, for example, FATF Recommendation 32 concerning ‘Cash Couriers’.
28. In a study published by Europol in 2017, Spain was the only EU member state that reported that cash transport companies were subject to AML requirements. See Europol, *From Suspicion to Action: Converting Financial Intelligence into Greater Operational Impact* (Luxembourg: Publications Office of the European Union, 2017), p. 18.
29. Author’s interview with official of supervisory authority in London, June 2017.
Regulatory Framework for Self-Fill Cash Machines

As of 31 December 2016, there were 70,020 cash machines in the UK.\footnote{UK Finance, ‘UK Cash & Cash Machines: 2017 Summary’, August 2017.} According to data of the European Association for Secure Transactions, the UK was the country with the highest number of cash machines in the EU, ahead of countries in which cash payment is more prevalent.\footnote{European Association for Secure Transactions (EAST), ‘ATMs in Europe’, <https://www.association-secure-transactions.eu/industry-information/atms-europe-2/>}, accessed 22 November 2017. Since 2014, a majority of cash machines in the UK have been by owned by independent ATM deployers (IAD), as opposed to banks and building societies.\footnote{Payments UK, ‘UK Cash and Cash Machines: Summary’, May 2015, p. 3; UK Finance, ‘UK Cash and Cash Machines: 2017 Summary’, 2017, p. 3.}

Cash machines may be legally used for so-called ‘local cash recycling’, which the Code of Conduct for the Authentication of Machine-Dispensed Banknotes defines as the ‘practice of filling customer-operated cash dispensers with banknotes tendered by the public without these notes being sent via a wholesale cash processor’.\footnote{Cash Services, ‘Code of Conduct for the Authentication of Machine-Dispensed Banknotes’, Version 3.0, March 2017.} Local cash recycling may present various advantages for businesses operating a self-fill cash machine, including a reduction of bank charges for cash-handling.

At the same time, self-fill cash machines may also be exploited to introduce ill-gotten gains into the financial system. Cash proceeds can be converted into digital funds wired from the account of unwitting users to the machine’s owner (and potentially onwards to the ultimate beneficiary).\footnote{For a detailed analysis of risks relating to IADs, see, for example, Financial Transactions and Reports Analysis Centre of Canada (FINTRAC), ‘2007 FINTRAC Report on White-Label ATMs’, 2007.}

Self-fill cash machines are subject to regulations designed to prevent the circulation of counterfeit banknotes. However, statutory transparency obligations to block their misuse for money laundering are currently lacking. While such potential misuse is not limited to MSBs, it illustrates the opacity of channels that may be used by MSBs that have no access to the banking system.
III. Recommendations for More Efficient and Effective Oversight

BANKS ARE REQUIRED under the MLRs to assess the ML/TF risks associated with their customers; and the costs of mitigating those risks inform their decision to grant or reject an application from potential customers, alongside other factors such as a bank’s business strategy. Accordingly, the challenges discussed previously, which increase the risk mitigation costs, may contribute directly to a bank’s decision as to whether to accept an MSB as a customer.

The new Payment Services Regulations, which will require banks to justify any decision not to take on a customer, may enhance the transparency of the cost-benefit calculation.1 The Regulations are unlikely, however, to fundamentally alter the outcome of that calculation unless the risk mitigation costs are reduced. If MSBs’ access to banking services is to be eased, public authorities should therefore engage with the MSB sector and the banking sector to address the challenges discussed in Chapter II.

Potential solutions may relate to the monitoring and enforcement of existing rules, information-sharing, and transparency requirements for MSBs. The recommendations take account of existing initiatives mentioned in Chapter I.

Monitoring and Enforcement of Existing AML Rules

The FATF report on the role of hawala and other similar service providers in ML and TF recognises that,

[all things being equal, the less stringent up-stream conditions under registration regimes are expected to call for more on-going supervision and surveillance – particularly if the market is composed of a large number of smaller players.]

Consistent with this, and considering evidence of continued criminal abuse in the MSB sector, the sector’s supervision should be strengthened to reflect the risks and challenges associated with the various characteristics discussed in Chapter II.

