FINANCIAL CONDUCT AUTHORITY

The treatment of Politically Exposed Persons – multi-firm review

July 2024

Contents

Chapter 1

Introduction and executive summary

1.1 The United Kingdom ('UK') is one of more than 200 countries and jurisdictions committed to international standards that require additional financial checks on individuals who hold significant public functions, known as Politically Exposed Persons ('PEPs'). The UK Parliament has written those standards into domestic law through the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (the 'Regulation').

1.2 The anti-money laundering ('AML') requirements for PEPs also extend to their relatives and close associates ('RCAs'). These requirements are global and are set internationally by the Financial Action Task Force, of which the UK Government is an active member. The reason for these global standards is the increased risk that PEPs, and those connected to them, may be at risk of being targeted for bribery and corruption, with the financial system used to launder the associated proceeds.

1.3 However, controls must also be balanced with the need for good customer treatment starting at account opening and throughout the relationship. In 2017, we published our Guidance to help financial services firms implement a risk-based and proportionate approach. This makes it clear they should generally treat UK PEPs and their RCAs as lower risk. Only where firms identify other higher risk indicators should they take more intrusive measures.

1.4 We want a system that is proportionate so that public servants are not unfairly denied access to the financial products and services necessary for everyday life, or to disproportionate delays and requests for information.

1.5 In recent years, UK Parliamentarians have raised concerns that some FCA-regulated firms are not effectively applying our Guidance. The problems raised included PEPs and RCAs having to provide a lot of information about their wealth and income, as well as PEPs and RCAs being denied services, respectively because of their status or connection to a PEP.

1.6 Parliament asked us to review this in more detail, under Section 78 of The Financial Services and Markets Act 2023. This required us to review how effectively firms are following our current Guidance on the treatment of PEPs for AML purposes and, in light of our findings, to consider whether it remains appropriate.

1.7 We have looked at how firms apply the definition of PEPs and RCAs to individuals and assessed how firms are set up to take a risk-based and proportionate approach in their management and treatment of UK PEPs and RCAs, in accordance with our Guidance.

1.8 We also contacted over 1,000 PEPs and received 65 individual responses. We considered all the responses in our planning and selection of firms to review. We undertook data-gathering and analysis with an initial group of firms from 5 retail sectors. We then narrowed this down to 15 firms for a more detailed review, assessing their policies and procedures for the risk management and treatment of PEPs. These 15 firms were not

intended to be a representative sample across the entire retail market. Nevertheless, they hold approximately 60% of the UK market share for retail main current accounts and include large firms in retail banking and consumer credit lending. This included the firms most often referenced in the PEPs' responses, as well as firms that would potentially be better performers. Subsequently, we selected 5 of the 15 firms for customer file reviews against the relevant regulations and our Guidance and held interviews with 3 of the 15 firms.

Chapter 2

Summary of our findings

2.1 We found that most firms had systems and controls designed to implement our Guidance. However, there was room for improvement in all the firms we assessed. The issues included:

- **Some firms included definitions for PEPs and RCAs that are not in line with the regulations and our Guidance** Of the 15 firms reviewed, 7 used a definition of PEPs and/or RCAs that was wider than we would have expected.
- **Some firms did not have effective arrangements in place to review PEPs and RCAs to ensure the PEP classification remained appropriate after the PEP had left public office** Five of the 15 firms reviewed did not have suitable policies and procedures to appropriately review the PEPs/RCAs status after the individual ended their public function. This is necessary to consider declassifying these customers as PEPs/RCAs in a timely way. The customer file reviews showed that 2 of the 5 firms with inadequate policies and procedures did not provide evidence that they had considered declassifying some of their PEPs in a timely manner.
- **A small number of firms did not effectively consider the customer's actual risk in their assessment and rating** Of the 15 firms reviewed, 2 had a risk assessment methodology that did not properly take account of all the relevant risk factors and individual circumstances. We saw some problems in the customer files we reviewed, including failing to provide a clear rationale or narrative explaining the customer's risk rating.
- **Despite the need to improve the firms' policies and procedures, customer file testing did not show firms regularly applying excessive enhanced due diligence measures (EDD) for customers** Some PEPs and RCAs told us they had received requests for information which they considered excessive. However, in our customer file reviews we only saw a small number of cases of disproportionate information requests.
- **All of the 15 firms were clear that they would not decline products or services to UK PEPs or their RCAs simply because of PEP status** According to the data collected from firms (covering the period 1 July 2022 to 30 June 2023), we know that some PEPs and RCAs were denied products or services, and/or had existing accounts closed. Where this happened, the firms explained this was due to financial crime reasons, not because of PEP status. This will have included cases where the rejection or closure was due to customers not providing the information that firms requested. In our limited customer file review, we did not see any cases where PEPs or RCAs were rejected or had accounts closed simply because of PEP status. We also note that a small number of firms were not taking on any PEPs as customers due to regulatory remediation programmes they had in place.
- **Firms need to improve the clarity and detail of communications with PEP and RCA customers** We identified that 6 of the 15 firms reviewed needed to improve the clarity and quality of their customer communications and provide more detail in their requests and/or notifications so that customers could understand what they were being asked to do and why.

- **Most of the 15 firms needed to improve staff training** We saw weaknesses in staff training in 10 firms. Training could be improved by using practical examples and case studies, as well as examples of good and poor practices to improve staff understanding and achieve consistency in customer treatment.
- **Ten of the 15 firms had made changes and improvements following the recent amendment to Regulation 35 (which sets out firms' AML obligations on PEPs under the Regulation) but some needed to update their policies to reflect this legislative development** With effect from 10 January 2024, the legal starting point for UK PEPs and RCAs is that they should be treated as presenting a lower level of risk than a foreign PEP, if there are no enhanced risk factors. If no enhanced risk factors exist, the legislation says that the extent of EDD measures for UK PEPs and RCAs is to be less than that applied for foreign PEPs and RCAs. Some firms are operating under global policies and procedures which are not appropriately tailored to reflect the UK requirements or our Guidance on PEPs.

Chapter 3

Actions all firms need to take

3.1 While we have given the firms in this review detailed feedback on the remediation needed, we expect all firms to draw relevant lessons from the review's findings. In particular, we expect all firms to:

- Review their current arrangements (policies, procedures, controls) for the risk management and treatment of PEPs and RCAs against these findings. Their current arrangements must reflect the legislative position, effective from 10 January 2024, which makes clear that UK PEPs and RCAs should be considered as presenting a lower level of risk if no enhanced risk factors are present.
- Address any gaps they identify in their current arrangements. This includes making any necessary improvements such as updating their policies and procedures, (ensuring these are aligned with the relevant regulations and our Guidance) and more practical staff guidance on the risk-based and proportionate approach for the treatment of PEPs and RCAs.
- Make sure that communication with customers is clear and effective when requesting information so that PEPs and RCAs can understand what information is being sought and why the requests are being made. Firms will, where relevant, need to comply with the Consumer Duty requirements to ensure their communications meet customers' information needs, are likely to be understood by customers and enable them to make decisions that are effective, timely and properly informed.
- Make sure that staff are appropriately trained (through, for example, the use of case studies and other practical guidance) so that the firm's policies and procedures are consistently and effectively applied in line with the regulations and our Guidance.

3.2 We also encourage all firms to read and respond to our consultation to provide feedback on whether the changes we propose to our Guidance are appropriate in response to these findings, and/or whether any further changes are required.

Chapter 4

Actions we are taking

4.1 We have provided detailed feedback to the 15 firms we reviewed regarding the remediation we expect. In a small number of cases, we are appointing an independent skilled person for a more detailed review and report on remediation.

4.2 The issues we identified were mainly about the firms' practical implementation of our Guidance. However, we intend to make some targeted changes to our current Guidance to be clearer on some of the issues we identified. For example, clarifying some PEP definitions and the senior management oversight and approval that should take place for anyone identified as a PEP or RCA.

4.3 We have launched a consultation on the proposed clarifications to our Guidance so that we can identify whether any further changes – other than those we intend to make – are required to give effect to Regulation 35 of the Money Laundering Regulations (effective from 10 January 2024). We welcome feedback on our consultation by October 2024.

Chapter 5

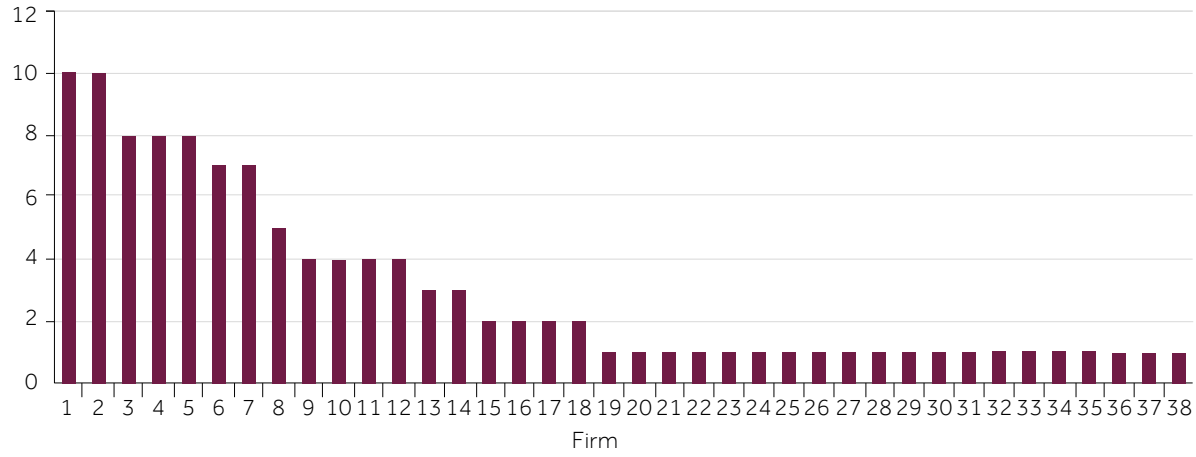
Review – Approach

5.1 This report presents our findings from the review we conducted with firms on 7 key questions. These questions are listed in the Terms of Reference ('ToR') and reflect the main areas this review looked at. The findings cover instances of non-compliance and inconsistencies with the relevant requirements and our Guidance, as well as some examples of good practices.

