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Politically Exposed Persons Regime

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Summary

Politically exposed persons (PEPs) are individuals around the world with "prominent public functions". Obvious examples are Government Ministers and Members of Parliament.

The law recognises the risk of PEPs abusing their positions for private gain and using the financial system to launder the proceeds of this abuse. PEPs, as well as their families and close associates, must therefore go through enhanced scrutiny when using the services of certain firms that act as "gatekeepers" to the financial system, such as banks.

The Financial Action Task Force is an international body that sets and monitors anti-money laundering and counter-terrorist financing standards. Its recommendations (including on PEPs) have been adopted at EU level through directives, which have been implemented in the UK by secondary legislation.

UK law requires "gatekeepers" to the financial system to perform enhanced checks on PEPs, their families and their known close associates. Such firms need to have measures in place to identify PEPs, assess the level of risk they pose, and manage the relationship appropriately. Criminal and regulatory sanctions are available for non-compliance.

Criticism of the regime by PEPs, including British MPs, has focused on two points:

- firstly, on the relatively recent requirement to treat domestic and foreign PEPs alike, even for domestic PEPs without formal executive power; and
- secondly, on perceived overly-cautious approaches taken by some risk-averse firms, which it has been argued resulted in disproportionate due diligence measures taken against PEPs, their families or their close associates.

Financial Conduct Authority guidance published in July 2017 sought in part to address these issues.

In a December 2018 report, the Financial Action Task Force rated the UK "compliant" with its main recommendation on PEPs, noting that "all criteria are met".

For wider information about economic crime in the UK, see our briefing Economic crime in the UK: a multi-billion pound problem.

1. Background

Politically exposed persons (PEPs) are individuals around the world with "prominent public functions". Obvious examples are Government Ministers and Members of Parliament.

The law recognises the risk of PEPs abusing their positions for private gain and using the financial system to launder the proceeds of this abuse. PEPs, as well as their families and close associates, must therefore go through enhanced scrutiny when using the services of certain firms.

The law on PEPs

The Financial Action Task Force (FATF) sets international standards for countering money laundering and terrorist financing, including on the treatment of PEPs. It is an inter-governmental body set up in 1989 which now has 37 members (including the UK).[1]

A series of EU directives – six in total - have incorporated and built on these standards, requiring Member States to implement them.

The UK Government decided not to opt into the EU's *Sixth Money Laundering Directive*[2] on the basis that "The UK's domestic legislation is already largely compliant with the Directive's measures" and in fact "goes much further" in some areas.[3] The most recent directives applicable to the UK therefore are the *Fourth and Fifth Money Laundering Directives*[4] (MLD4 and MLD5). These were implemented in the UK by the *Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017* (as amended by the *Money Laundering and Terrorist Financing (Amendment) Regulations 2019*) (the MLRs).

The MLRs are the current law in this area. Following the transition period agreed with the EU, the UK will no longer be required to implement EU law. Any future changes to money laundering laws can be made by the Government using secondary legislation under the *Sanctions and Anti-Money Laundering Act 2018*.[5]

Regulation 48 of the MLRs imposes a duty on the Financial Conduct Authority (FCA) to issue guidance about the enhanced customer due diligence measures required for PEPs (the FCA Guidance). These were published in July 2017.

The concept of PEPs was used in the creation of Unexplained Wealth Orders (UWOs) under the *Criminal Finances Act 2017*. This briefing deals with the primary regime for PEPs under money laundering law and

1 Financial Action Task Force, FATF Members and Observers
2 OJ L 284/22, 12 November 2018
3 Home Office and Ministry of Justice, Eighth Annual Report to Parliament on the Application of Protocols 19 and 21 to the Treaty on European Union (TEU) and the Treaty on the Functioning of the Union (TFEU) in Relation to EU Justice and Home Affairs (JHA) Matters (1 December 2016 – 30 November 2017), February 2018, p7
4 OJ L 141/73, 5 June 2015 (MLD4) and OJ L 156/43, 19 June 2018 (MLD5)
5 Explanatory Notes, Sanctions and Anti-Money Laundering Act 2018, para 8

does not address UWOs - see our briefing on UWOs for more information on them.

For information on the threat of economic crime in the UK, see our briefing Economic crime in the UK: a multi-billion pound problem.

