

Review of the treatment of domestic politically exposed persons (PEPs): terms of reference

Summary

The FCA is launching a review of how regulated firms treat domestic PEPs. The review will assess how firms are meeting the anti-money laundering (AML) legislation and our guidance to conduct proportionate and risk-based due diligence on their clients.

International standards for AML are set by the Financial Action Task Force (FATF) and the UK has implemented its AML standard through legislation passed in parliament which requires that additional measures are taken for those who are PEPs. The FCA's role is to give guidance on the implementation of those standards.

We are carrying out this review because of concerns that firms may not be treating customers individually as directed by both the legislation and FCA guidance. This matters as individuals may find themselves excluded from products or services through no fault of their own. As well as potential unfairness, this also potentially harms the reputation of the UK's financial services sector. The review will seek input from UK PEPs, and their family members and known close associates. It will assess firms' arrangements, ensuring that we include firms where there is intelligence that indicates concerns in their conduct with PEPs. We will take prompt action if we identify any significant problems in the arrangements of any firm assessed. We will share with HM Treasury our findings that may have bearing on the statutory framework. By 29 June 2024, we will publish our findings and, if necessary, initiate a consultation on revised guidance.

This review is being conducted in compliance with Section 78 of the Financial Services and Markets Act 2023.

Introduction

The anti-money laundering (AML) obligations under the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations (MLRs), require firms to carry out additional scrutiny when dealing with people who hold prominent public functions, wherever in the world they hold them (commonly known as Politically Exposed Persons, PEPs). This is because PEPs may be able to abuse their public office for private gain and may use the financial system to launder the proceeds of this abuse of office. The MLRs require firms to apply extra measures, known as enhanced due diligence

(EDD), to PEPs. This includes information about their source of wealth. EDD must also be applied to any family members or close associates of PEPs.

In July 2017, we published guidance FG17/6 (our Guidance) to help the firms we supervise under the MLRs to apply a proportionate and risk-based approach to PEPs. In line with the legislation, this guidance made clear that domestic PEPs, and their family members or known close associates, should be treated as 'lower risk', as long as there are not any other risk factors outside of their position as a PEP. As the guidance sets out, in conducting due diligence for lower risk PEPs, firms should be using information that is reasonably available to them, including information in the public domain, and take less intrusive steps to establish their source of wealth than they use for other PEPs. Only where there are higher risk indicators (not linked to their position as a PEP) should the firm take more intrusive measures. The guidance also made clear that we expect a firm will not decline or close a business relationship with a person merely because that person meets the definition of a PEP (or is a family member or known close associate of a PEP). Since 2018, PEPs as well as their family members and known close associates have also been able to complain to the Financial Ombudsman Service about their treatment.

We have heard from domestic PEPs that firms may not be applying an effective and proportionate risk-based approach to them and their family or known close associates. Intelligence also indicates that some firms could be using standardised questionnaires, used automatically, for PEPs and their family members and known close associates that may not sufficiently recognise the expectations on lower risk for UK domestic PEPs. There is a concern that firms may be failing to properly implement our guidance. This matters as individuals may be excluded from products or services through no fault of their own.

We have taken several steps to remind the financial industry and specific firms that they should follow our guidance- which makes clear that firms should take a proportionate approach- and that we take non-compliance seriously. We also collect regular information from a number of firms on the number of domestic PEPs they have. This includes information about account closures or rejections to help us monitor these firms' conduct.

We expect firms to explain how appropriately they are implementing their AML controls under the MLRs, and how these meet the FCA's Consumer Duty which came into force on 31 July this year.

Conduct of Review in Accordance with FSMA 2023

Section 78 of the Financial Services and Markets Act 2023 requires the FCA to review the way that firms are applying the guidance and, following that assessment, to consider whether this guidance remains appropriate or requires amendment. The Act requires that this work is completed within 12 months,

and that we publish these terms of reference within 3 months of the act coming into force on 29 June 2023.

Our Approach to the Review

Our work will assess how firms manage the risks from UK PEPs and their family members or known close associates, in line with the risk-based approach outlined in the MLRs and our guidance. This will include how firms:

- Are applying the definition of PEPs to individuals who truly hold prominent positions (and not applying the definition to local government, more junior members of the senior civil services or anyone other than the most senior military officials).
- Are conducting proportionate risk assessments of UK PEPs, their family members and known close associates. This will include how firms take into account any other risk factors outside the customer's position as a PEP.
- Carry out risk-based and proportionate EDD of individual customers.
- Are applying enhanced ongoing monitoring for PEPs and keeping EDD up to date for UK PEPs so that it is proportionate and commensurate based on the risk.
- Decide to reject or close accounts for PEPs, including their family members and known close associates, to check these decisions are in line with the applicable legislation, our Guidance and the consumer duty.
- Are effectively communicating with their PEP customers when opening an account, seeking information to keep EDD up to date and when accounts are closed. This includes how firms approach questions or complaints from these customers, and
- Keep their PEP controls under review to ensure they remain appropriate, including how their senior management are informed about and oversee the operation of PEP controls.

This review will consider the concerns around domestic PEPs as part of the wider context of firms' controls to ensure they are managing the overall risks of all PEPs effectively and proportionately. Our guidance makes clear that in the UK firms' controls need to be tailored to the requirements of the UK rules. As part of the review, we will also consider whether the approach of firms, in particular those headquartered overseas, to UK PEPs is driven by other international requirements that could apply to those firms.

The assessment above will be informed by:

- Engagement and feedback with UK PEPs themselves, and/or their family members and known close associates, to understand their experiences and problems they have had with regulated firms.
- Information collected from relevant firms and other stakeholders such as the Financial Ombudsman Service, and
- Risk based supervisory reviews of firms, based on the information collected from firms and from their customers, to assess how they are implementing their policies and procedures in practice in adherence to the law and guidance. As well as firms selected because of intelligence that indicates concerns, we will also assess firms with different practices to identify good practices.

Responding to the Findings

In conducting our review, we will be prioritising firms where intelligence indicates concerns in their conduct with PEPs. If we find significant problems in the arrangements of any firm we will take prompt action with that firm to resolve those problems, and not wait for the completion for the review.

On completion of the review, we will publish our findings on the FCA website. If the review identifies we need to amend our guidance, we will publish a consultation on doing so. Any consultation will also consider any changes needed to the guidance following amendments to the MLRs made by the Government in response to section 77 of the Financial Services and Markets Act 2023.