PEPs' input and selection methodology for firms assessed

5.2 In August 2023, we contacted over 1,000 UK PEPs and received 65 responses, mainly from Parliamentarians. The table below shows how these were spread against the various firms mentioned in their responses.

Figure 1: Number of firms and times mentioned by PEPs



5.3 Our firm selection methodology also included all of the 12 most-referenced firms as part of our initial data collection exercise to decide which firms should be subsequently assessed in more detail under this review. Seven of the 12 were part of the 15 firms we selected and assessed in detail (see Figure 2 below).

5.4 Although a few PEPs reported positive experiences, the most common problems were disproportionate requests for due diligence (sometimes leading to delays) and account rejections/closure with little or no explanation.

Figure 2. The flowchart below sets out the methodology and approach taken, in 3 phases.

PEPs' Input

Over 1,000 UK PEPs contacted, resulting in 65 responses

The responses helped to shape the review's approach and the firms included

Phase 1
Detailed data collection from 36 firms and assessment for areas of potential concern

Firms' annual financial crime return (REP-CRIM) identified an initial group of 36 firms with the largest PEPs numbers across 5 retail sectors:

- Retail banking
- Building Societies
- Consumer credit lending
- E-Money institutions & payment services
- Wealth management

These 36 firms represented over 73% of the UK market share for retail main current accounts and, on comparison, we found this included 12 of the most referenced firms in the 65 responses received from PEPs.

Phase 2
Assessment of 15 firms' policies and procedures to assess their adherence to our Guidance

Following phase 1 analysis, we identified 15 of these firms for a detailed review in phase 2. Our firm selection for phase 2 sought to ensure that a range of different firms were included (i.e. including those who were likely to be better and weaker performers from the data). However, this selection was not intended to be a representative sample across the entire retail market. These 15 firms hold 60% of the UK market share for retail main current accounts and include large firms in retail banking and building societies, and consumer credit lending. On comparison, we found this included 7 firms identified in the PEPs' responses.

Phase 3
40 customer files reviewed to assess firms' controls in practice and record keeping and interviews with firms

Five firms, from the 15, were selected for customer file reviews. A total of 40 customers' files were reviewed. This included 30 files for UK PEPs/RCAs and 10 files for overseas PEPs (to allow a comparison of the approach for UK PEPs and foreign PEPs at each firm). Interviews were held with three other firms from the 15.

Firms assessed on whether they are:

ToR 1 – applying the definition of PEPs to individuals who truly hold prominent positions

ToR 2 – conducting proportionate risk assessments of UK PEPs, their family members and known close associates

ToR 3 – carrying out risk-based and proportionate EDD of individual customers

ToR 4 – applying enhanced ongoing monitoring for PEPs and keeping EDD up to date so that it is proportionate and commensurate based on the risk

ToR 5 – deciding to reject or close accounts, and if these decisions are in line with the applicable legislation, our Guidance and the Consumer Duty

ToR 6 – effectively communicating with their PEP customers

ToR 7 – Keeping their PEP controls under review to ensure they remain appropriate

Chapter 6

Detailed Findings

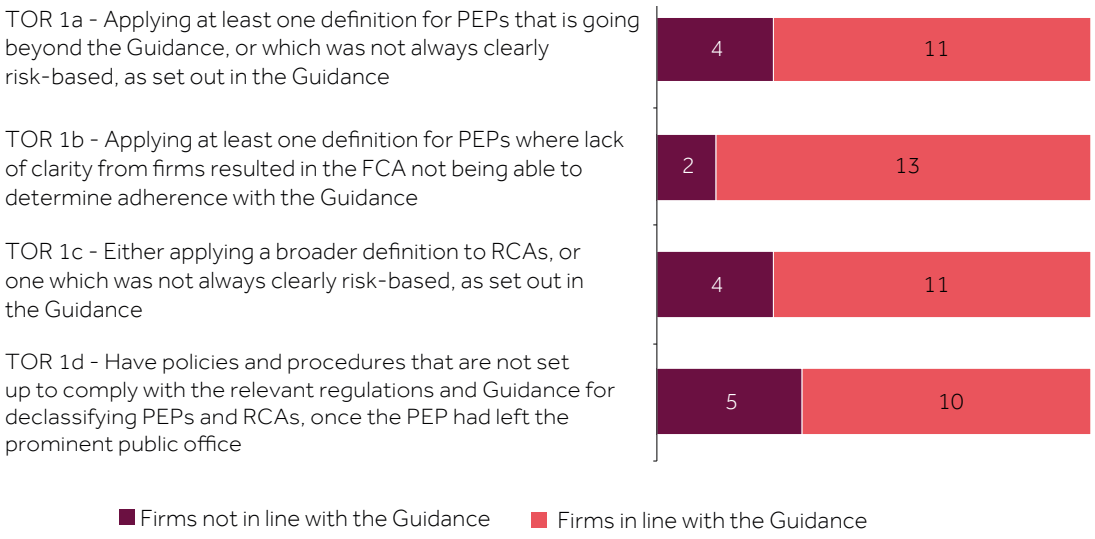
6.1 We have organised our findings into sections corresponding to each of the 7 ToR questions. We have also provided more detail in each section on the specific aspects we assessed for each question. We report our findings, the actions we expect firms to take and any good practices we observed.

Findings: ToR 1 – Are firms applying the definition of PEPs to individuals who hold truly prominent positions?

6.2 **Aim:** To assess if firms are applying the definition of PEPs to individuals who hold truly prominent positions (and not to local government, more junior members of the senior civil service or to anyone other than the most senior military officials). We also assessed whether firms were declassifying PEPs and RCAs in line with the relevant regulations and our Guidance.

6.3 To assess this, we broke the ToR 1 question down into 4 separate risks or potential issues, shown below. 1(a) to 1(c) assessed how firms were defining PEPs and RCAs, whilst 1(d) sought to assess how the 15 firms reviewed declassify PEPs and RCAs.

Figure 3: Firms appropriately applying PEP definitions



PEPs and RCAs Definitions

6.4 **Our current Guidance** Paragraphs 2.16-2.20 explain who should be treated as a person holding a prominent public function under the regulations. Our Guidance is clear that UK local government officials should be excluded, and the definition should not be applied to more junior members of the senior civil service and only to the most senior military officials. Family members are defined in paragraphs 2.21 to 2.23 to include

siblings of PEPs as well as spouse/civil partner, parents, children and their spouses or civil partner, but this is not a complete list. The Guidance sets out that firms can go beyond the definitions in the regulations but only using a risk-based approach. Known close associates are defined in paragraph 2.25.

6.5 **Potential harmful impact on the treatment of customers** If firms do not comply with our Guidance they will subject customers, who they inappropriately define as PEPs, to measures including EDD, source of funds (SOF) and source of wealth (SOW) checks. Although these measures may not significantly differ from how firms manage non-PEP high-risk customers, the automatic requirements triggered by PEP status could result in asking for disproportionate information. It may also result in PEPs and RCAs seeking new financial services providers, causing disruption and inconvenience.

6.6 **Potential impact on the adequacy of AML controls.** AML controls become less risk-based and more inefficient, resulting in an opportunity cost where resources could have been directed to higher risks.

1(a): Were firms applying any definitions for PEPs beyond our Guidance, or which were not always clearly risk-based, as set out in our Guidance?

6.7 Our review of firms' policies and procedures showed 4 of the 15 firms applied definitions which were broader than expected under our Guidance, capturing individuals who should not be defined as PEPs. For example, one of these firms included senior executives entrusted with a prominent function by an international sports organisation, another included international sporting officials, as well as one that included senior management/board members of government-funded charities (including non-profit), and political pressure and labour group officials. We also saw similar issues in the customer file reviews.

1(b): Were firms applying any definitions for PEPs where lack of clarity in their documentation meant we could not determine if they were complying with our Guidance?

6.8 Two of the same 4 firms mentioned under 1(a) above also applied at least 1 definition for PEPs whose lack of clarity in their documentation meant it was unclear whether these positions were included as PEPs on a risk-sensitive basis.

1(c): Were there similar issues with the definitions for RCAs?

6.9 We found that 4 firms, including 1 of those in the previous findings in this section, either applied a broader definition to RCAs or one which was not clearly risk-based, as set out in our Guidance. As a result, a broader population may be at risk of automatic EDD and other mandatory AML measures for PEPs and RCAs.