2. The PEP regime

2.1 Who is a PEP?

The MLRs define a PEP as "an individual who is entrusted with prominent public functions, other than as a middle-ranking or more junior official".[6] It includes ministers, MPs, ambassadors, and judges who sit on supreme courts.

The full list

The list of people who should be treated as PEPs comprises:

a. heads of state, heads of government, ministers and deputy or assistant ministers;

b. members of parliament or of similar legislative bodies;

c. members of the governing bodies of political parties;

d. members of supreme courts, of constitutional courts or of any judicial body the decisions of which are not subject to further appeal except in exceptional circumstances;

e. members of courts of auditors or of the boards of central banks;

f. ambassadors, charges d'affaires and high-ranking officers in the armed forces;

g. members of the administrative, management or supervisory bodies of State-owned enterprises;

h. directors, deputy directors and members of the board or equivalent function of an international organisation.[7]

The list is non-exhaustive, and the MLRs only say that PEPs "include" the above.

The list applies to people in the UK - so British MPs, for example, are PEPs. In a UK context, the FCA guidance has provided that:

> firms should only treat those in the UK who hold truly prominent positions as PEPs and not to apply the definition to local government, more junior members of the senior civil service or anyone other than the most senior military officials.[8]

Family members and close associates

The enhanced due diligence requirements also apply to "family members" and "known close associates" of PEPs.

The MLRs define a family member as:

- a spouse or civil partner of the PEP;
- children of the PEP and the spouses or civil partners of the PEP's children; or
- parents of the PEP.

Again, this is not an exhaustive list. The FCA Guidance considers that siblings should be included. It also says that for PEPs which are assessed

6 Reg 35, para 12
7 Reg 48, para 14
8 FCA Guidance, para 1.6

to pose a particularly high risk, "it may be appropriate to include a wider circle of family members (such as aunts and uncles)".[9]

Known close associates of PEPs are defined as:

- 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.

An obvious example would be a business partner of a PEP. The MLRs make clear that when deciding whether someone is a known close associate of a PEP, it only needs to have regard to information in its possession or which is publicly available from a credible source.[10]

2.2 To whom does the obligation apply?

The enhanced due diligence obligations for PEPs apply to firms considered to be 'gatekeepers'[11] to the financial system - gatekeepers are "essentially, individuals that 'protect the gates to the financial system' through which potential users of the system, including launderers, must pass in order to be successful".[12] Within its scope are typical banks, law and accountancy firms, and estate agents.

The full list

The full list of "relevant persons" to whom the obligations apply are:

a. credit institutions;
b. financial institutions;
c. auditors, insolvency practitioners, external accountants and tax advisers;
d. independent legal professionals;
e. trust or company service providers;
f. estate agents and letting agents;
g. high value dealers;
h. casinos;
i. art market participants;
j. cryptoasset exchange providers; and
k. custodian wallet providers.

The MLRs then go into further detail on each of these. For example, a high value dealer (part g. above) is someone who accepts or makes high value cash payments of EUR 10,000 or more (or its equivalent in another currency),[13] which might include a business that deals in cars.

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9 FCA Guidance, para 2.23
10 Reg 35, paras 12 and 15
11 See for example the European Commission's analysis, Anti-money laundering and counter terrorist financing
12 FATF Report, Laundering the Proceeds of Corruption, July 2011, p19
13 See Reg 14(1)(a) and Gov.uk, Money laundering supervision for high value dealers

2.3 What is the obligation?

The obligation is to "apply enhanced customer due diligence measures and enhanced ongoing monitoring".[14] For "relevant persons" this means they need to:

- have appropriate procedures in place to be able to **identify** whether a customer (or their beneficial owner) is a PEP (or a family member or known close associate of a PEP), and manage the enhanced risks that might arise from such a business relationship;
- once that customer has been identified as a PEP (or their family member or known close associate) to **assess** the level of risk associated with that customer, and the extent to which enhanced due diligence measures needs to be carried out; and
- to **manage** the enhanced risks arising from the business relationship with such a customer.[15]

Taking each of these in turn:

Identifying PEPs

The obligation is to have in place "appropriate risk-management systems and procedures" to identify PEPs, their family members and known close associates. This includes where that customer is acting through an agent (such as a solicitor on a property transaction). The FCA Guidance list three sources firms might use as part of the identification process:

- "Public domain information" like websites, reliable news sources and the work of reputable pressure groups focused on corruption risk;
- "Reliable Public Registers" which in the UK might include registers maintained by Companies House and the Electoral Commission; and
- if appropriate for the nature and size of the firm, "commercial databases" that contain lists of PEPs, family members and known close associates.