1. ‘The Payment Services Regulations 2017 (UK)’.
2. FATF, ‘The Role of Hawala and Other Similar Service Providers in Money Laundering and Terrorist Financing’, p. 49.
**Recommendations**

The number of MSBs registered in the UK and operating in other EEA states contributes to the UK’s role as a major financial centre. At the same time, based on the supervision arrangements for passporting entities, the concentration of MSBs in Britain also gives UK supervisors, and more specifically HMRC as the home supervisor for AML/CTF, a particular responsibility. HM Government should assess (including through an international benchmarking) to what extent the human and technological resources available within HMRC for the supervision of MSBs are commensurate with the specific characteristics of the sector in the UK.

An assessment of resources should consider the challenges and needs of MSB supervision. This includes determining whether HMRC is in a position to verify institutions’ actual compliance with reporting requirements (as opposed to written policies and procedures), by accessing and comprehensively reviewing transaction records during inspections. Based on available information, no MSB has been prosecuted for failure to disclose a suspicion of money laundering, which is criminalised under Section 330 of the Proceeds of Crime Act 2002.

HMRC may need to consider evaluating its use of unannounced inspections and the scale of responses to non-compliance to increase the deterrent effect of supervision.

**Information Sharing and Coordination**

Mitigating financial crime risks in the MSB sector is a shared concern requiring a coordinated approach by the sector itself, supervisors, banks and others. Building on existing initiatives, the recommendations below are designed to strengthen the sharing of information among all relevant actors.

1. **Information sharing and coordination between law enforcement and supervisors**

**Recommendation**

Past investigations into MSBs confirm the operational importance of information held by HMRC as the MSB supervisor, such as details provided during the registration process or inspection reports. Officers interviewed for this paper described cases of successful coordination among various agencies to comprehensively tackle money laundering networks involving MSBs, using the legal tools available to the various agencies involved (seizure, restraint on property, company dissolution).

However, considering the speed of transactions and the complexity of networks, all relevant parties should consider mechanisms to further facilitate and expedite responses to information requests, such as designated focal points or memorandums of understanding allowing the sharing of certain types of information at the working level. In addition, *spontaneous* information

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3. Author’s interviews with law enforcement officials in London, June and August 2017.
sharing should be encouraged through awareness raising and guidelines. This could include encouraging law enforcement to inform supervisors when an investigation into a predicate offence reveals potential links with an MSB, even when its role is not specifically covered by the investigation.

Further coordination could also build on the experience of the task force convened by the Metropolitan Police Service, which brings together representatives from law enforcement and supervisors. To maximise and sustain the benefits of this task force, such cooperation should be supported by appropriate information-sharing arrangements and a mandate endorsed at senior management level.

2. Information sharing and coordination among supervisors

Depending on their legal status and activity, MSBs may be supervised by HMRC, the FCA, or both, where the FCA is the prudential supervisor and HMRC monitors compliance with the MLRs. The dual responsibility for the supervision of MSBs can lead to duplication or, in some cases, inconsistencies. For example, the more than 1,000 MSBs offering money remittances are listed in two separate registers, and their agents are screened separately by the FCA and HMRC.

Recommendation

HMRC and the FCA should consider developing synergies in the supervision of entities that are currently subject to their joint supervision. While both supervisors communicate extensively, integrating their efforts would reduce costs and potentially enhance the effectiveness of supervision. HMRC and the FCA may consider consolidating the initial screening of money remittance providers and agents, and their respective registers with respect to money remitters. To ensure accountability, a more coordinated approach would need to be complemented by a clear statement on each supervisor’s responsibilities.

3. Coordination within law enforcement

Recommendation

Given the complexity of cases involving MSBs, and the geographic scope of professional money laundering networks, opportunities for increased coordination within law enforcement should be considered. For example, establishing a team with a national mandate (within the NCA, HMRC or within a police force) could lead to the pooling of resources, build the skills required to dismantle money laundering networks and clarify the accountability for the response to the criminal abuse of the MSB sector.
As in other areas of organised crime, the law enforcement response to ML risks in the MSB sector would also benefit from a higher recognition of the role of financial investigations, and their enhanced integration with investigations on predicate offences.  

