Consultation Response

AFME response to the FCA's consultation on proposed amendments to Guidance on the treatment of politically exposed persons (PEPs)

17 October 2024

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the FCA's consultation on proposed amendments to Guidance on the treatment of politically exposed persons (PEPs). AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate for stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA), a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

AFME is registered on the EU Transparency Register, registration number 65110063986-76.

Considerations in addition to responses to consultation questions

AFME members generally welcome the FCA's proposals to amend the Guidance on the treatment of politically exposed persons (PEPs). We provide detailed responses to the consultation questions in the section below.

We note that the FCA proposes to amend its guidance to clarify that UK PEPs should be treated as lower risk across a group, unless that is not permitted by the local law in a given jurisdiction. This makes clear the FCA's expectations of how UK PEPs should be treated in subsidiary undertakings and UK branches of firms headquartered outside the United Kingdom.

We suggest that it would be helpful for the FCA also to clarify its expectations for UK branches and subsidiaries of international firms headquartered in jurisdictions that require a higher standard of enhanced due diligence (EDD) to be performed on *all* PEPs that enter a relationship with a group entity, including UK PEPs or PEP-connected customers.

We note that Regulation 35 requires that the '*starting point for the assessment*' should be that a UK PEP or PEP-connected customer presents a lower level of risk than a non-UK PEP. We also note that this assessment should consider all circumstances relevant to the situation, including other jurisdictions' legal and regulatory requirements.

Where a UK branch or subsidiary of an international firm is headquartered in a jurisdiction which requires a higher standard of EDD to be performed on all potential PEPs or PEP-connected persons, it is our understanding that such branches or subsidiaries shall be able to meet the requirements of their Home State jurisdiction without being in breach of UK regulation.

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We therefore request that the FCA clarifies that it does not expect UK branches and subsidiaries of international firms to discount Home State regulatory requirements. We suggest that the following text (or similar) is added to the guidance:

> *The UK branches and subsidiaries of firms with their group headquarters in a third country may be precluded from treating UK PEPs as lower risk where this is not permitted by the law of the Home State of their headquarters. Where the Home State law requires EDD to be performed by international group entities on all PEPs, this should be permitted and applied on a risk-sensitive basis, taking into consideration (to the extent permissible by Home State law) the risk assessment and mitigation provisions within this Guidance.*

Consultation Questions

Question 1 - Do you agree with our proposal and wording in Paragraph 2.16 to clarify that NEBMs of UK civil service departments are not PEPs? If you disagree, please provide reasons for this.

AFME agrees with the FCA's proposal to clarify that non-executive board members (NEBMs) of UK civil servant departments are not PEPs. AFME would welcome further guidance on how this proposal would apply to NEBMs of non-UK bodies.

AFME welcomes the delineation between persons with executive and non-executive decision-making power when determining PEP classifications and conducting PEP risk assessments. AFME requests that the FCA provide a definition and illustrative examples of 'executive powers' (including '*true* executive powers') to help firms to assess the extent of potential executive power a subject of assessment may possess, to determine more effectively PEP status, and to permit appropriate risk mitigation activity. We would also welcome clarification as to what the FCA defines as 'large scale abuse', how the FCA expects firms to verify when a PEP ceases to be a PEP, and on how the FCA expects firms to approach PEPs holding office in British Overseas Territories (for example, Gibraltar).

Paragraphs 2.17 and 2.18 provide that whilst it is not normally required to treat public servants below Permanent or Deputy Permanent Secretary as having a prominent public function, middle ranking and more junior officials could act on behalf of PEPs. This could be read to suggest that middle ranking or more junior officials would need to be identified and be subject to CDD to determine whether they act on behalf of a PEP. We suggest a clarification to make clear that identification and due diligence measures are not required for middle ranking or more junior officials in the UK, or to allow firms to apply proportionate and risk-based measures in such cases.

Question 2 - Do you agree with our proposal and the wording in Paragraph 2.15 to allow more flexibility in signing off PEP relationships? Are there other approaches to senior management signing off PEP relationships that we haven't included?

