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12 April 2017

Dear Andy

**WMA's<sup>1</sup> response to GC 17/2: Guidance on the treatment of politically exposed persons (PEPs) under the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017**

Our detailed response to the questions in the Consultation are set out in the appendix accompanying this letter.

If you have any queries please contact us.

Yours Sincerely



**Giulia Lupato**

**Policy Advisor**

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<sup>1</sup>The Wealth Management Association (WMA) is a trade association that represents 180 wealth management firms (full members) and associate members who provide professional services to our full member firms. WMA members firms look after over £825 billion of wealth for over 2.2 million retail investors. WMA full members deal in stocks, shares and other financial instruments for individuals, trusts and charities through a range of services spanning execution only, advisory and discretionary fund management. The WMA exists to support its members and their clients through education and engagement, advocacy and influence, research and analysis and by playing an active role as a facilitator and thought leader. WMA firms operate across more than 600 sites, employing over 27 000 staff. These firms also run over 5.5 million client portfolios and carry out over 20 million trades a year.

## FCA Guidance Consultation on PEPs – WMA Response

As a general note, we support HMT and FCA's approach to PEPs that allows firms to adopt a risk-based approach when it comes to applying EDD to PEPs, so that lower-risk PEPs would be subject to less invasive scrutiny than higher-risk PEPs – but still within the boundaries of EDD.

### **Q1- Do you agree with the definition we propose for who should and should not be considered a PEP, family member or close associate?**

We agree with the definitions in principle. However, there are some elements of the definitions that would benefit from further clarifications:

#### **1. Para 2.11**

- “*middle-ranking or more junior official*” – having clear guidance assisting firms in being able to identify “*middle ranking or more junior officials*” would be of great help to firms and enhance the efficiency of the process. For example, a middle ranking official could be identified as any civil or military official with grade “A4” or lower (or non-UK equivalent).
- “*members of the governing bodies of political parties*” – In its 2016 Consultation on the transposition of 4MLD, HMT stated that there are over 400 political parties registered in the UK. The consultation also queried whether stakeholders would benefit from some form of criteria or examples set out in guidance of the political parties to which this applies, e.g. those having elected Members of Parliament, the European Parliament or the Devolved Legislatures. We remain supportive of this initiative: registering a political party is easy and inexpensive, and having founded a political party would not, in our view, automatically qualify an individual as PEP. Therefore, we would welcome guidance on this topic from HMT or from FCA.
- “*state-owned enterprises*” – it would be useful to have clarifications about what the FCA would consider a “state owned enterprise”
- “*international organisations*” – it would be useful if these could be defined (the Directive does not define them). Examples of international organisations that FCA may want to include in the guidance could be:
  - International public bodies, such as the United Nations and its agencies, NATO, IMF, World Bank, EU institutions and agencies
  - International bodies that are not of a public nature but that anyway have political influence, such as FIFA, UEFA, FIA, IOC,

We also refer to Regulation 47(a), where there is a requirement for FCA to include guidance on *what functions are not to be taken to be “prominent public functions” for the purposes of determining whether an individual is a PEP.*

We suggest adding an additional paragraph containing examples of where FCA would not deem a specific function to be a “*prominent public function*” for the purposes of determining whether an individual is a PEP.

For example, senior civil or military officials with grades A5 to A7 (inclusive, or non-UK equivalent) could be identified as falling outside the scope of “*prominent public function*” for the purposes of the identification of PEPs.

## **2. Para 2.15**

It would be beneficial to have examples of the “*other risks*” that a firm would need to assess in order to establish if a family member of a PEP who ceased office still needs to be subject to EDD.

## **3. Para 2.16**

It would be useful to have an additional sentence stating that the list is not exhaustive, to allow firms to take into account other categories of people than those listed.

We have the real-life example of a client who disclosed themselves as PEP in force of their close friendship with a member of a royal family.

**Q2- Are there situations that are covered in the draft guidance that by their nature present a higher or lower risk than we have considered? Also, are there other risk factors which should be included in the guidance? Please provide supporting arguments on the level of risk associated with these situations/risk factors.**

**Para 2.17** – “*A PEP may pose a lower risk if he/she solely operates in a country, such as the UK, that has the following characteristics [...]*”.

Whilst we support the inclusion of a description of the characteristics that a low-risk country could present, we believe it is nevertheless important to state that the assessment needs to be made on a case-by-case basis. We would also suggest deleting the specific reference to the UK as this may lead to the assumption that all UK PEPs are low-risk, which is not necessarily the case – see for example the “expenses scandal” which involved UK MPs.

Moreover, we believe that the products being traded or services being requested by the PEP may also carry a risk element.

Therefore we would suggest including a list of those products and services which, by nature and by circumstance, may carry a higher or lower risk of ML/TF.