- One firm included political party candidates and union representatives as known close associates by virtue of a professional connection to the PEP.
- One firm defined family members as 'an individual who is closely related to the PEP' but without clarifying the exact nature of the relationship.

- One firm extended the definition of family members to include 'aunts, uncles, nieces and nephews', but without explaining their risk-based approach for this definition.
- One firm used a category of 'distant family members' (e.g. in-laws, uncles, aunts, grandparents, cousins, etc) as standard practice.

PEPs and RCAs Declassifications

6.10 **Aim:** To assess the approach taken by firms towards declassifying a PEP and any RCAs, once the individual has left the prominent public function.

6.11 **Our current Guidance** As part of ongoing monitoring and ongoing due diligence, firms should review PEP status at appropriate points so that these individuals and RCAs do not have to meet additional requirements for longer than necessary. Our Guidance states that when a PEP no longer holds a prominent public function, the individual should continue to be subject to risk-based EDD '***for a period of at least 12 months'*** (para 2.19). After this period, firms should consider whether the PEP can be declassified, based on their assessment of risk. Under paragraph 2.24, family members should be treated as ordinary customers, and subject to customer due diligence (not EDD) obligations from when the PEP leaves office. This means they should not be subject to continuing EDD measures unless this is justified by the firm's assessment of other risks posed by the customer.

6.12 **Potential harmful impact on the treatment of customers** Without reasonable risk-based assessments, PEPs and/or RCAs who are not declassified will continue to have to meet PEP-related requirements for longer than proportionate. We remind firms of the Consumer Duty which came into effect in July 2023. This requires firms to act to deliver good outcomes for retail customers. For example, they must act in good faith towards retail customers and avoid causing foreseeable harm. If they find customers have suffered foreseeable harm because of their acts or omissions, they must take appropriate action to rectify the situation, including providing appropriate redress.

6.13 **Potential impact on the adequacy of AML controls** AML controls are less risk-based and more inefficient, resulting in an opportunity cost where resources could have been directed to higher risks.

1(d): Were there any issues in the firms' policies and procedures for the declassification of PEPs and RCAs?

Declassifying PEPs

6.14 Five of the 15 firms, including 3 of those in the findings above (1a-c), did not have appropriate policies and procedures for reviewing and declassifying PEPs and RCAs in line with the relevant regulations and our Guidance.

- Two firms had policies which would never consider declassifying, as a PEP, any individual who has held a prominent public position, such as a Head of State or National Government.
- One firm had a policy to perform EDD for another 4 years after the PEP has left public office (in addition to the mandatory minimum 12 months).

- One firm's policy was only to declassify PEPs it has defined as holding non-prominent positions, and only after at least 3 years under a risk-based assessment. We remind firms that PEPs are defined as individuals who hold truly prominent positions, so this firm's definition and approach are inconsistent with that.
- One firm was amending its policy to a period of at least 18 months before considering declassifying PEPs (RCAs can be declassified without delay). This was in contrast to the firm's previous position of waiting 5 years after the individual has left the prominent public function.

6.15 From customer file testing involving 5 firms from the 15 assessed in detail, we found the following issues with 2 firms (included in the 5 firms mentioned above):

- One did not provide any evidence it had at least considered declassifying 3 PEPs (out of 8 customer files reviewed) despite these having left their public position years earlier.
- The other continued to classify one of its customers as a PEP despite the individual having been inactive in their role for 4 years.

Declassifying the RCAs of a PEP

6.16 Based on the policies and procedures, 4 firms of the 15 (all in point 1(d) above) have an approach inconsistent with the relevant regulations and our Guidance.

- One firm's policy is to continue to perform EDD for 5 years on the RCAs of the PEP, after they have left the prominent public function.
- One firm's policy, where the PEP was high-risk, is to continue to perform EDD on the RCAs of the PEP, for 5 years after they have left office.
- One firm's policy is to declassify only the RCAs of PEPs it defines as holding non-prominent positions, and only after at least 3 years under a risk-based assessment. This firm will also never consider declassifying the RCAs of a PEP that held a prominent public function, such as a Head of State or National Government.
- One firm's policy is not to consider declassifying RCAs for at least 12 months after the PEP has left office.

Example of good practice on the declassification of PEPs and RCAs

The firm considers several risk factors in its declassification process, including any:
- ongoing links/ interests to businesses more susceptible to corruption
- adverse information
- ongoing political connections
- likelihood of a return to office soon

Actions firms should take

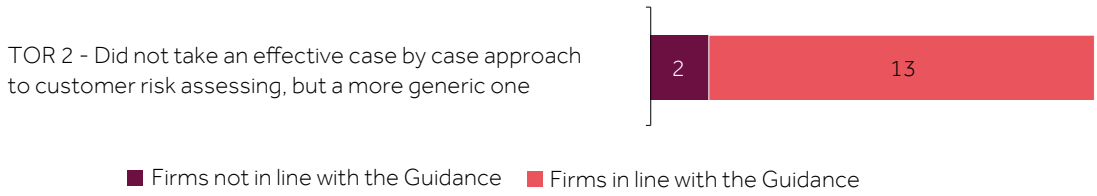
6.17 We expect firms to apply definitions for PEPs and RCAs that are consistent with the regulations and our Guidance. Firms should review their approach to ensure this is the case. Where firms have attributed PEP status to customers that do not meet the definition, they should declassify them and only treat them as high-risk if they deem the customer's individual circumstances pose an increased risk of money laundering (Regulation 33(1)(a)). Firms need to have appropriate policies, procedures and arrangements for declassifying PEPs and RCAs, consistent with the regulations and our Guidance.

6.18 Firms should also have appropriate systems and controls in place that enable them to identify when a PEP ceases to hold the prominent public function. This will trigger the period for a review (for declassifying the PEP), in line with the regulations and our Guidance. When firms identify that a PEP no longer holds the public function, they should review and assess the RCAs of that PEP, to decide if they should be declassified. They should do this without waiting for the minimum 12 months to expire, as this only applies to PEPs.

Findings – ToR 2 – Are firms conducting proportionate risk assessments of UK PEPs, their family members and known close associates?

6.19 **Aim:** To assess if firms are conducting proportionate risk-based assessments of UK PEPs and their RCAs, including how firms take into account any other risk factors outside the customer's position as a PEP.

Figure 4: Firms conducting proportionate risk-based assessments



6.20 **Our current Guidance** We expect a case-by-case approach for risk assessing PEPs, rather than a generic one (paragraph 1.5). Paragraph 2.28 makes it clear that no single risk factor means a customer should automatically be treated as posing a higher risk and firms need to make a holistic (comprehensive) assessment that considers all features of the customer. Paragraph 2.29 states that UK PEPs should be treated as low risk, unless a firm has assessed that other risk factors mean they pose a higher risk. Where the PEP is low risk, we expect the RCAs (paragraph 2.31) to be treated as such, unless their circumstances suggest otherwise.

6.21 **Potential harmful impact on the treatment of customers** Firms' failure to undertake a holistic (comprehensive) risk assessment and to take a case-by-case approach could mean they apply disproportionate EDD measures. For example, where PEPs are all automatically assessed or defaulted to a high-risk rating this will automatically trigger potentially more intrusive EDD measures which may be disproportionate.

6.22 **Potential impact on the adequacy of AML controls** This approach could adversely affect the efficient and effective use of a firm's resources which should be focused where the risks are inherently higher.

ToR 2: Were there any issues regarding the approach taken by firms for customer risk assessments?

6.23 Based on our review of their policies and procedures, 2 of the 15 firms assessed in detail did not effectively consider the customer's individual circumstances when assessing the risk they posed, as expected by our Guidance. One firm classified all PEPs and their RCAs as high-risk because of an 'override' mechanism for certain customer types, such as PEPs. The second firm rated PEPs as low risk, mainly due to their geographic location (UK) and its lower risk product offering but did not seemingly take a more holistic approach.

6.24 We identified some issues in a number of the customer files of 4 firms, which included:

- Failing to clearly set out the reasons and rationale for the customer's risk rating. In one case, the risk rating changed from low to high and back to low without any clear explanation. Generally, the same firm's customer files lacked adequate detail, with 5 of the 8 files reviewed assessed as inadequate.
- For another of the 4 firms, as well as 3 files lacking rationale for the rating, another 3 had inconsistent risk ratings, resulting in 6 of the firm's 8 files assessed as inadequate.
- One other firm from the 4 did not provide evidence of a customer risk assessment when it belatedly identified the customer as a PEP.

Examples of good practice seen on customer risk assessments

Holistic customer risk assessment including key factors:
- information from customer due diligence and EDD
- political profile from screening and other indicators of PEP status
- reputational information from name screening
- product, service and account information from the product profile
- geography, obtained from customer due diligence, EDD and product usage profile

The customer risk assessment was promptly reviewed and reconsidered by the firm following changes to the PEP's circumstances.

Actions firms should take

6.25 Firms need to review their current arrangements to ensure their approach and customer risk assessment methodology are compliant with our Guidance and the amended Regulation 35. As set out above, under the revised Regulation 35, the starting point for assessing UK PEPs and RCAs is that the customer should be treated as presenting a lower level of risk than a foreign PEP, if no enhanced risk factors are present.