We agree with and welcome further flexibility in the approach to senior management signoffs for PEP relationships.

Firms differ in their size and nature of business and as a result, differ in the models they adopt and in the Senior Management Regime stakeholders they involve in assessing the risk of PEP relationships. We therefore

urge caution in calling out only the SMF17 role in assessing PEP relationship risk, given that SMF17s do not own the risk at a customer level. We believe that identifying only the SMF17 role is inconsistent with other MLR obligations where senior management signoff is required but for which the FCA does not specify the role holder(s) who should be required to sign off, and as such, would set an unhelpful precedent for the regime.

We understand that it is already the case that a delegate of the MLRO can sign off PEPs, in line with the delegation principles in SYSC / the FCA Handbook. We propose that for lower risk situations, the updated PEP guidance should refer to relevant parts of the FCA Handbook to explicitly note that a suitably placed delegate of the MLRO may sign off PEP relationships and that in lower risk relationships a sign off in first line should be sufficient.

For firms subject to the Senior Management Regime, deputy arrangements and delegation lines in this context are part of the SMF17's reasonable steps. We believe that such a clarification would be in the spirit of the FCA's proportionate approach and would provide certainty for firms documenting their AML/CTF policies and procedures. We wish to emphasise the importance of the independence of the MLRO, and to make clear that the MLRO does not own the risk. The MLRO not vetoing a PEP must not be understood as the MLRO accepting responsibility for risks arising from the PEP. Risk ownership is a first line responsibility and must remain so.

On a related note, we consider that the guidance provided in the FCA's multi-firm review requires clarification. Paragraph 6.87 states that 'Senior Management must be involved in the approval process for establishing and maintaining PEP relationships', but then proceeds to say that firms should apply a risk-based approach to senior management approval. We consider the risk-based approach to be appropriate in such cases and most conducive to firms making the best use of scarce resources to effectively identify and mitigate risk.

We note the reference in paragraph 2.35 to a reference in paragraph 2.16 providing the definition of a senior manager. We understand this reference should be to paragraph 2.15 instead.

Question 3 - Do you think our proposed wording in paragraphs 2.12, 2.15, 2.27, 2.29 and 2.35 is sufficient to reflect the changes to the MLRs in January 2024? If not, what additional wording is needed?

We generally welcome and appreciate the additional guidance provided by these changes.

On paragraph 2.12, we propose a small addition to the wording in the last sentence, such that it reads

> *Regulation 35(3A) sets out that the starting point for the risk assessment where a customer or potential customer who is entrusted with a prominent public function by the United Kingdom ('domestic PEPs') or their family members and known close associates is that they <u>generally</u> present a lower level of risk than a non-domestic PEP.*

This better reflects the regulatory premise in our view.

On paragraph 2.15, as noted in our introductory remarks, we note that the FCA has helpfully clarified expectations relating to outbound branches and subsidiaries of UK firms. It is equally important to clarify expectations of inbound branches and subsidiaries which are required to adhere to the law of their Home State jurisdiction, many of which require EDD to be performed on all PEPs and PEP-connected customers, including those in the UK.

In keeping with our earlier comments, we acknowledge that the new guidance recognises senior managers other than the MLRO (or their delegates) may approve PEP relationships. This is an important point, recognising the ownership of PEP risks rests with the first line of defence, with the MLRO function having oversight of AML systems and controls. To further highlight this point, we recommend that the sentence requiring an MLRO '*to be aware of any PEPs onboarded or rejected*' be further clarified to confirm the MLRO is not expected to be familiar with all PEPs onboarded, especially the lowest risk ones, but instead should be provided with relevant management information and quality assurance control results to be able to perform their role appropriately.

On paragraph 2.29, we suggest a small change, such that it reads

> *Lower risk indicators – product*
>
> *The customer is seeking access to a product the firm has assessed to pose a lower risk. This will include products assessed as low risk by the firm to which it applies a level of due diligence other than enhanced due diligence (in the absence of other risk factors).*

Simplified or less resource-intensive methods of due diligence are applied as a result of a holistic customer risk assessment. The decision is not solely driven by product risk. We therefore suggest this clarification. We also suggest that the guidance clarify that the indicators provided are illustrative examples and not a definitive list.