There is no rule that applies to all firms (although industry-specific guidance is available) – each must make an individual assessment of what procedures are appropriate taking into account factors like the general risk of money laundering and terrorist financing to its business and the extent to which that risk might be increased by establishing business relationships with a PEP, their family member or their known close associate.[16]

Assessing risk

Where a firm's systems have identified a person as a PEP (or their family member or close associate), they need to "assess the level of risk

14 Reg 33(1)
15 Reg 35(1) and (3)
16 Reg 35(2)

associated with that customer" and therefore "the extent to which enhanced due diligence measures need to be carried out".

The FCA Guidance makes clear that firms should not refuse or terminate a business relationship simply because it has identified that the customer is a PEP. In such a case, the firm should collect appropriate information and assess the risk; only if the risks are higher than they can mitigate will it be appropriate to decline or terminate that business relationship.[17]

Three factors are listed in the FCA Guidance as indicators of the level of risk in dealing with a particular PEP (or their family or close associate):

1 **The product being sold**. Some products are more capable of being misused to launder the proceeds of large-scale corruption than others;

2 **Geography**. A lower risk can be determined where the information available to the firm suggests that that country of that PEP has certain characteristics, such as an association with low levels of corruption, political stability, and free and fair elections; and

3 **Personal and professional**. Lower levels of risk are suggested by an individual who must meet rigorous disclosure requirements (such as through registers of interests) or who do not have executive decision-making responsibilities (such as opposition MPs). Higher levels of risk would be suggested by someone, for example, who has personal wealth or a lifestyle which is inconsistent with known legitimate sources of income or wealth.

A family member or close associate of a PEP will naturally pose a lower risk if the PEP themselves poses a lower risk. For such people, high-risk factors include appointment to a public office that appears inconsistent with personal merit.[18]

In any case, the MLRs state that when commencing or proposing to continue a business relationship with a PEP (or their family member or associate), the firm must:

- have approval from senior management;
- take adequate measures to establish the source of wealth and source of funds which are involved; and
- conduct enhanced ongoing monitoring of the business relationship with that person.[19]

Managing the risk

Once the risk has been assessed, the firm needs to take measures proportionate to the level of risk. The FCA Guidance suggests, for example, that in a higher risk situation: (i) more intrusive and exhaustive steps should be taken to establish the source of funds; (ii) oversight and approval of the business relationship should take place at a more senior

[17] FCA Guidance, paras 2.12 and 2.13
[18] Ibid, paras 2.29 to 2.31
[19] Reg 38, para 5

level of management; and (iii) the business relationship should be subject to more frequent and formal review.[20]

Other enhanced customer due diligence measures set out in the MLRs that firms might consider appropriate to take include:

a. seeking additional independent, reliable sources to verify information provided or made available;

b. taking additional measures to understand better the background, ownership and financial situation of the customer, and other parties to the transaction;

c. taking further steps to be satisfied that the transaction is consistent with the purpose and intended nature of the business relationship; and

d. increasing the monitoring of the business relationship, including greater scrutiny of transactions.[21]

If a firm is unable to apply the measures needed to ensure an appropriately enhanced level of due diligence, it should refuse or terminate the business relationship.[22]

2.4 Enforcement

Firms or individuals that breach the enhanced due diligence requirements for PEPs (or their families or close associates) imposed on them are committing a criminal offence, punishable by a fine and/or up to two years in prison. It is a defence to show that all reasonable steps were taken, and all due diligence was exercised, to avoid committing the offence. There are also separate offences for prejudicing investigations and providing false or misleading information.[23]

Civil (non-criminal) penalties that can be imposed include (i) regulatory fines; (ii) publishing statements of censure; (iii) the cancellation, suspension or limitation of permissions a person might have to conduct regulated financial activities; and (iv) prohibitions on officers of firms serving in management roles if they were knowingly involved in a breach.[24]

In 2015 the FCA fined Barclays £72m for failing to undertake enhanced due diligence on political exposed persons.[25] In June 2020 Commerzbank were fined £37m, in part because the way it "identified and considered the risks associated with politically exposed persons…was inadequate".[26] Although issued in relation to conduct under the previous regime, these fines indicate the potentially heavy consequences of non-compliance.