Findings – ToR 3 – Are firms carrying out risk-based and proportionate EDD of individual customers?

6.26 **Aim:** To assess if firms are carrying out risk-based and proportionate EDD of individual customers. To assess this we broke down ToR 3 into 3 different component questions – 2 on the proportionality of how firms were applying EDD and 1 on the adequacy of SOF and SOW checks, which are mandatory for all PEPs and RCAs.

Applying EDD measures

6.27 **Our current Guidance**. Paragraphs 2.35 and 2.36 give examples of risk-based measures that firms can take in lower and higher risk situations. These include applying less exhaustive and less intrusive measures for low-risk PEPs and RCAs, e.g. using publicly available information. Conversely, more detailed and intrusive steps should be taken for high-risk PEPs and RCAs, e.g. more frequent and thorough reviews.

6.28 **Potential harmful impact on the treatment of customers** Firms without effective policies, controls and procedures may ask PEPs and RCAs for disproportionate amounts of information. Since UK PEPs and RCAs should be treated as low risk, unless other enhanced risk factors are present, this could result in customers being subject to measures that are overly burdensome and/or intrusive.

6.29 **Potential impact on the adequacy of AML controls** EDD, including SOF and SOW, are fundamental to assess and reduce the inherent risk of money laundering and, for PEPs, the increased risk of laundering proceeds from corruption. If these controls are not effectively risk-based, firms may apply insufficient measures in higher risk cases which may expose them to increased risk. Firms may also fail to undertake appropriate enhanced ongoing monitoring which is key to managing money laundering risks.

3(a): Were there issues regarding the practical application by firms of EDD, including SOF and SOW?

6.30 We did not see excessive or disproportionate levels of initial EDD performed on PEPs and RCAs. However, our customer file reviews identified other issues, including 1 firm undertaking insufficient SOF and SOW checks, as well as a lack of sufficient evidence of the SOF and SOW checks performed (see 3(c) below) by another firm. We also saw a case of disproportionate ongoing EDD measures (i.e. EDD collected as part of an account review or refresh rather than on account opening), which we cover below under ToR 4.

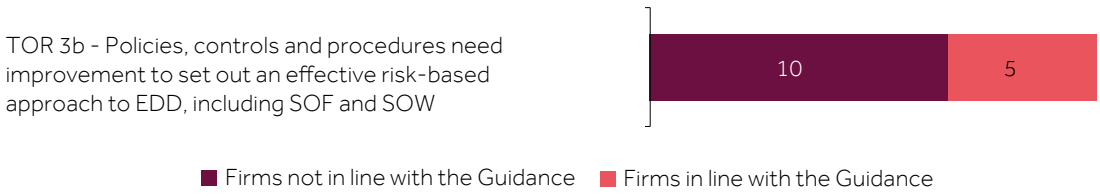
6.31 We saw inadequate EDD measures taken by 1 firm involving insufficient levels of SOF and SOW checks on 2 customer files. These were for high-risk customers, with no customer outreach and by using internal systems only. The less intrusive EDD measures were deemed inadequate considering the customers' high-risk rating in both cases.

Examples of good practices on EDD measures

- Applying less intrusive and proportionate EDD measures in lower-risk cases, with limited customer contact and relying mainly on existing information and publicly available sources
- Using open-source checks, as well as publicly available information, that was appropriate to the customer's risk rating
- Using string searches for adverse media checks, including name + any known alias + any known title + broad range of search terms related to financial crime

3(b): Were there issues regarding the risk-based and proportionate approach taken by firms to EDD, including SOF and SOW?

Figure 5: Firms taking risk-based and proportionate approach



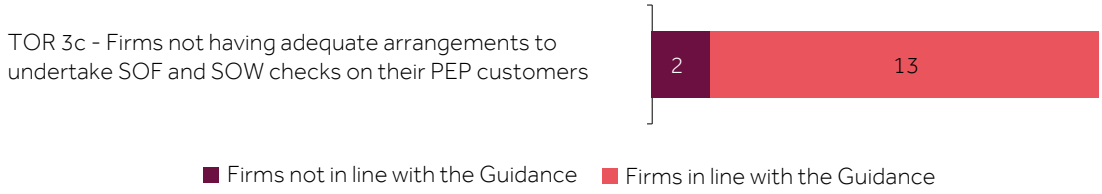
6.32 We found that 10 of the 15 firms had policies, controls and procedures that needed improvement to set out an effective risk-based approach to EDD, including SOF and SOW. However, although the policies and procedures were not sufficiently detailed, the evidence from the customer file testing carried out indicated that these issues did not generally translate into disproportionate and overly burdensome EDD measures in practice.

6.33 Based on the review of policies and procedures, we saw that:

- Nine of these 10 firms did not have practical guidance on how to take an effective risk-based approach and what a proportionate lower level of EDD would consist of. This is particularly relevant for UK PEPs and RCAs who should be treated as lower risk if there are no other risk factors.
- Seven firms (including 6 from the point above) did not have practical and detailed guidance to ensure they performed the SOF and SOW checks in line with a risk-based and proportionate approach, as set out in our Guidance.
- Three firms (also included in the first point) did not always use publicly-available information in their practices, as set out in their policies and procedures.

3(c): Did firms have adequate arrangements to comply with their obligations, and did they sufficiently evidence measures to establish SOF and SOW?

Figure 6: Firms evidencing measures to establish SOF and SOW



6.34 **Our current Guidance** Paragraph 2.33 requires firms to take adequate measures to establish the SOF and SOW in the business relationship with PEPs and RCAs. Paragraphs 2.35 and 2.36 set out the expectations and provides some examples for a flexible and risk-based approach to meet these mandatory requirements for all PEPs and RCAs.

6.35 **Potential harmful impact on the treatment of customers** None are envisaged for customers themselves. By not undertaking any SOF and SOW checks, firms will not be seeking any information and records from PEPs and RCAs.

6.36 **Potential impact on the adequacy of AML controls** SOF and SOW checks are mandatory for customer relationships with PEPs and RCAs, under Regulation 35(5)(b). These are fundamental to assessing and evaluating inherent risk, including the increased risk of laundering any proceeds from corruption. If not appropriately risk-sensitive, firms may apply insufficient SOF and SOW measures in higher risk cases which may expose them to an increased risk. Failing to establish SOF and SOW, as required under the legislation, could result in regulatory action for a breach of the relevant regulations.

6.37 Based on our review of the firms' policies and procedures, we found that 2 of the 15 firms did not have adequate policies and procedures to ensure that they can effectively meet their obligations under Regulation 35(5)(b), to establish SOF and SOW for PEPs and RCAs – a mandatory requirement.

6.38 The customer file reviews identified that, for a different firm, 4 of their 8 customer files lacked adequate evidence of SOF and SOW, in line with their obligations, as well as with our Guidance and their internal policies.

Examples of good practices seen regarding SOF/SOW checks

In 1 firm, staff training and guidance included detailed information on corroboration strength factors, i.e. relevance to the SOW, independence of the information, reputation of the source(s), directness (customer is directly linked to the economic activity) its comprehensiveness, as well as the levels provided by the corroborating materials (high / medium / low / no corroboration). The firm's guidance also includes the different types of acceptable corroborating materials and recommended SOW documentation, and practical examples of acceptable corroborative records.

Actions firms should take

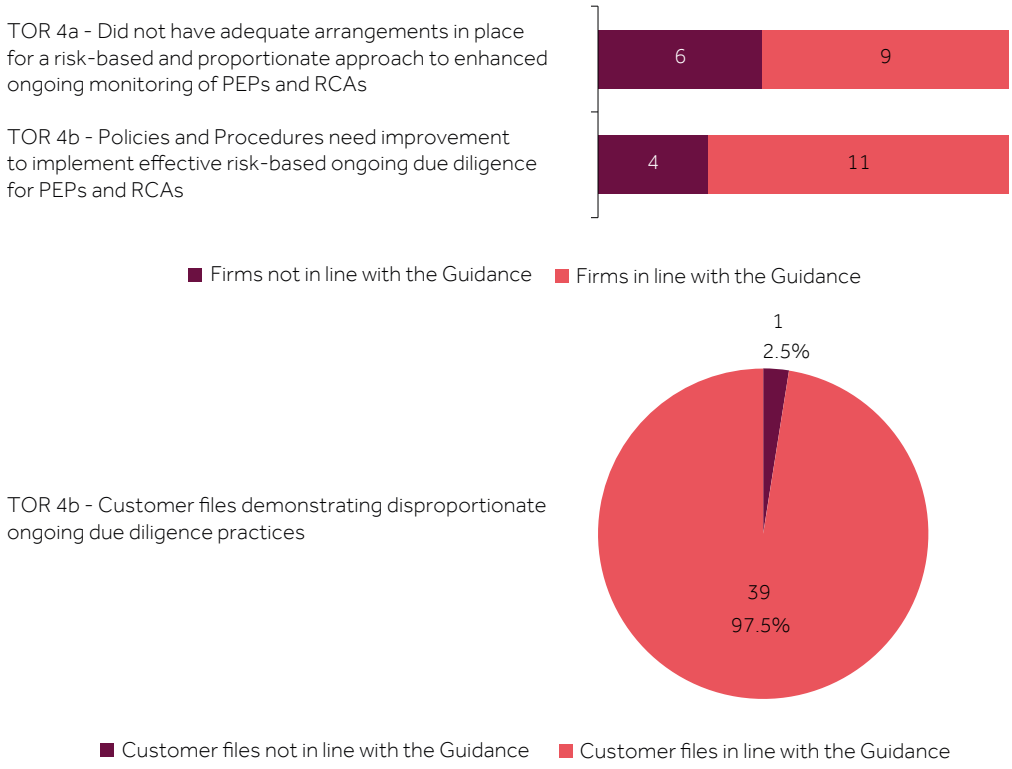
6.39 Firms should review their current arrangements (policies, controls, procedures etc) to ensure they apply an effective risk-based and proportionate approach to EDD measures, including SOF and SOW. Their policies and procedures should be aligned with the relevant legal requirements and our Guidance. We suggest cross-referencing relevant parts of our Guidance to their policies and procedures.