We suggest that the cross-reference in paragraph 2.29 to 2.13 should be to 2.12.

On paragraph 2.35 (and by extension, 2.19), we suggest that the guidance clarify that once a firm has concluded that a foreign PEP poses a lower level of risk, it may undertake the same level of due diligence as undertaken with domestic PEPs if no enhanced risk factors are present.

In paragraphs 2.27, 2.29, 2.35, we suggest adding the case studies and good and bad practice examples which the FCA identified during its multi-firm review of the treatment of PEPs.

Question 4 - Do you agree with the minor amendments we propose to the Guidance? Are there other changes we should consider?

We agree with the minor amendments you propose.

We note the particular complexity which will arise for global banks where firms may need to apply different risk ratings (and potentially apply different due diligence measures) to the same UK PEPs in different locations. This will impact on firms which are a) UK headquartered with non-UK branches or subsidiaries, or b) non-UK headquartered but with UK branches or subsidiaries, and operating under a firm-wide framework, and on customers, with whom firms may need to re-engage to obtain further information to satisfy non-UK requirements. Creating additional technical compliance complexity distracts from implementing a true risk-based approach and prevents firms from devoting the most efficient level of resource to higher risk areas (including law enforcement priorities).

Question 5 - Based on our PEPs Review and the MLRs, is there additional Guidance that you think should be reflected in the update to the Guidance? If so, what specific Guidance should we consider and how do you think it would support firms' risk-based approach to EDD?

We would welcome additions to the helpful guidance covered by paragraphs 2.39 – 2.41 to assist firms with corporate and institutional customers, which do not generally bank PEPs as individuals.

The guidance could clarify the expectations for PEP-linked corporate entities. Currently it is unclear whether entities linked to a UK domestic PEP should also be considered lower risk (regardless of any beneficial ownership percentages, or any position the PEP holds in that entity), and whether firms would be expected to apply a risk-based approach.

Within 2.40, we propose to clarify the current text *'[t]hese could range from applying customer due diligence measures in cases where the PEP is just a figurehead for an organisation*' by adding a specific citation to Regulation 28(6)(7) and to delete the text currently in parentheses *('(this will vary according to the circumstances of each entity but could be the case even if they sit on the board, including as a non-executive director)*') . This would cover situations where the PEP is not a beneficial owner exercising significant control of more than 25% of the shares or voting rights of the legal entity customer. If the PEP is a figurehead and has no executive powers, then the client on the board of which they sit has limited exposure to PEP influence and is not to be classified as a PEP entity. This would support an effective risk-based approach to PEP-connected customers based on the PEP's control, influence and investment or financial dividend associated with the legal entity customer.

In paragraph 2.40, we propose to add a final sentence which supports an effective risk-based approach, such that the paragraph ends with

> *Where the PEP is not using their own funds in relation to the business relationship with the legal entity customer, depending on circumstances, firms may decide not to treat the legal entity as a PEP, or adopt measures outlined in 2.35, in absence of other higher risk indicators outlined in 2.30.*

We also request that the FCA provides guidance on:

- the treatment of state-owned entities
- expectations for relatives and close associates, and on the concept of association (in the sense of '*known close associate*') in relation to joint beneficial ownership, especially in relation to controlling rather than owning UBOs (correlation between 2.25 and 2.41)
- situations where a legal entity owned by a PEP would and would not be expected to be subject to EDD
- what lower levels of EDD would look like in practice, and
- on '*establish[ing] source of wealth*', to confirm that this doesn't mean verification in all situations (i.e. when there is no enhanced risk factors present)
- regulatory expectations for the classification of a corporate entity beneficially owned by a domestic PEP
- instances where an entity is linked both to domestic and foreign PEP.

We would be very happy to discuss any of the points made in this submission, if this could be helpful.

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