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20 FCA Guidance, paras 2.35 and 2.36
21 Reg 38, para 1
22 Reg 31, para 1 and FCA Guidance, para 2.14
23 Reg 86 to 88
24 Reg 76 to 78
25 FCA, FCA fines Barclays £73m for poor handling of financial crime risks, 26 November 2015
26 FCA, Final Notice to Commerzbank AG, 17 June 2020, para 2.5.2

3. Common queries

This section answers common queries about the PEP regime.

3.1 Are domestic and foreign PEPs treated alike?

Yes, in the sense that the MLRs apply to both. But the FCA Guidance says that UK PEPs "should be treated as low risk, unless a firm has assessed that other risk factors not linked to their position as a PEP mean they pose a higher risk".

This means that the enhanced due diligence requirements do apply to UK PEPs (and their family members and known close associates), but firms should consider the nature of that PEP's responsibilities when assessing the risk and judging how to manage it. For example, an opposition or backbench Government MP with no ministerial office should be treated as lower risk than a Government Minister. [27]

3.2 How can a PEP identify if they're a PEP?

In most cases it will be obvious, such as for UK MPs. But there will be borderline cases.

MLD5 required Member States to:

> […] issue and keep up to date a list indicating the exact functions which, according to national laws, regulations and administrative provisions, qualify as prominent public functions.[28]

The Treasury Select Committee reported in March 2019 that:

> The Politically Exposed Persons regime is an important part of the system for preventing money laundering. We have heard that defining PEPs remains difficult for institutions, both large and small. While commercial solutions are available, they may be beyond the resources of very small companies. We recommend that the Government creates a **centralised database** of PEPs for the use of those registered by AML supervisors. [emphasis added][29]

The UK Government, however, took the view that the functions identified in the FCA Guidance was sufficient, so has not published a specific list.[30] For borderline cases therefore the FCA Guidance can be consulted. The Guidance makes clear, for example, that members of parliament for the devolved administrations should be included. Civil servants below Permanent or Deputy Permanent Secretary level normally should not.[31]

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27 FCA Guidance, para 2.29
28 Article 20a, para 1 of MLD5
29 Treasury Committee, Economic Crime – Anti-money laundering supervision and sanctions implementation, 5 March 2019, para 171
30 HM Treasury, Transposition of the Fifth Money Laundering Directive: response to the consultation, p22
31 FCA Guidance, para 2.16

3.3 When does a PEP cease to be a PEP?

This happens when someone ceases to perform the "prominent public function" that made them a PEP, for example an MP who leaves Parliament. In such a case they should continue to be treated as a PEP (i) for 12 months from the date on which they ceased to perform that function; or (ii) for such longer period as a firm considers appropriate to address risks of money laundering or terrorist financing in relation to that person.[32] The FCA considers that applying enhanced measures for over 12 months however will only be necessary where that firm has assessed that PEP as posing a higher risk.[33]

3.4 To whom can PEPs, their family members and close associates complain if they feel unfairly treated by a firm?

The FCA Guidance states that:

> The Financial Ombudsman Service will consider complaints from PEPs, their family members or close associates – and will take the guidance into account when deciding what is fair and reasonable in all the circumstances of a complaint.

The process for making a complaint is set out on the Financial Ombudsman Service website.

3.5 Life insurance companies often don't have a business relationship with the beneficiary - what approach should these firms take to long-term insurance contracts?

The MLRs state that before paying out under such a policy, or before such a policy is assigned, the firm should take reasonable measures to determine whether one or more of the beneficiaries of a policy (or the beneficial owner of a beneficiary) are PEPs or a family member of known close associate of a PEP.

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32 Reg 35, para 9
33 FCA Guidance, para 2.19

4. Commentary

4.1 Application of the rules to domestic PEPs

Prior to the MLRs and 4MLD, the relevant law was the *Third Money Laundering Directive*[34] (3MLD), as implemented in the UK by the *Money Laundering Regulations 2007*.

