



Managing PEP Risks: Understanding Recent Regulatory Changes and FCA Guidance Updates

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The recent amendments to regulations and the FCA's proposed updates to guidance significantly impact how firms should manage their relationships with Politically Exposed Persons (PEPs). These changes emphasise treating domestic PEPs as lower risk than non-domestic PEPs and encourage firms to apply more tailored, risk-based approaches in their due diligence processes. In this article, we explore these regulatory updates and provide insights on how firms can align their practices to ensure compliance while maintaining fair treatment of PEPs.

The FCA defines Politically Exposed Persons (PEPs) as “individuals whose prominent position in public life may make them vulnerable to corruption. The definition extends to immediate family members and known close associates”. Due to the risks perceived to be associated with such individuals, firms are directed by regulations and guidance from the regulator in how they should manage relationships and approach treatment of PEPs.

Amendments to the MLRs

The UK Government updated the Money Laundering and Terrorist Financing Regulations (MLRs) on 10 January 2024, introducing significant changes regarding the treatment of PEPs. The amendments focus on the distinction between domestic and non-domestic PEPs and Regulation 35 has been updated to reflect this distinction. Regulation 35 addresses the risk assessment and enhanced due diligence (EDD) measures for PEPs. The update states:

“For the purpose of the relevant person’s assessment under paragraph (3), where a customer or potential customer is a domestic PEP, or a family member or a known close associate of a domestic PEP—

(a) the starting point for the assessment is that the customer or potential customer presents a lower level of risk than a non-domestic PEP, and

(b) if no enhanced risk factors are present, the extent of enhanced customer due diligence measures to be applied in relation to that customer or potential customer is less than the extent to be applied in the case of a non-domestic PEP.”

The amendments therefore dictate that financial institutions should treat domestic PEPs as lower risk than non-domestic PEPs, and apply a lower level of EDD, sans other risk factors. See the full amendment from the UK Government [here](#).

FCA Guidance

Following a review of UK firms, the FCA found that largely, PEPs were not being treated unfairly. However, to maintain good practices, the FCA published further guidance for firms on 18 July 2024. The guidance stresses the importance of firms ensuring PEPs are not subjected to excessive or disproportionate checks and would not be denied an account based on their status.

The key areas of improvement the guidance focuses on include:

1. **Defining PEPs accurately:** Firms are advised to strictly adhere to the legal definitions of PEPs, their family members, and close associates, avoiding broader interpretations.
2. **Timely status review:** Upon a PEP leaving public office, firms should promptly reassess the individual's risk status.
3. **Effective communication:** Firms must ensure that PEPs are informed of the reasons for their risk classification in line with Consumer Duty.
4. **Risk-based approach:** The actual level of risk posed by PEPs should be carefully considered, rather than applying blanket EDD measures.
5. **Enhanced staff training:** Staff handling PEPs should receive appropriate training.

Lower vs. Higher Risk Indicators

Once a PEP is identified, firms must take a more bespoke and nuanced approach in assessing their risk factor. The FCA provides a framework for distinguishing between lower and higher risk PEPs:

- **Lower risk indicators:** PEPs may pose a lower risk if they are subject to rigorous public scrutiny, lack executive decision-making power, or have ceased to be PEPs for over a year. In such cases, firms may adopt less intrusive due diligence measures.
- **Higher risk indicators:** PEPs who display wealth inconsistent with known income, face credible allegations of misconduct, or are involved in large, non-transparent public procurements may require more stringent EDD.

EDD measures

Firms must implement several EDD measures for PEPs, including:

- **Business relationship approval:** Senior management must approve the establishment of business relationships with PEPs.
- **Source of wealth and funds verification:** Firms should take adequate steps to verify the PEP's source of wealth and funds, adapting the intrusiveness of these measures based on the assessed risk.
- **Ongoing monitoring:** Continuous monitoring of the PEP, promptly ceasing to apply any enhanced measures once they leave office to family and close associates, and then less frequent formal reviews. Firms can do this through periodic reviews, transaction monitoring or alert systems.

FCA consultation

The regulator is currently running a consultation where it proposes to amend the guidance to:

- reflect the new legal starting point that UK PEPs should be treated as lower risk
- make clear that non-executive board members of civil service departments should not be treated as PEPs solely for that reason
- give greater flexibility in who can approve or sign off PEP relationships within firms, not limited to senior management

The consultation is open to 18 October 2024. Submit your feedback [here](#).

Conclusion

The FCA expects firms to refine their approach to managing PEP risks now and not after final guidance is published. Implementing a robust PEP risk assessment process is crucial, as this will allow for consistent evaluations of each PEP's risk level. This approach not only helps in complying with the FCA's guidance but also ensures fair treatment of customers, aligning with broader regulatory expectations like the Consumer Duty.

By differentiating between domestic and non-domestic PEPs and calibrating due diligence accordingly, firms can better manage risks and maintain compliance. As the regulatory landscape evolves, firms should stay updated and refine their policies and procedures to meet these stringent requirements.

This post contains a general summary of advice and is not a complete or definitive statement of the law. Specific advice should be obtained where appropriate.