For example, within our industry, we have identified:

- the following products/services that may, in certain circumstances, carry a higher risk of being abused for money laundering purposes:
  - exchange traded commodities where the client can choose to take physical delivery (e.g. gold)
  - requesting to buy or sell physical commodities such as precious stones and metal
  - Bearer instruments
  - Bespoke structured instruments that allow further credit and withdrawal
  - the trading of highly liquid instruments online and through a corporate account
  - currency spot transactions at a loss and with no specific reason
  - requests to re-materialise recently purchased shares
  - requests to put money into specific third countries and in connection with corporate actions
  - requests to purchase third country products without a strategy or reason for the client to invest in these countries
  
- the following products/services as carrying a lower risk to be abused for money laundering purposes:
  - ISA
  - JISA
  - LISA

**Para 2.18** – “a politically exposed person may pose a higher risk if she/he has any of the following characteristics (i) personal wealth or lifestyle inconsistent with known legitimate sources of income or wealth; (ii) subject to credible allegations of financial misconduct (e.g. facilitated, made or accepted bribes); (iii) there is evidence they have sought to disguise the nature of their financial circumstances”

In case of individuals presenting the above characteristics, does the FCA agree that the firm would not contravene para 2.5 (derisking) if it decided to refuse to onboard such individuals? We believe that refusing to take such individuals as clients would not represent de-risking.

In addition, we would consider a PEP’s connection with complex and opaque corporate or trust structures as a higher risk indicator.

**Para 2.19** – “A family member or close associate of a politically exposed person may pose a lower risk if they have the following characteristics: [...]

(ii) he or she is a family member or close associate with a PEP who is no longer in office”;

It is our understanding from Regulation 35 (9) and (11) that a PEP’s family member or close associate stops being subject to EDD once the PEP ceases office.

Therefore we suggest deleting this bullet point as it gives the impression that EDD continues to apply to these people, which is not the case.

(iii) he or she is under 18 years of age”.

Being under 18 years of age may not necessarily be an indicator of lower risk, as under 18s do not have control over assets transferred to them under a bare trust, which would therefore be at higher risk of being abused.

In addition to the existing lower risk indicators, we would suggest adding references to the PEP’s family or close associate’s source of funds, for example

- Wealth derived from legitimate income which is not related to the PEP’s office
- Wealth or lifestyle consistent with known legitimate sources of income or wealth
- Having a reputation of integrity (for example, being an FCA-approved person)
- Appointment to public office consistent with personal merit.

### **Q3- Are there further measures that a firm might take in lower or higher risk situations?**

#### **Para 2.22**

We note that “*senior management*” is not defined here or in the MLR – and it appears to be a different figure than the one defined by the Directive. We also note that giving guidance on *who should be treated as coming within the definition of “senior management”* is a requirement within the remit of the FCA under Regulation 47(f) of the MLR 2017.

We would therefore suggest adding a definition of “*senior management*”.

We also note that Regulation 47(g) requires FCA to give guidance on *what constitutes “adequate measures” and “reasonable measures” for the purposes of paragraphs (5) and (6) respectively of Regulation 35.*

The text of the guidance refers to Regulation 35(5) only, creating an inconsistency with MLR 2017.

There is reference to “*adequate measures*” but no further guidance as to what the FCA would consider adequate in establishing the source or wealth/funds. We suggest adding some guidance to this regard.

Some examples of measures that the FCA may want to include as guidance for higher risk situations are the following:

- Checking the income of PEPs who are public officials against publicly available records
- Requesting appropriate documentation to justify the income of those PEPs whose income is not made public, for example a letter from the employer confirming the PEP's remuneration
- If the money is claimed to have generated by the sale of a specified investment, evidence of the transaction
- If the money is claimed to have generated from the sale of a company or a stake in a company, evidence of the transaction
- If the money is claimed to be company profits, copy of the company's financial statements
- If the money is claimed to come from inheritance, grant of probate with copy of the will (or equivalent if the inheritance is coming from another country), letter from solicitor (or equivalent non-UK figure)

**Para 2.24 and 2.25** – The two paragraphs refer to oversight and approval of the relationship taking place “*at a less senior level of management*” for lower-risk situation and “*at a more senior level of management*” for higher-risk situations.

We are not aware of other instances where FCA has divided a firm's senior management into different levels over client relationship matters. It would therefore be useful if FCA could expand on this topic and explain what is meant by “less senior” and “more senior” management within a firm, why this differentiation is needed and how firms should apply this to their management structures.

We note the requirement in Regulation 47(g) for FCA to provide guidance on *the situations where it would be appropriate for the senior management approval mentioned in regulation 35(5) to be given by an individual who is not a member of the board of directors (or, if there is no board, the equivalent management body) of a business*. It is not clear whether paragraphs 2.24 and 2.25 are meant to address this point (due to the lack of guidance as to the meaning of “senior management”), therefore some further clarity on this would be much appreciated.

We also note that Regulation 47 (i) requires FCA to give guidance on *what sort of monitoring and scrutiny is required for the purposes of regulation 35(5) and (8)*. Whilst paras 2.24 and 2.25 appear to explain “*appropriate risk management systems and procedures*” as per Regulation 47(c), there is no reference in the text to monitoring and scrutiny. We would therefore suggest that a paragraph is added with guidance on this issue.

Some examples of monitoring and scrutiny could be

- For higher risk PEPs
  - Frequent checks of the PEP against the sanctions list (how frequent would depend on the characteristics of the individual business relationship)
  - More stringent monitoring of transactions, which may result in a larger number of transactions being subject to further scrutiny/approval
- For lower risk PEPs
  - Checks of PEP against sanctions list may not be as frequent as for higher risk PEPs
  - Transaction monitoring appropriate and proportionate to the level of risk posed by the PEP.