

Guidance consultation

Guidance on the treatment of politically exposed persons (PEPs) under the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017

March 2017

1 Consultation

Background

- 1.1 The term 'politically exposed persons' (PEPs) refers to people who hold high public office. The current regime, as per the Money Laundering Regulations 2007, requires firms to apply extra measures, called "enhanced due diligence" when dealing with those who are PEPs in a state other than the UK, as well as family members or close associates of those PEPs.
- 1.2 The UK must update its anti-money laundering regime by 26 June this year by transposing the 4th Money Laundering Directive (4MLD). This includes expanding the definition of a PEP to include those holding a politically exposed position in the UK. HM Treasury consulted on the transposition of 4MLD in late 2016 and published draft regulations on 15/03/2017.
- 1.3 Section 333U of the Financial Services and Markets Act 2000 (FSMA) requires us to publish guidance to firms we supervise under the Money Laundering and Transfer of Funds (Information on the Payer) Regulations 2017 (the Regulations), on how they treat customers who meet the definition of a PEP under these new rules prior to them coming in to force. Section 333U of FSMA states that this guidance must include guidance as to who should and should not be considered a PEP and set out requirements on how firms can take a proportionate, risk based and differentiated approach to meeting their obligations under the Regulations.

- 1.4 The Government has proposed in the draft regulations to make changes to the FCA's obligation to provide guidance. Our proposed guidance already covers much of the new tasking but we will work with the Government during the consultation period to further refine the guidance in line with this requirement and in line with feedback from consumers and the industry.

New Guidance

- 1.5 We have prepared guidance based on our understanding of the risks and experience of cases where firms have applied enhanced due diligence measures that were not commensurate with the risk posed by the PEP.
- 1.6 In the draft guidance in Chapter 2, we have set out the regulatory requirements as set down in the draft Regulations. Where the FCA interprets the regulatory requirements this is shown in italics.
- 1.7 This draft guidance is aimed at all relevant persons that are subject to supervision by the FCA under the regulations. This will include (but is not limited to) banks, building societies, wealth management firms and investment managers.
- 1.8 The guidance will impact consumers who hold public office in the UK or elsewhere and their family members and close associates. We welcome views from affected consumers on the impact of this guidance.
- 1.9 We will keep the final guidance under review, including taking in to account complaints to the Financial Ombudsman Service and feedback from consumers and regulated firms. Where the guidance is not meeting its aims, we will consult on amendments to the guidance.
- 1.10 We welcome any comments you may have including in response to the questions below. You can send your response by email to pepsguidanceconsultation@fca.org.uk or via post to Andy Watson, Financial Crime Department, Financial Conduct Authority, 25 the North Colonnade, Canary Wharf, E14 5HS.
- 1.11 As the law requires this guidance to be in place by 26 June 2017 we would welcome comments by Tuesday 18 April 2017.
- Q1- Do you agree with the definition we propose for who should and should not be considered a PEP, family member or close associate?
 - Q2- Are there situations that are covered in the draft guidance that by their nature present a higher or lower risk than we have considered? Also, are there other risk factors which should be included in the guidance? Please provide supporting arguments on the level of risk associated with these situations/risk factors.
 - Q3- Are there further measures that a firm might take in lower or higher risk situations?

2 Draft Guidance

Who is this guidance aimed at?

- 2.1 This guidance is aimed at relevant persons whose compliance with the Regulations is overseen by the FCA (referred to as 'firms' throughout this guidance).

What is the purpose of this guidance?

- 2.2 This document provides guidance required by section 333U of Financial Services and Markets Act (FSMA) on the definition of PEPs in line with the Regulations and how firms should meet their obligations when conducting transactions or business relationships with PEPs. A reference in this guidance to "regulation" refers only to provisions in this legislation unless otherwise stated.
- 2.3 This guidance should be read in conjunction with guidance on PEPs produced by the Joint Money Laundering Steering Group and guidelines issued by the joint European Supervisory Authorities (ESAs).

What do firms need to do?

- 2.4 Firms are obliged by Regulation 35 to have appropriate risk-management systems and procedures to identify when their customer (or the beneficial owner of a customer) is a PEP and to manage the enhanced risks arising from having a relationship with that customer. Business relationships with the family and known close associates of a PEP are also subject to greater scrutiny. This guidance discusses this further.
- 2.5 *In meeting obligations under the Regulations and this guidance, the FCA expects firms to do so in a proportionate manner. The FCA's view is that there should be relatively few cases where it is necessary to decline business relationships solely because of anti-money laundering requirements and, in relation to this guidance, this should only happen where PEPs pose a high money laundering risk.*

Why do PEPs pose a risk?