Findings – ToR 4 – Are firms applying enhanced ongoing monitoring for PEPs and keeping EDD up to date so that this is proportionate and commensurate based on the risk?

6.40 **Aim:** To assess if firms are applying enhanced ongoing monitoring (e.g. scrutiny of transactions) for PEPs, and ongoing due diligence (keeping EDD information up to date) for UK PEPs and RCAs that it is proportionate and commensurate based on the risk.

6.41 To test this, we broke down ToR 4 into 2 different component questions – how firms carry out ongoing monitoring for transactions, and how effective they are at keeping due diligence up to date. 4(a) refers to the firms' approach to risk-based and proportionate ongoing monitoring activities and 4(b) relates to firms' approach to keeping customer due diligence and EDD up to date.

Figure 7: Firms' enhanced ongoing monitoring and ongoing due diligence



6.42 **Our current Guidance**. Paragraph 2.15 states that once a firm has entered into a PEP relationship with a customer, the firm must conduct enhanced ongoing monitoring. The nature and extent of this will depend on the risk assessment. The risk-based and proportionate approach should be driven by the individual risk profile of the PEPs and RCAs. The same approach applies to ongoing due diligence.

6.43 **Potential harmful impact on the treatment of customers** Firms may undertake unnecessary customer contact and outreach in lower risk situations. For example, this could involve disproportionate requests for information or the frequency and/or extent of reviews not matching the level of risk.

6.44 **Potential impact on the adequacy of AML controls** Failing to focus efforts and resources on the highest risk, such as not applying appropriate levels of enhanced ongoing monitoring and due diligence. This could adversely impact the efficient and effective use of a firm's resources which should be focused where risks are inherently higher.

4(a): Did firms have adequate arrangements in place for risk-based and proportionate enhanced ongoing monitoring of PEPs and RCAs?

6.45 We found that 6 of the 15 firms needed to improve their policies and procedures for ongoing monitoring of customer relationships with PEPs and RCAs. These did not clearly provide for a risk-based and proportionate approach.

6.46 Observations about enhanced ongoing monitoring:

- One firm did not have transaction monitoring arrangements that were adequately risk-based, as these were applied uniformly to all customers. We saw no evidence of any differentiated or risk-based approach, based on the different customer risk profiles for PEPs and RCAs.
- Four firms (including the one from the finding above) had procedures which lacked sufficient guidance and examples of situations and scenarios that might 'trigger' the need for ad hoc reviews of a customer's activity, outside of the cyclical (periodic) reviews.
- A different firm from those above had policies and procedures that lacked detail and guidance on their risk-based approach to ongoing monitoring, including in lower risk cases.

6.47 From the customer file reviews, we identified the following:

- In 5 instances the same firm provided insufficient evidence of its transaction monitoring, with very limited supporting records.
- One firm did not provide evidence on 2 files that they had reviewed actual transactions against the customer's expected activities, contrary to their own policy.
- A different firm provided limited details on a file about the investigation of an alert, with no commentary or summary to explain the reason for the alert and why this was discounted.

Examples of good practices in enhanced ongoing monitoring

One firm had specific transaction monitoring rules for PEPs, as part of its enhanced ongoing monitoring arrangements. The same firm performed a risk-based transactional review against expected activities, (Regulation 28(11)(a)), when undertaking periodic reviews for PEPs and RCAs.

One firm had a comprehensive list of circumstances and events that could generate a trigger for an unscheduled customer review, as part of ongoing monitoring. These included:

- if the customer requests unnecessary or unreasonable levels of secrecy
- staff becoming aware that the customer has engaged in unusual or questionable conduct or actions
- where a customer is found to have engaged in transactions with a person identified by authorities as having links to criminality
- where reliable information or news sources allows the firm to identify that the customer has allegedly engaged in illegal conduct or has dealings with another party involved in this conduct

4(b): Did firms have adequate arrangements for risk-based and proportionate ongoing due diligence?

6.48 We found that 4 of the 15 firms had policies and procedures that needed improvement in relation to ongoing due diligence for PEPs and RCAs. We did see that most firms were reviewing lower risk PEPs and RCAs less frequently than higher risk PEPs. For example, having a 2 or 3-year review cycle for lower risk PEPs, compared to annually for higher risk PEPs.

6.49 However, some policies and procedures did not adequately set out a clear risk-based approach on how these reviews should be carried out. We identified the following:

- One firm did not have documented procedures for ongoing due diligence.
- Two firms had a lack of documented procedures and guidance on customer outreach for PEPs and RCAs, in the absence of any changes, where information might be needed. For example, in the case of an alert or another 'trigger event'.
- One firm's policies and procedures did not provide clarity on the risk-based approach for ongoing due diligence, e.g. where the PEPs circumstances were unchanged, and on their requirements for higher risk PEPs.

6.50 The customer file reviews identified the following key issues:

- In 4 files, the same firm failed to provide adequate supporting evidence of the ongoing due diligence checks carried out.
- One case of disproportionate outreach, as part of ongoing due diligence, involved a long-standing customer who was a UK PEP. Despite the firm having already established sufficient information about the customer's wealth and expected salary from employment, the firm contacted the customer multiple times, and subsequently contacted their employer.

Examples of good practices regarding ongoing due diligence

One firm used previous information collected for EDD purposes, avoiding any unnecessary customer outreach.

One firm demonstrated a strong documented rationale for its risk-based approach to ongoing due diligence. It conducted further checks on SOF/ SOW due to the customer's potential exposure to sanctioned jurisdictions, to determine whether any funds had originated from any high-risk industries or sectors in these jurisdictions.

Actions firms should take

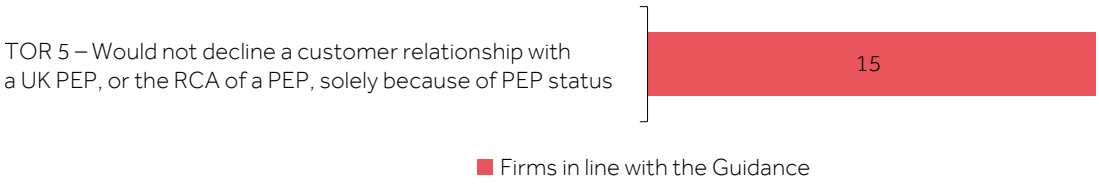
6.51 Firms need to review their current arrangements (policies, controls, procedures etc) to ensure they apply a risk-based, proportionate and effective approach to enhanced ongoing monitoring and ongoing due diligence for PEPs and RCAs. Their policies and procedures should be in line with the relevant requirements in Regulation 35(5)(c) and our Guidance and we suggest cross-referencing relevant parts of our Guidance.

Findings – ToR 5 – Where firms decide to reject or close accounts, are these decisions in line with the applicable legislation, the FCA Guidance and the Consumer Duty?

6.52 **Aim:** To assess if firms are deciding to reject or close accounts for PEPs, their RCAs; to check these decisions are in line with the applicable legislation, our Guidance, and the Consumer Duty.

ToR 5: Did firms have any practices of declining customer relationships with PEPs and RCAs, because of PEP status?

Figure 8: Firms declining customers because of PEP status



6.53 **Our current Guidance** Paragraph 2.13 states our expectations that firms should not decline or close a business relationship with an individual merely because that person meets the definition of a PEP, or because they are the RCAs of a PEP. PEPs and RCAs are not to be denied access to financial services without justifiable grounds not connected to the PEP's public function.

6.54 **Potential harmful impact on the treatment of customers** If policies and procedures are not sufficiently clear, PEPs and their RCAs might be unjustly denied access to financial services based on PEP status, causing anxiety and significant inconvenience. This could result in PEPs and RCAs needing to seek alternative providers, with likely disruption to services and potential distress. It may also reduce willingness to perform public roles if individuals perceive there are risks of being adversely affected from holding a PEP position.