4. Public–private information sharing and communication

Recommendations

Information sharing between the MSB supervisor and MSB principals

Agents are an essential component of the MSB sector, but present a challenge for supervisors given their number, fluidity, and frequent lack of financial background. Given the role of principals in training and monitoring agents, HMRC should consider possibilities for an enhanced partnership with them to better map and mitigate ML risks. Specifically, consistent with principals’ obligation to screen agents prior to registering them with HMRC, principals may be required to inform HMRC whenever an agency arrangement is terminated due to financial integrity concerns. The cooperation with MSBs should be informed by the experience of the UK’s Joint Money Laundering Intelligence Taskforce.

Communication between supervisor and banks on respective roles in supervision and risk mitigation

The respective responsibilities of the FCA and HMRC under the MLRs mean that, unlike in countries in which the AML supervision of financial institutions is performed by a single authority, the MSB supervisor has fewer opportunities to engage directly with banks on ML risks associated with customers registered as MSBs. There is generally little awareness of MSBs’ supervision among banks due to this lack of engagement. The FCA and HMRC should coordinate to proactively communicate to banks the nature of HMRC’s supervision and responses to ML risks in the sector. This would allow banks to take these factors into account when considering whether to take on MSBs as customers, and to adjust their own mitigation strategies to the supervisor’s findings on risk patterns, for example those relating to businesses offering money services illegally.

Regulation 51 of the MLRs 2017 provides for the collection and publication of regulatory information, as further specified in Schedule 4 to the MLRs, and Regulation 85 foresees the public announcement of disciplinary measures taken against supervised entities. While this information will enhance the transparency of the supervisory regime, more detailed, qualitative

5. Such a system exists in Italy. See Decreto Legislativo n. 231/07, as amended by Decreto Legislativo n. 90/2017, Art. 45.2.
explanations of the supervision conducted by HMRC would be needed in order to inform banks’ risk assessment and mitigation. Such clarification would also help to address the common perception that banks are expected to act as the regulator of the MSB sector, which was expressly refuted by the AML supervisor in the US.\footnote{7}

5. Private-to-private information sharing

Recommendations

MSB principals have a key responsibility in ML prevention and detection under the MLRs, and have in fact played a key role in the mitigation of ML risks in the sector. Building on existing measures, HM Treasury and the Home Office should determine to what extent MSB principals’ contribution to AML efforts may be strengthened through increased information-sharing within the sector.

HM Treasury and the Home Office may consider whether MSB principals could and should be provided with a legal basis to share information on agents whose agency agreements are terminated due to poor levels of compliance or specific ML/TF suspicions. Such a system was established in Spain by an industry body of MSBs, with the approval of relevant authorities.\footnote{8} The database, which includes all agents reported to the FIU in a suspicious activity report, can be accessed by all members of the sector.\footnote{9} A principal is not allowed to enter into a new business relationship with an agent listed in the database, and principals who have an existing business relationship with a listed agent are required to conduct enhanced due diligence and apply additional controls.\footnote{10} Similarly, a database of terminated agents is in the process of being set up in the US with the support of FinCEN and the Federal Trade Commission.\footnote{11}

Building on the recent introduction of provisions allowing for bilateral information-sharing within the regulated sector in the UK under certain conditions, the potential development of a shared database of high-risk agents should be considered, in consultation with data protection authorities.

\footnote{7} ‘However, the Bank Secrecy Act does not require, and neither does FinCEN expect, banking institutions to serve as the de facto regulator of the money services business industry any more than of any other industry. FinCEN recognizes that, as a practical matter, it is not possible for a bank to detect and report all potentially illicit transactions that flow through an institution’. See FinCEN, ‘Statement on Providing Banking Services to Money Services Businesses’, 10 November 2014.
\footnote{8} Author’s phone interview with SEPBLAC representative, July 2017.
\footnote{9} Author’s phone interview with Spanish MSB, July 2017.
\footnote{10} Author’s phone interview with Spanish MSB, July 2017.
Transparency Requirements for MSBs

As discussed previously, some of the obstacles to an effective oversight of MSBs stem from structural factors that affect the clarity of the sector’s composition or the transparency of transactions. The following recommendations are intended to create the conditions for a more effective risk-based approach in supervision, and thus reduce the associated costs for supervisors. The recommendations consider the need to avoid creating a disproportionate regulatory burden for MSBs, which can have the unintended consequence of further displacing business underground.