- 2.6 PEPs - as well as their families and persons known to be close associates - are required to be subject to enhanced scrutiny by firms subject to the Regulations. This is because international standards issued by the Financial Action Taskforce (FATF) recognise that PEPs may be in a position to abuse their public office for private gain. As FATF says

“these requirements are preventive (not criminal) in nature, and should not be interpreted as stigmatising PEPs as such being involved in criminal activity”.

- 2.7 A PEP may then use the financial system to launder the proceeds of this abuse of office. It is by virtue of their function that a person becomes a PEP and hence is required to be subject to enhanced scrutiny by firms.
- 2.8 Likewise, a PEP’s family or close associates may also benefit from, or be used to facilitate, abuse of public funds by the PEP. It is as a result of this connection that family and known close associates are required to be subject to greater scrutiny. Family and close associates are not themselves PEPs solely as a result of their connection to a PEP.

Do all PEPs pose the same risk?

- 2.9 *No. The risk will differ between PEPs. This guidance discusses how firms may differentiate between PEPs that represent a lower risk and those that represent a higher risk.*

Should firms apply the same measures to all relationships with PEPs?

- 2.10 *No. When conducting transactions or business with PEPs, firms should take a proportionate, risk-based and differentiated approach. This means that PEPs, PEPs’ family and PEPs’ close associates that pose a lower risk should be subject to less scrutiny than those who present a higher risk.*

Who is a PEP?

- 2.11 Regulation 35(12)(b) defines a ‘politically exposed person’ as an individual who is entrusted with prominent public function, other than as a middle-ranking or more junior official. It includes, but is not limited to, the following:
- heads of state, heads of government, ministers and deputy or assistant ministers; members of parliament or of similar legislative bodies;
 - members of the governing bodies of political parties;
 - members of supreme courts, of constitutional courts or of other high-level judicial bodies, the decisions of which are not subject to further appeal, except in exceptional circumstances;
 - members of courts of auditors or of the boards of central banks;
 - ambassadors, *chargés d’affaires* and high-ranking officers in the armed forces;
 - members of the administrative, management or supervisory bodies of state-owned enterprises;
 - directors, deputy directors and members of the board or equivalent function of an international organisation.
- 2.12 This includes those who hold such a position in the UK or abroad but is not an exclusive list.

- 2.13 Regulation 35(9)(a) and (b) provides that a person who is a PEP should continue to be treated as a PEP for a period of at least 12 months after the date on which that person ceased to be entrusted with that public function; or for such longer period as the relevant person considers appropriate to address risks of money laundering or terrorist financing in relation to that person. For lower risk situations it will not normally be necessary to continue to treat someone as a PEP for longer than 12 months after they left office.

Who are the “family” of a PEP?

- 2.14 Regulation 35(12)(c) defines ‘family members’ of a PEP to include the following:

- a spouse or partner of that person
- children of that person and their spouses or partners;
- parents of that person.

This is not an exclusive list.

- 2.15 Regulation 35(11) states that the provisions in Regulation 35(9) (that require a PEP to continue to be treated as a PEP after he or she leaves office) do not apply to family members who should be treated as ordinary customers, *unless other risks are apparent*, from the point that the PEP leaves office.

Who are people “known to be close associates” of a PEP?

- 2.16 Regulation 35(12)(d) defines a “known close associate” of a PEP to include the following:

- an individual known to have joint beneficial ownership of a legal entity or a legal arrangement or any other close business relationship with a politically exposed person;
- an individual who has sole beneficial ownership of a legal entity or a legal arrangement which is known to have been set up for the benefit of a PEP;

A known close associate of a PEP is not a PEP themselves purely as a consequence of being associated with a PEP.

What are some indicators that a PEP poses a lower risk?

- 2.17 *In the FCA’s view, these are indicators that a PEP poses a lower risk:*

Lower risk indicators - geographical

A PEP may pose a lower risk if he/she solely operates in a country, such as the UK, that has the following characteristics:

- *associated with low levels of corruption*
- *political stability and free and fair elections*
- *strong state institutions*
- *credible anti-money laundering defences*

- *a free press with a track record for probing official misconduct*
- *an independent judiciary and a criminal justice system free from political interference*
- *a track record for investigating political corruption and taking action against wrongdoers*
- *strong traditions of audit within the public sector*
- *legal protections for whistleblowers*
- *well-developed registries for ownership of land, companies and equities*

Lower risk indicators – personal and professional

A PEP may pose a lower risk if he/she has the some of the following characteristics:

- *is subject to rigorous disclosure requirements (such as registers of interests, independent oversight of expenses)*
- *does not have executive decision-making responsibilities (such as a government MP with no ministerial brief or an opposition MP)*
- *has ceased to be a PEP for at least 12 months.*

What are some indicators that a PEP poses a higher risk?