6.55 **Potential impact on the adequacy of AML controls** A commercial policy/decision to not establish or maintain customer relationships with PEPs and RCAs is unlikely to have an impact on a firm's AML controls. However, this might also indicate that the firm's AML

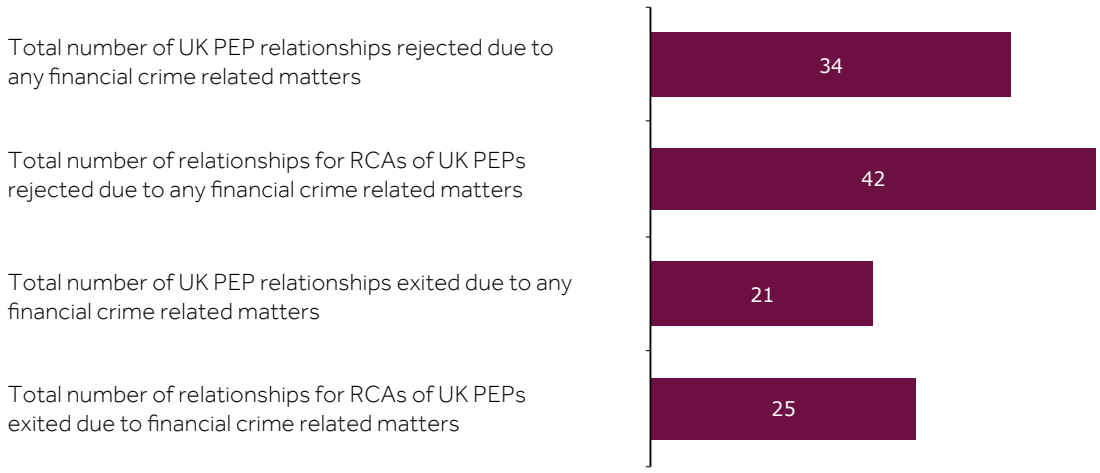
controls are not sufficiently mature for managing the risks from certain types of higher risk customers.

6.56 Based on our review of their policies, procedures and information, it was clear that none of the 15 firms assessed in detail said they would decline a customer relationship involving UK PEPs, or the RCAs of a UK PEP, simply because of PEP status. However, 2 of the 15 firms did not have a risk appetite statement specifically covering PEPs and RCAs. They told us that relationships with UK PEPs and RCAs are within their risk appetite and are governed with oversight from senior management.

6.57 Firms' policies were clear that where they identify concerns and issues involving financial crime, whether during customer onboarding or in the life cycle of an existing customer, they may decide to decline an application or terminate an existing relationship. However, this was not specific to PEP status and applies to all customer types.

6.58 For the period 1 July 2022 to 30 June 2023, 7 of the 15 firms rejected and/or exited one or more UK PEPs and/or RCAs for financial crime related matters, not because of PEP status, as illustrated in the figures below. The 15 firms assessed had a total of 8,234 UK PEPs and 10,989 UK RCAs. The values below equate to about 0.7% of UK PEPs (rejected and/or exited) and 0.6% of their RCAs (rejected and/or exited). Approximately 66% of the rejections and exits were by 1 firm. We also know that some PEPs and RCAs had applications declined for new products or services, and/or had existing accounts closed from the PEP submissions received. This will have included cases where the rejection or account closure was due to the customer not providing information the firm requested.

Figure 9: Rejections and exits of UK PEPs and RCAs



6.59 In our review of 40 customer files, we saw 1 case where the customer account was closed. We did not see any evidence that this was related to their PEP status.

6.60 As noted in the executive summary, some firms assessed in phase 1 (the initial larger group of firms considered), but not included in the 15 assessed in detail, have been undertaking significant ongoing remediation programmes for their AML controls. Due to those programmes, some firms had certain restrictions on customer onboarding.

For example, restrictions on onboarding certain customers (including PEPs) until they improved their overall AML controls.

Actions firms should take

6.61 Firms should consider clearly setting out, in their risk appetite statements, their position on establishing and maintaining customer relationships with all PEPs and RCAs, UK and foreign. Customers must be treated fairly and not harmed by PEP status or, for RCAs, through a PEP connection.

6.62 Any decisions on any 'new to firm' applications that are rejected, or any existing accounts terminated for customer relationships involving PEPs and RCAs, should be made on a justifiable and risk-sensitive basis. The decision-making process should include appropriate governance and oversight.

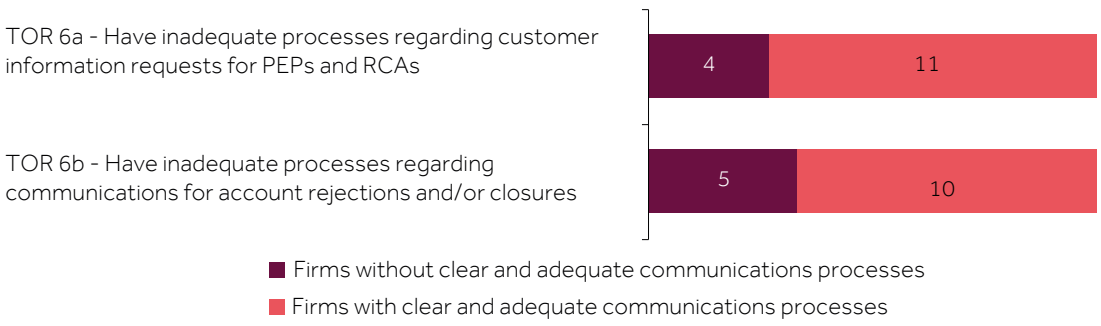
6.63 Where any firm has a temporary restriction that affects its onboarding of UK PEPs and RCAs, such as an AML controls remediation programme, this should be lifted as soon as the remediation reaches the stage where this is possible.

Findings – ToR 6 – Are firms effectively communicating with their PEP customers?

6.64 **Aim:** To assess if firms are effectively communicating with PEP and RCA customers when (i) opening an account (ii) seeking information to keep EDD up to date and (iii) when rejecting or closing accounts, including how firms approach questions or complaints from PEP customers.

6.65 We broke ToR 6 into 2 different component questions. 6(a) involves firms' communications when requesting information from PEPs and RCAs, for example, for ongoing due diligence, and 6(b) covers communications when rejecting an application or closing an existing customer account.

Figure 10: Firms' communications with PEPs and RCAs



6.66 **Our expectations** Firms should make sure they provide all customers, including PEPs and RCAs, with clear and adequate information. For example, an explanation for information and/or records requested where this is necessary. Doing so is consistent with expectations under the Consumer Duty.

6.67 **Potential harmful impact on the treatment of customers** If firms fail to clearly communicate their requests, or a decision to reject or close an account with PEPs and RCAs, this could cause anxiety and inconvenience. Firms are reminded that they must consider the Consumer Duty in how they communicate, which requires firms to act in good faith towards retail customers and to avoid causing foreseeable harm.

6.68 **Potential impact on the adequacy of AML controls** Failures to communicate clearly with customers may reduce the efficiency and effectiveness of a firm's AML controls. For example, it may result in a firm having to repeatedly follow up on requests for information and/or records. It may also undermine the firm's ability to get urgent information quickly from customers, e.g. in the event of AML triggers or escalations, account freezing or closure.

6(a): Did firms have inadequate communications processes when requesting information from PEPs and RCAs?

6.69 Our review showed that all the firms recognised the need for effective communications with customers. However, we saw that 4 of the 15 firms had inadequate processes for customer information requests. They did not make it sufficiently clear to customers why they were being asked for additional information. For 3 of these firms, the justification for the request was too generic, such as simply referring to the firm needing to satisfy its regulatory obligations.

Examples of good practices regarding communications used for information requests

One firm used a template letter which outlined the firm's regulatory obligations and explained its requirement to obtain due diligence information.

One firm used template communications with tailored sections outlining the specific information required and explaining which supporting documents are acceptable.

6(b): Did firms have inadequate communications processes when informing PEPs and RCAs about account rejections and/or account closures?

6.70 Based on the information from the 15 firms, including any examples and/or templates, 5 of these (including 3 from the finding above under 6(a)) had inadequate processes for communications regarding new account rejections and/or closures of existing accounts. This was mainly due to a lack of explanation. For example:

- One firm used templates that included the wording 'we won't be able to tell you why your account(s) has been closed.'

- One firm did not provide a template/letter for account rejection. It also gave no specific reason(s) for the 60-day account closure notification (as currently required), other than stating it was exercising its right under the Terms and Conditions.

Example of good practices for communications on account rejections or closures

One firm provided an example template for terminating an account. The reason provided was a breach of the 'Acceptable Use Policy' with a link to the relevant Policy. Another reason that might result in account termination was the customer's failure to provide information despite multiple requests.

Actions firms should take

6.71 When requesting information and/or records, communications should be clear and contain enough information to enable customers to understand the reason for the request and what is needed.

6.72 While complying with their legal obligations, good customer treatment includes effective communication. For example, explaining the reasons for any rejections of new application(s), or when deciding to terminate any existing customer account(s). In these situations, firms should provide customers with relevant contact details to help those who want to follow up or submit a complaint.