1. Enhanced transparency of MSB networks

A review of public information on MSBs reveals several recurrent patterns that contribute to the complexity of the sector’s structure. For example, several MSBs with similar names may be registered at the same address or share the same senior staff. Identifying and analysing such networks of MSBs on a case-by-case basis is possible, but, given the sector’s size and fluidity, the required resources are considerable and often exceed the capacity of supervisors and law enforcement.

Recommendation

The recent introduction of an online application process for MSBs is intended, among other purposes, to allow HMRC to obtain more information on MSBs and better understand their business case at the time of registration. Building on this recent development, HMRC may consider introducing additional mechanisms that could, for example, require MSBs to disclose and explain potentially relevant factors such as past companies operating at the same premises or under the same management; or corporate relationships with other companies – for example, through a common owner – whether those companies are registered as MSBs or not.

The information would allow HMRC to map out the sector more systematically and may, at the same time, deter certain practices that reduce the transparency of the sector’s composition. While certain MSBs may fail to submit the relevant information, this could, in the case of a subsequent investigation, contribute to supporting allegations of criminal intent.

2. Periodic reports on transaction volume

Under the current framework, MSBs have limited obligations to submit periodic reports to supervisory authorities. MSBs offering money remittance services are subject to annual reporting requirements for prudential purposes, and small payment institutions are expected to demonstrate that their annual turnover is below the applicable threshold of €3 million per month. However, those reporting requirements are not specifically designed for AML purposes.

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12. The most relevant forms issued by the FCA are FSA056 (Authorised Payment Institution Capital Adequacy Return) and FSA057 (Payment Services Directive Transactions).
By contrast, as the examples below demonstrate, the experience of other jurisdictions confirms the value of collecting periodic information on the aggregate volume of transactions as a tool to adjust AML supervision and the risk-based approach.

*Italy*

All financial institutions registered in Italy, including MSBs, are required to provide aggregated, anonymous data on all operations exceeding €15,000 (including through split transactions) to the Financial Intelligence Unit (FIU) in support of its analysis of local or national patterns.\(^\text{13}\) The value of cash transactions is indicated separately. The aggregation criteria are set by the FIU and include: the type of payment instrument; the location of the reporting branch; the customer’s economic sector and residence; and the counterparty’s location and financial intermediary.\(^\text{14}\)

The FIU uses the aggregated data received from financial institutions, together with other sources, to conduct its strategic analysis of patterns that may warrant additional verifications or may support law enforcement. For example, the data may be used to identify outliers or to detect trends over time in the data supplied by a given institution.\(^\text{15}\) With respect to cash payments more specifically, the available data has contributed to the development of an econometric model detecting discrepancies between the volume of cash transactions in a certain geographic area and its local socioeconomic characteristics.\(^\text{16}\)

The usefulness of the aggregated data sent to the Italian FIU’s was recognised in the FATF’s assessment of Italy’s AML/CTF system.\(^\text{17}\) One limitation is that the obligation to submit the data applies only to payment institutions registered in Italy, although some payment institutions operating in Italy under EEA passporting rules do file the reports on a voluntary basis. However, the FIU’s experience indicates that even incomplete data may provide useful indications of potential risks. For example, a drop of reported remittances to China from €2.674 billion in 2012 to €557 million in 2015 (when remittances to other countries were broadly stable) triggered additional verifications. This revealed that a high proportion of agents had moved to payment institutions that did not have equivalent controls in place and did not submit the required aggregated data to the FIU.\(^\text{18}\)

\(^{13}\) ‘Decreto Legislativo No. 231 (Italy)’, Article 33, 21 November 2007.
Spain

In addition to suspicious activity reports, financial institutions in Spain are required to submit specific data to the FIU on a monthly basis (regardless of any suspicion). In particular, MSBs are required to submit aggregate information about their money remittance activity, broken down by country of origin or destination, and by agent or place of business. Instructions issued by the FIU clarify that, for each of the five corridors with the highest volume of transactions in a given month, MSBs are also expected to indicate the aggregate volume and the number of transactions carried out by the twenty agents with the highest turnover for the relevant corridor.