2.18 In the FCA's view, these are indicators that a PEP poses a higher risk:

Higher risk indicators - geographical

A PEP may pose a greater risk if she/he is from, or closely connected to, a country with some of the following characteristics:

- *associated with high levels of corruption*
- *political instability*
- *weak state institutions*
- *weak anti-money laundering defences*
- *armed conflict*
- *non-democratic forms of government*
- *widespread organised criminality*
- *a political economy dominated by oligopolistic actors with close links to the state*
- *lacking a free press and where legal or other measures constrain journalistic investigation*
- *a criminal justice system vulnerable to political interference*
- *lacking expertise and skills related to book-keeping, accountancy and audit, particularly in the public sector*
- *law and culture antagonistic to the interests of whistleblowers*
- *weaknesses in the transparency of registries of ownership for companies, land and equities*

Higher risk indicators – personal and professional

A politically exposed person may pose a higher risk if she/he has any of the following characteristics:

- *personal wealth or lifestyle inconsistent with known legitimate sources of income or wealth*
- *subject to credible allegations of financial misconduct (e.g. facilitated, made, or accepted bribes)*
- *there is evidence they have sought to disguise the nature of their financial circumstances*

- *is responsible for, or able to influence, large public procurement exercises, particularly where procurement is not subject to competitive tender, or otherwise lacks transparency*
- *is responsible for, or able to influence, allocation of scarce government licenses such as mineral extraction concessions or permission for significant construction projects.*

This is not an exhaustive list; other factors may suggest higher risk as new corruption typologies develop.

What are some indicators that a PEP's family or known close associates pose a lower risk?

2.19 *A family member or close associate of a politically exposed person may pose a lower risk if they have the following characteristics:*

- *He or she is a family member or close associate with a PEP who themselves poses a lower risk;*
- *He or she is a family member or close associate with a PEP who is no longer in office;*
- *He or she is under 18 years of age.*

What are some indicators that a PEP's family or known close associates pose a higher risk?

2.20 *The family and close associates of a politically exposed person may pose a higher risk if they have any of the following characteristics:*

- *Wealth derived from the granting of government licences (such as mineral extraction concessions, licence to act as a monopoly provider of services, or permission for significant construction projects).*
- *Wealth derived from preferential access to the privatisation of former state assets*
- *Wealth derived from commerce in industry sectors associated with high-barriers to entry or a lack of competition, particularly where these barriers stem from law, regulation or other government policy*
- *Wealth or lifestyle inconsistent with known legitimate sources of income or wealth*
- *Subject to credible allegations of financial misconduct (e.g. facilitated, made, or accepted bribes)*
- *Appointment to a public office that appears inconsistent with personal merit*

What measures should firms take when they identify a customer is a PEP, or a family member or known close associate of a PEP?

2.21 *The Regulations require that enhanced customer due diligence measures are taken to manage and mitigate the risks posed by PEPs and their families and known close associates.*

2.22 *This includes appropriate risk management systems to determine whether the customer, or the beneficial owner of the customer, is a politically exposed person, or a family or known close associate of a PEP. Regulation 35(5) requires that firms:*

- have approval from senior management for establishing or continuing business relationships with such persons;
- take adequate measures to establish the source of wealth and source of funds that are involved in business relationships or transactions with such persons;
- conduct enhanced, ongoing monitoring of those business relationships.

To what extent may public information be taken into account?

2.23 *When deciding whether a person is a known close associate of a PEP, firms only need to have regard for information that is already in their possession or credible information that is publicly known. Firms should also make use of credible public information when establishing source of wealth and source of funds and the true beneficiaries of long-term insurance policies. This could include information from public registers, such as beneficial ownership registers and registers maintained by the Electoral Commission under the Political Parties, Elections and Referendums Act 2000. Firms should take account of the information on these types of registers so that firms minimise the burden on customers and avoid duplication with other regimes where appropriate.*

What measures may firms take in lower-risk situations?

2.24 *The FCA believes the following measures can be appropriate in lower-risk situations:*

- *Undertake customer due diligence to establish whether the customer is a family member or has a close relationship with a PEP.*
- *Take less intrusive and less exhaustive steps to establish the source of wealth and source of funds of family members or known close associates of a PEP; for example, only use information already available to the institution (such as transaction records or publicly-available information) and do not make further inquiries of the individual unless anomalies arise.*
- *Oversight and approval of the relationship takes place at a less senior level of management.*
- *After the firm becomes aware a PEP has left office, promptly cease to apply any enhanced measures to family and close associates*
- *A business relationship with a PEP or a PEP's family and close associates is subject to less frequent formal review.*

What measures may firms take in higher-risk situations?

2.25 *The FCA believes the following measures can be appropriate in higher-risk situations:*

- *Take more intrusive and exhaustive steps to establish the source of wealth and source of funds of family members or known close associates of a PEP*
- *Oversight and approval of the relationship takes place at a more senior level of management.*
- *A business relationship with a PEP or a PEP's family and close associates is subject to more frequent and thorough formal review as to whether the business relationship should be maintained.*