Under the previous regime, firms were able to treat domestic PEPs differently to foreign ones. So, for example, a bank could have decided not to apply enhanced due diligence to a UK MP who was applying to open a bank account.

Thompson Reuters noted in anticipation of the new regime that:

> Firms will no longer be able to treat foreign and domestic PEPs differently under the new regime. At the moment firms have to apply enhanced due diligence measures to account for the risks posed by foreign PEPs but not for domestic PEPs. The 4MLD will change this, although in reality most large firms take a blanket approach to assessing the risks posed by PEPs from the UK and overseas.[35]

In a 2016 adjournment debate, MPs raised concerns about the application of the enhanced due diligence obligations to domestic banks. The focus of the debate was on banks who had tightened the measures they take in dealing with domestic PEPs "in advance of the introduction of the fourth money laundering directive" (i.e. what is now the law). The MP who secured the debate, Charles Walker, raised concerns about the regime, saying that:

> In regards to the teenage children of MPs, it amounts to intrusive demands for information. One 18-year-old was recently contacted by her bank demanding that she produce personal information or face losing her banking facilities.
>
> […]
>
> A Back-Bench colleague, who agreed to be interviewed by his bank, was required to answer questions about his account dating back 25 years. This colleague is yet to turn 50.

In her response, Harriet Baldwin, Economic Secretary to the Treasury, said:

> I regularly inform my officials and the bank representatives whom I meet that my ears are bent every time I go into the Tea Room or the Lobbies, and now they will know that I am not exaggerating. I hear Members' frustration loud and clear
>
> […]
>
> As he states, the current global rules on anti-money laundering require that, in cases of high risk, banks and regulated businesses carry out enhanced due diligence on all PEPs—that is, those individuals entrusted with a prominent public function, be it politicians, high-ranking members of the military, senior members

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34 OJ L 309/15, 25 November 2005
35 Thompson Reuters, Fourth money laundering directive: a regulatory shift

> of the judiciary or others. Indeed, I myself got caught by this when I held an account with an American firm.
>
> […]
>
> Let me be clear: this change should not prevent any Member of this House, or any other individual in this category, from gaining or maintaining a UK bank account.[36]

There has been limited debate on this issue since the FCA Guidance, which clarified the lower risk posed by domestic PEPs, was published in July 2017. The FCA informed the Treasury Select Committee in May 2018 that:

> We are aware that some banks no longer offer services to categories of customers they deem to be high risk of money laundering.
>
> […]
>
> We are also working with UK banks, via UK Finance, on a set of principles on how they deal with decisions to close relationships. This encourages, where possible, communication with those customers prior to termination and we hope that dialogue might avoid some closures.[37]

4.2 International compliance

The Financial Action Task Force produces 'mutual evaluation' reports to monitor countries' compliance with its recommendations, including on PEPs. In December 2018. In December 2018 the UK was rated "compliant" with its main recommendation on PEPs, it being noted that "all criteria are met".[38]

In December 2016 the United States was rated "partially compliant", with the report raising concerns that:

> All investment advisers, MSBs [money service businesses] and life insurance companies are not covered. Other significant shortcomings are that domestic and international organizations PEPs are not covered.[39]

In its most recent spreadsheet published for all evaluated countries (last updated November 2020), the United States remains listed as "partially compliant".[40]

Canada is one of comparatively few countries rated "non-compliant". In its last evaluation dated September 2016 the FATF noted that relevant legislation had been passed in Canada but implementing regulations had not yet been brought into force.[41] Turkey has more recently been evaluated and rated "non-compliant" on the basis that "there is no specific reference to or obligation on FIs [financial institutions] relating to foreign or domestic PEPs".[42]

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36 HC Deb 20 January 2016, 2016, vol. 604, col. 1519 onwards
37 Financial Conduct Authority (FCA) written submission to the Treasury Committee inquiry into economic crime, May 2018, para 4
38 FATF, United Kingdom Mutual Evaluation Report, December 2018, p198
39 FATF, United States Mutual Evaluation Report, December 2016, p208
40 FATF, Consolidated assessment ratings, updated 17 November 2020
41 FATF, Canada Mutual Evaluation Report, September 2016, p146
42 FATF, Turkey Mutual Evaluation Report, December 2019, p190

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