Box 2: Example of Reporting Requirements under Spanish Law

An MSB has 300 agents and operates on 40 corridors, with corridors A, B, C, D and E registering the highest volume of transactions during the relevant period. For each of the 40 corridors and for each of the 300 agents, the MSB’s monthly report will indicate the aggregate volume and the number of transactions conducted during the relevant period. In addition, the report will indicate the aggregate volume and the number of transactions on corridor A for each of the 20 agents with the highest volume of transactions on that corridor. The same information is provided, mutatis mutandis, for each of corridors B–E.

The aggregate data may therefore be used by the FIU to detect outliers and adjust supervisory measures accordingly. It also provides a reference point during potential inspections.

France

In France, financial institutions that carry out money remittances are required to submit an annual report to the supervisor stating: the number of clients, as well as the number and total value of transactions, broken down by corridor, type of transaction (inward or outward) and by number of agents. In 2016, a uniform template to be filled in by financial institutions was issued.

The Netherlands

In contrast to the models listed above that rely on the submission of aggregated data, the Dutch supervisory model for MSBs involves the collection of bulk data. MSBs operating in the Netherlands (including passporting institutions) are required to submit quarterly reports to the Central Bank (DNB) that include all cash transactions, with details such as the country of origin and destination, the transferred amount and any agents involved. Transactions via agents in other EEA countries are not included.

The analysis of the collected data is used to inform the DNB’s supervision of relevant payment institutions (seventeen as of October 2017). For example, targeted inspections may be conducted in response to potentially unusual transactions, and the DNB can determine to what extent a payment institution has complied with its transaction monitoring obligations. The direct analysis of bulk data also allows the DNB to gain additional insights on suspicious patterns and therefore to enhance the guidance it provides to supervised entities. In addition, the data is used to identify patterns that may not be detected by individual institutions. The collected data is used exclusively for supervision purposes.

Recommendation

In light of the above, HM Treasury, HMRC, the FCA and the NCA (as the host organisation for the UKFIU) should consider the introduction of periodic reporting requirements for MSBs. The collection of aggregated data on a systematic basis would seem particularly critical for the supervision of a large sector involving close to 2,000 entities. Reporting requirements could be adjusted depending on the types of activity conducted by MSBs.

If accompanied by clear guidance from the supervisor, such a measure would not create an unreasonable burden for businesses, given that the underlying data is already to be collected under the MLRs. In addition, requesting aggregate data (as opposed to bulk data) avoids privacy concerns generally associated with the transmission of personal data. However, the benefits of such a measure can be realised only if combined with an investment in the necessary analytical capabilities within supervisory authorities. These benefits could be further increased through harmonisation of reporting requirements at the European or international level.

3. Adapt transparency requirements for agents depending on number of principals

As discussed in Chapter II, the existence of agency agreements between a given agent and multiple principals may reduce principals’ ability to detect suspicious patterns (compared with a situation in which an agent conducts business on behalf of a single principal).

The difference in ML risks is reflected, for example, in Swiss legislation, which draws a distinction depending on whether an agent offers money remittance services on behalf of a single principal, or on behalf of several. In the latter scenario, an agent will automatically be considered a financial intermediary and will therefore be subject to direct supervision.\textsuperscript{25} The FATF Mutual Evaluation of Switzerland recognised that this measure strengthened AML/CTF efforts in the sector.\textsuperscript{26}

Recommendation

HM Treasury and HMRC should determine to what extent the regulatory and supervisory approach for agents needs to reflect the distinction set out above. Restrictions on the ability for agents to operate on behalf of more than one principal may not be compatible with competition laws and may drive up costs. Other solutions, however, would avoid such consequences. For instance, while HMRC relies on principals to assess whether their agents are fit-and-proper, additional scrutiny may be warranted in instances in which agents operate on behalf of multiple principals.