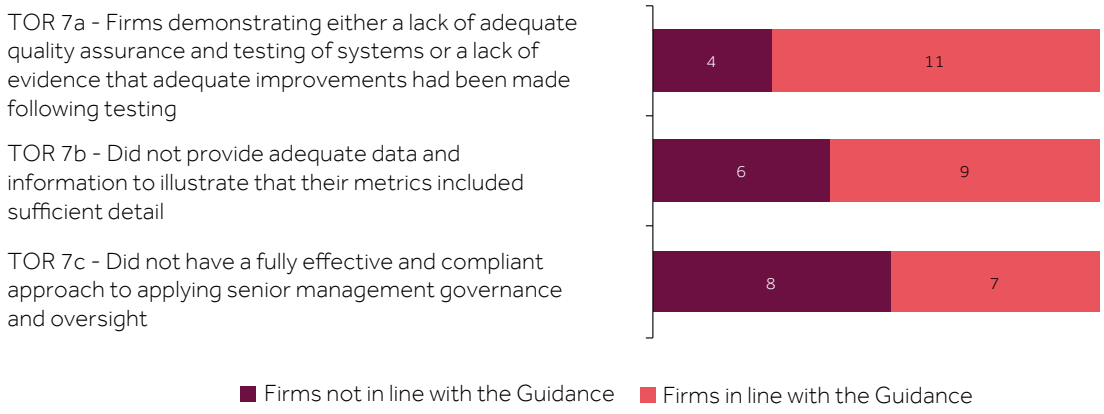
Findings – ToR 7 – Do firms keep their PEP controls under review to ensure these remain appropriate?

6.73 **Aim:** To assess if firms are keeping their PEP controls under review so they remain appropriate, including how their senior management are informed about and oversee the operation of PEP controls.

6.74 We broke ToR 7 down to 3 component questions. 7(a) relates to quality assurance and testing by firms, 7(b) is about the adequacy of Management Information ('MI') and 7(c) involves senior management approvals and oversight of PEPs and RCAs.

7(a): Did firms have inadequate quality assurance and testing of systems, or a lack of evidence that adequate improvements had been made following testing?

Figure 11: Keeping PEPs' AML systems and controls under review



6.75 **Our expectations** Quality assurance and testing of AML systems and controls are important to assess effectiveness and identify any deficiencies, so that these can be corrected. Our Financial Crime Guide (paragraph 2.2.5) sets out that firms should monitor the effectiveness of their policies, procedures, systems and controls. Regulation 21 supports the expectation that firms should regularly examine and evaluate the adequacy and effectiveness of their policies, controls and procedures.

6.76 **Potential harmful impact on the treatment of customers**. Without regular testing, firms cannot apply lessons learned which, if correctly applied, could reduce any negative impact on their treatment of PEPs and RCAs and the number of complaints they receive.

6.77 **Potential impact on the adequacy of AML controls**. Without testing, firms will fail to identify and address issues where their controls need improvement to achieve effective and compliant standards.

- Four of the 15 firms did not provide sufficient evidence of adequate and effective quality assurance and testing of their systems and controls in the last 2 years, or evidence that they had made adequate improvements following any testing.
- Two other firms out of the 15 told us they had made improvements as a result of internal testing. However, 1 had not fully embedded the recommendations, while the other did not provide any evidence about the improvements made.
- Two firms (including 1 of the above 2) told us they had carried out reviews but did not provide any evidence to show these had specifically assessed the firms' compliance with the regulations and our Guidance on PEPs.

7(b): Did firms have issues involving a lack of adequate management information (MI) on the risk management and treatment of PEPs and RCAs?

6.78 **Our expectations** Failing to produce adequate MI may adversely impact senior management's oversight of the firm's performance, including the risk management and treatment of PEPs and RCAs. Our Financial Crime Guide (2.2.2) sets out that MI provided to senior management should include relevant information about business relationships, as well as an overview of the effectiveness of the firm's financial crime systems and controls.

6.79 **Potential harmful impact on the treatment of customers**. A lack of MI metrics on PEPs and RCAs, e.g. the number of account rejections or closures, could adversely affect these customers' treatment if a firm is declining or exiting relationships, contrary to its own policies and risk appetite. MI enables senior management to have oversight. Without it, senior managers may not be aware of any emerging risks or issues within their firm.

6.80 **Potential impact on the adequacy of AML controls**. Without effective MI, a firm will be less able to analyse relevant key risk indicators and key performance indicators, as well as any trend analysis. A lack of adequate data will have an impact on senior management's oversight. The JMLSG Guidance – Part I, para. 3.35 (reinforced by paragraph 4.72) makes it clear that appropriate information should be available to senior management.

6.81 Based on the documentation and information reviewed, we saw issues about the MI and data on PEPs and RCAs involving 12 of the 15 firms:

- Six did not include adequate data and information in their MI metrics on PEPs and RCAs.
- Six other firms lacked more granular detail, such as collating the data into different categories, for example UK PEPs, foreign PEPs and RCAs of a PEP.
- Three firms from the 12 focused on operational metrics such as service level agreements rather than specific PEPs data.
- Two firms from the 12 did not have any PEP specific metrics to enable internal review. Instead, they relied on other reporting mechanisms to external regulators, such as the FCA's REP-CRIM and regulatory engagement activities.

7(c): Did firms have issues involving not having fully effective arrangements for senior management governance and oversight of PEPs and RCAs?

6.82 **Our expectations:** Senior management need to have effective oversight, including a risk-based approach to the approval process when establishing and maintaining relationships with PEPs and RCAs. Our Guidance sets out that, for lower risk PEP relationships, the Money Laundering Reporting Officer can provide sign-off for opening or maintaining a business relationship. Paragraph 2.36 states that, for higher risk PEPs, this should involve a more senior level of management.

6.83 **Potential harmful impact on the treatment of customers** Where firms do not apply the flexibility provided in our Guidance they may, in lower risk cases, unnecessarily escalate approvals for PEPs and RCAs. This process might result in delays to account approval and opening where these escalations might be unnecessary.

6.84 **Potential impact on the adequacy of AML controls** As PEPs may pose an increased inherent risk of money laundering, these relationships are subject to appropriate senior management oversight. Any lack of this oversight may result in inadequate challenge and scrutiny to the approval process. We remind firms that senior management approval to establish and/or maintain a business relationship with PEPs and RCAs is a mandatory requirement under legislation (Regulation 35(5)(a)), so any failure could result in breaching these obligations.

6.85 Based on the policies and procedures reviewed, as well as the customer file reviews, we saw that 9 firms of the 15 did not have a fully effective approach to applying senior management governance and oversight to PEPs and RCAs.

- One firm's policies did not mention that, where the firm proposes to enter into, or continue, a business relationship with a PEP, or the RCAs of a PEP, senior management approval is required.
- One firm's policies lacked detail demonstrating risk-based levels of sign-off, proportionate to the PEPs risk rating.

6.86 Customer file testing identified that:

- In 3 instances across 2 firms, the PEP customer files did not include evidence of senior management sign-off.
- For a different firm, we saw 3 customer files with issues involving the sign-off process. This included 1 file which was not approved by a person with sufficient seniority and another which was not signed off by all relevant stakeholders, in line with the firm's internal policy.

Examples of good practices in Senior Management approval

Proportionate level of sign-off based on PEP risk rating, with individuals of less seniority approving lower risk PEPs and more senior management approving higher risk PEPs.

Evidence of escalation to relevant committees for higher risk PEPs. For example, undergoing a governance process and decision-making before relationships are established and/or retained.

Approval process involving stakeholders in the first and second lines of defence, including clearly documented rationale for decision making, and audit trails.

Actions firms should take

6.87 Firms should perform regular testing of their AML systems and controls, to assess ongoing effectiveness and compliance with their obligations and our Guidance, and to identify any gaps or weaknesses that need to be addressed. Firms should also ensure senior management have effective oversight of customer relationships involving PEPs and RCAs, including receiving meaningful MI. Senior Management must be involved in the approval process for establishing and maintaining PEP relationships. Firms should apply the flexibility our Guidance affords in taking a risk-based approach to senior management approval as set out in paragraph 2.15 of our Guidance.

Chapter 7

Additional findings not specifically related to our Guidance – observations on wider systems and controls for firms' risk management and treatment of PEPs

7.1 The review also looked at other AML controls in the 15 firms' wider systems and controls on PEPs and RCAs. We identified some weaknesses regarding staff training, and the need to improve policies and procedures.

Staff training on PEPs' systems and controls

7.2 **Our expectations** Regulation 24 requires firms to take appropriate measures to ensure employees are aware of their AML risks and requirements. Our Financial Crime guide (2.2.6) sets out that training should be appropriate to employees' roles. Firms should ensure relevant staff have effective knowledge and training, including identifying and defining PEPs and RCAs, the customer due diligence and EDD requirements and processes.

7.3 Based on the documentation and information reviewed, we saw that 10 of the 15 firms needed to improve their staff training. We also identified 1 other firm that had no provision for specific staff training on PEPs. Common weaknesses seen were:

- For 8 firms, the training materials lacked practical examples including case studies, good and poor practices on the risk management and treatment of PEPs.
- In 3 of these 8 firms there was inconsistency between the training and staff guidance. For example, differing PEP definitions and references to risk ratings such as 'very high risk' without any explanation or accompanying definition.

Examples of good practices in staff training

One firm provided training that included case studies and internal cases.

One firm provided staff guidance on adverse media screening and searches, with practical examples to generate critical thinking and discussion, and helping staff to differentiate the UK approach to PEPs risk management against other jurisdictions where the firm operates.