4. Re-assess risks related to cash handling

Recommendations

Self-fill cash machines

As a complement to the NRA, HM Treasury should evaluate the ML risks associated with self-fill cash machines and assess to what extent those risks are mitigated by the current regulatory framework. Areas for consideration may include controls conducted by private sector entities providing self-fill cash machines, disclosures concerning the origin of cash used to fill the machines, and verifications on their beneficial owners.

Cash assets

HM Treasury should evaluate the role of cash in the circumvention of AML regulations, especially in shadow banking through MSB networks, and consider any adjustments to the regulatory framework that would help mitigate those risks or facilitate potential prosecutions. For example, MSBs may be asked to disclose to their supervisor the amount of physical cash that they are holding. In order to limit the burden for businesses, disclosures could be organised in various levels of magnitude (£20,000–£50,000, £50,000–£100,000, etc.), on the understanding that an MSB would not be expected to file a disclosure as long as its cash reserves are within the relevant range. While certain MSBs may fail to make a truthful disclosure, such a failure could, in the case of a subsequent investigation, contribute to supporting allegations of criminal intent.

\textsuperscript{25}‘Ordonnance sur la lutte contre le blanchiment d’argent et le financement du terrorisme (Switzerland)’ ['Anti-Money Laundering and Terrorist Financing Ordinance'], 955.01, Art. 2, para. 2, subpara. b. 5.

5. Increased transparency of cash transports

Recommendation

Considering the risks associated with the use of cash transport companies as discussed in Chapter II, and consistent with the requirement under the Fourth Anti-Money Laundering Directive that AML/CTF obligations be extended, in whole or in part, to professions or businesses that pose high ML/TF risks, 27 HM Treasury should verify the adequacy of the current regulatory framework for this sector. In particular, it should determine whether cash transport companies should have due diligence obligations, at least above a certain threshold or when dealing with customers that present a higher money laundering risk, such as MSBs.

Conclusion

OVER THE PAST several years, MSBs have encountered growing difficulties in accessing banking services. Concerns about money laundering and terrorist financing risks in the sector are not the sole reason for this trend, but have undoubtedly informed banks’ decisions to terminate business relationships with MSBs or decline to take them on as new customers.

MSBs’ reduced access to the banking sector has not addressed the underlying concerns. As various trends confirm, it has in fact compounded money laundering risks and has further impaired the authorities’ ability to trace financial flows. For example, the lack of access to banking services can be considered one of the reasons for the increased freight transfer of cash, which poses significant challenges for supervisors and law enforcement. Certain MSBs that lose a bank account may continue to operate as agents of larger MSBs, thus reducing further the bank’s visibility over their transactions. They may also use the bank account of a different entity or operate without any registration.

It appears, therefore, that ML risks involving MSBs will be most effectively managed if legitimate MSBs are able to access banking services and are fully integrated in the global financial system. While enhancing access to banking services is one of the objectives of the EU’s Payment Services Directive 2, it is unclear whether PSD2 will, on its own, address the underlying factors. Specifically, to the extent that a bank’s decision to take on an MSB is informed by a cost-benefit analysis, the situation is unlikely to change so long as the costs required to mitigate financial crime risks outweigh the benefits of the business relationship.

An effective response to ML risks in the MSB sector will require a coordinated effort of the supervisors, banks and MSBs, and will need to consider the structural challenges to the sector’s effective oversight. The recommendations in this paper are designed to support a dialogue on measures that would strengthen the current supervision of the sector with limited resource implications, with a view to restoring confidence in the sector among banks and ultimately reducing risk mitigation costs. Improvements should focus on enhanced information-sharing and on increasing the transparency of MSB operations, which will allow supervisors to apply the risk-based approach more effectively.

Strengthening the supervision of the MSB sector should be seen as one part – albeit an important one – of a broader strategy against illicit financial flows. Reforms to this effect will specifically need to be complemented by measures designed to detect businesses offering financial services without the required registration, to address new money laundering methods (such as through virtual currencies or mobile money), and to increase international cooperation, which remains indispensable to investigations into controller-led money laundering networks.
About the Author

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