Global Policies and Procedures

7.4 **Potential harmful impact on the treatment of customers** Where global policies go beyond the UK requirements and our Guidance, PEPs and RCAs could be adversely impacted. For example, firms may apply broader PEPs definitions than those set out in our Guidance, and/or may not declassify PEPs and RCAs in a way that is consistent with the UK regulations and our Guidance.

7.5 **Potential impact on the adequacy of AML controls** AML controls for UK PEPs and RCAs, as well as other lower risk PEPs, may involve excessive risk management measures that are not effectively risk-based. This may generate inefficiencies, resulting in an opportunity cost where resources could have been directed to higher risk PEPs and RCAs.

7.6 Twelve of the 15 firms assessed operate under group (or international) policies and procedures and group guidance governing the risk management and treatment of PEPs and RCAs. For 4 of these 15 firms, the policies and procedures for the UK need improvement to ensure they are fully aligned and effectively reflect UK legislative requirements and our Guidance on the treatment of PEPs and RCAs.

7.7 If firms fail to do this, there is a risk of using measures that are inconsistent with the requirements in the UK regulations and our Guidance, with a potentially adverse impact on PEPs and RCAs. This might involve applying definitions to individuals who should not be classified as PEPs, not declassifying PEPs and RCAs in line with the regulations and our Guidance and not applying risk-based and proportionate EDD measures.

Examples of good practices in firms' policies and procedures

Policies and procedures which clearly refer to relevant parts of our Guidance on PEPs.

Clear differentiation between the levels of senior management approval and oversight for non-high risk and high-risk PEPs, proportionate to the risk.

Policies and procedures covering the different PEP definitions and declassification requirements to be applied in certain countries. This included PEP classification guidelines on how the definition of PEPs and RCAs will differ based on requirements in different jurisdictions where the firm operates.

Actions firms should take

7.8 Firms operating under group-wide or global/international policies and procedures need to ensure these include and clearly reflect UK requirements. For example, this could be achieved through a UK-specific addendum to accurately reflect the relevant regulations and our Guidance to achieve a compliant approach and application. Where group or

global policies are currently not fully consistent, firms will need to amend and align these with the regulations and our Guidance on PEPs.

7.9 More generally, firms can improve their policies and procedures by including more detailed and practical guidance for staff, particularly on the risk-based approach to EDD. This could include practical examples, case studies and good and poor practices, to achieve consistency. We suggest cross-referring the relevant parts of our Guidance to their policies. Firms should ensure their policies and procedures are aligned with the updated provisions in Regulation 35 on UK PEPs and RCAs.

7.10 Firms must also ensure that staff training is effective so that personnel have the appropriate knowledge and ability to manage customer relationships with PEPs and RCAs in full compliance with the relevant requirements and our Guidance.

Implementation of the Statutory instrument (SI) 1371 in January 2024

7.11 We looked at whether the 15 firms had made any changes following the amended Regulation 35. Ten firms had taken actions, such as updating their policies, implementing new processes and rolling out staff training. Some introduced a specific 'low-risk' rating for UK PEPs and RCAs who had no other enhanced risk factors. Three firms had ongoing or pending work to implement new standards and to align their policies and procedures with the updated regulation. The other 2 firms told us their policies and procedures did not need amending, but we provided feedback to 1 of these based on our assessment of their systems and controls.

Applying the Consumer Duty

7.12 The Consumer Duty introduced a more outcomes-focused approach to consumer protection, setting high expectations for firms' standard of care to their customers. It applies to all authorised firms conducting retail market business and comprises:

- **The Consumer Principle** – reflects the overall standard of behaviour we want from firms and requires them to act to deliver good outcomes for retail customers.
- **'Cross-cutting rules'** – these require firms to act in good faith towards retail customers, avoid causing them foreseeable harm and enable and support them to pursue their financial objectives.
- **'Four outcomes'** in areas that represent key elements of the firm-consumer relationship: governance of products and services; price and value; consumer understanding and consumer support.

7.13 We found that none of the 15 firms had implemented changes to any policies and procedures specific to PEPs in light of the Consumer Duty. However, 3 firms had updated their wider policies and procedures which positively affected all customers, not just PEPs.

Examples of good practices for the Consumer Duty

Ahead of the Consumer Duty coming into effect, a firm developed a handbook to help staff understand the reasons for and requirements of the Duty.

One firm made improvements which included implementing specific controls to help compliance with the Consumer Duty rules and monitoring performance through governance committees.

Actions firms should take

7.14 Firms should consider the Consumer Duty in their treatment of PEPs and RCAs and make any appropriate changes and/or updates to their current policies and procedures if needed.

7.15 Firms should, in particular, consider how they are implementing the cross-cutting rules, the consumer understanding outcome and the consumer support outcome in their financial crime policies and procedures.

Annex 1

Glossary of common terms used

Term	Meaning
AML	Anti-money laundering. See 'money laundering.'
Customer Due Diligence (CDD)	'Customer due diligence' ('CDD') describes the measures that firms must take to identify and verify their customers. CDD also includes assessing, and where appropriate, obtaining information on the purpose and intended nature of the business relationship.
Customer Risk assessment	Regulation 28(12)(13) outlines the requirements for firms to conduct a risk assessment and the risk factors the firm should take into account (Regulation 18(1)).
Enhanced Due Diligence (EDD)	Regulations 33-35 require firms to apply additional, 'enhanced' measures in higher risk situations (see FCG 3.2.7G to FCG 3.2.9G), including a mandatory requirement for EDD for PEPs and RCAs.
Family members and known close associates. Together referred to as "RCAs"	Regulation 35(12)(b) defines a family member of a PEP as persons including a spouse or civil partner of a PEP, children of the PEP and the spouses or civil partners of the PEPs children, and the parents of a PEP. Our Guidance gives further detail on the definitions. Regulation 35(12)(c) defines a known close associate of a PEP as being either an individual known to have joint beneficial ownership of a legal entity or a legal arrangement; or any other close business relations with a PEP or 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. For the purposes of this report, family members and known close associates are referred to as 'RCAs'
Financial Action Task Force (FATF)	An intergovernmental body that develops and promotes AML and counter terrorist financing standards worldwide.
Financial Crime	This is generally a term used for acquisitive crime where the perpetrator(s) achieves an illicit financial gain. The Financial Services and Markets Act 2000 defines financial crime 'to include any offence involving (a) fraud or dishonesty; (b) misconduct in, or misuse of information relating to, a financial market; or (c) handling the proceeds of crime'. The term 'to include' means that financial crime can be interpreted widely to include, for example, corruption or funding of terrorism.

Term	Meaning
Our Guidance	This refers to the Guidance we provide to firms regarding the treatment of politically exposed persons for anti-money laundering purposes under FG17/6
Joint Money Laundering Steering Group (JMLSG)	An industry body made up of financial sector trade bodies. It produces guidance on compliance with legal and regulatory requirements regarding money laundering.
Money Laundering	The process by which the proceeds of crime are converted into assets which appear to have a legitimate origin, so that they can be retained permanently, or recycled to fund further crime.
Money Laundering Regulations 2017	These regulations require firms to take steps to detect and prevent both money laundering and terrorist financing. The regulations identify the firms we supervise and impose a duty on us to take measures to ensure those firms comply with the requirements under the regulations.
Ongoing Monitoring	Regulation 28(11) requires ongoing monitoring of business relationships. This means that the firm scrutinises customer transactions and other aspects of their behaviour, throughout the course of their relationship. This is to identify where a customer's actions are inconsistent with what might be expected given what is known about them, their risk profile etc. Where the risk from the business relationship is increased, firms must strengthen their ongoing monitoring on a risk-sensitive basis. Firms must also update the information they hold on customers for anti-money laundering purposes. Regulation 33(5) states that, as part of EDD, this ongoing monitoring should be increased including greater scrutiny of transactions.
Policies and Procedures	Regulation 19(1) outlines that firms should establish and maintain policies, controls and procedures to mitigate and effectively manage the risks of money laundering to which they are exposed.
Politically exposed person (PEP)	A person entrusted with a prominent public function under Regulation 35 and our Guidance 'FG17/16: The treatment of politically exposed persons for AML purposes'.
Quality Assurance (QA) and Testing	Process used to evaluate and test if the firm's policies, controls and procedures are being applied correctly and effectively in practice in delivering the firm's products and services to customers. QA and testing are necessary to ensure the firm's operations are compliant with its legal and regulatory obligations, and consistent with the relevant internal and external guidance. QA and testing should identify any failings or weaknesses that could damage the firm's capability and operational performance.

Term	Meaning
Regulation or regulations	See Money Laundering Regulations 2017
Risk appetite (customers)	The amount and extent of risk that a firm is willing to take when deciding the types of customers that are within its acceptability criteria from a financial crime risk perspective, and with whom it is willing to establish and maintain a business relationship.
Systems and Controls	The firm's policies, controls, procedures and resources used to implement its financial crime strategy and systems, so that the firm can effectively identify, assesses, mitigate and manage the financial crime risk risks to which it is exposed through its business model and activities.
Source of Funds (SOF)	'Source of funds' refers to the origin of the funds in the business relationship or occasional transaction. It refers to the activity that generated the funds, for example salary payments or sale proceeds, as well as the means through which the customer's or beneficial owner's funds were transferred.
Source of Wealth (SOW)	'Source of wealth' describes how a customer has acquired their total wealth.

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