



# CUMMINGS PEPPERDINE ON PEPS AND DUE DILIGENCE

One of the words of 2023 is “unbanked.” Alongside it goes “de-banked” and both have come to prominence this year in the context of politically exposed persons, or PEPs.

Some questions which go to the root of this issue seem to have gone missing in action. They are:

1. what is a PEP;
2. what rules apply to a PEP; and
3. what does the FCA have to say about how PEPs should be treated.

Here we look at these questions and give you some useful guidance to use in your firm to help you work out how to tackle this issue in the context of maintaining an effective anti-money laundering (AML) and counter-terrorist financing (CTF) systems.

We also consider comment on how PEPs should be treated and recent FCA activity.

## BACKGROUND

The starting point is the UK’s risk-based approach and its three levels of customer due diligence (CDD) measures. The aim for the firm is to gather the information it needs to be able to assess the money laundering and terrorist financing risks associated with each business relationship, and then act as the basis for subsequent ongoing monitoring. Taking each in turn:

- the first measure is basic CDD which must be applied to all customers and businesses;

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- the second is extra enhanced due diligence (EDD) measures, which are applied to all high-risk customers and businesses. It is here that PEPs are placed; and
- finally, there are simplified due diligence (SDD) measures. These are more limited and apply only to low-risk customers and business.

## WHAT IS A PEP?

PEPs are one of the types of customer who may be high risk, and therefore EDD measures must be applied.

The definition of a “politically exposed persons” is an individual who is entrusted with prominent public functions, other than as a middle-ranking or more junior official. These include:

- heads of state, heads of government, ministers and deputy or assistant ministers;
- members of parliament or of similar legislative bodies;
- members of the governing bodies of political parties;
- 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;
- members of courts of auditors or of the boards of central banks;
- ambassadors, charges d'affaires and high-ranking officers in the armed forces;
- members of the administrative, management or supervisory bodies of state-owned enterprises; and
- directors, deputy directors and members of the board or equivalent function of an international organisation.

Family members are also caught, and these are defined as the PEP's:

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

Those who are a “known close associate” of a PEP are also caught. These are:

- individuals who either are known to have joint beneficial ownership of a legal entity or legal arrangement; or
- any other close business relationship, with a PEP, or who are the sole beneficial owners of a legal entity or legal arrangement that is known to have been set up for the PEP's benefit.

## WHAT RULES APPLY TO A PEP

Firms must have appropriate risk-management systems and procedures in place to determine whether a customer, or the customer's beneficial owner, is a PEP, a PEP family member or a known close associate of a PEP. To help firms identify PEPs, the UK maintains PEP lists.

The systems and procedures must manage the enhanced risks arising from the firm's business relationships or transactions with PEPs.

To determine what risk-management systems and procedures are appropriate, firms must take account of:

- their risk assessments (see Firm's own money laundering and terrorist financing risk assessment);
- the level of money laundering or terrorist financing risk inherent in their business;
- the extent to which that risk would be increased by a business relationship or transactions with a PEP, a PEP family member or a known close associate of a PEP; and
- any relevant money laundering or terrorist financing information made available by the FCA.

The first rule is to apply EDD and enhanced ongoing monitoring to mitigate any risks that may arise.

When assessing the money laundering and terrorist financing customer risk factors, firms must take into account the following:

- whether the business relationship is conducted in unusual circumstances;
- whether customers are resident in geographical areas of higher risk (geographical risk factors apply);
- whether they are dealing with legal persons or arrangements that are personal asset-holding vehicles;
- whether customers are using companies that have nominee shareholders or shares in bearer form;
- whether the customer's business is cash-intensive;
- whether the ownership structure of the customer's company appears unusual or excessively complex given the nature of the company's business; and
- the customer is a third-country national who applies for residence rights or citizenship in the member state in exchange for capital transfers, purchase of property or government bonds, or investment in corporate entities in that member state.

In addition to the EDD measures, firms must also:

- have approval from senior management for establishing or continuing the business relationship with that person;
  - take adequate measures to establish the source of wealth and source of funds that are involved in the proposed business relationship or transactions with that person; and
  - where the business relationship is entered into, conduct enhanced ongoing monitoring of the business relationship with that person.
- The FCA will expect you to follow your internal policies and procedures as to a PEP, a PEP family member or a known close associate of a PEP.

## WHAT DOES THE FCA HAVE TO SAY?

You may be forgiven for being confused here.

Key to the disentangling of information is that the PEP requirements are preventive only, nothing more, and refusing a business relationship with someone simply because they are a PEP is contrary to the letter and spirit of the regulatory requirements.

In fact, the FCA has said that does not expect firms to decline or end a business relationship with a person merely because they are a PEP, a PEP family member or a known close associate of a PEP.

This is a point to remember and take away with you.



## THE TEAM

Cummings Pepperdine is a leading advisor in crypto. We are one of a select few that advises a large and diverse global client base in the crypto space and the only to provide a complete crypto solution building on the three key areas of law, tax and FCA with legal underpinning at every point.

In law, we have a team of qualified and regulated solicitors and a barrister who retains right of audience.

In tax, we have one of the only crypto tax advisors who is both a qualified solicitor and qualified chartered accountant.

In regulation, our team comprises specialists in crypto compliance monitoring structures and governance oversight who are known to the FCA for the quality of their work.

The team is led by Claire Cummings, a leading solicitor specialising in crypto law and the current and evolving regulation. Claire is on the advisory boards of a crypto exchange and an NFT gaming guild and is also a member of the Global Digital Finance working group on



**Claire Cummings**

stablecoins. Claire has also acted as compliance officer, MLRO and director of an FCA regulated fund manager and qualified under SIB to trade derivatives. As a leading expert in crypto, Claire is a sought after speaker and has published multiple articles on the legal and regulatory issues surrounding cryptocurrencies and the crypto eco-system. Claire is named at the Top 10 influencer in London for hedge funds (2&20, 2022) and is included in the CityWealth Crypto Top 100

The Cummings Pepperdine Online Training Programme, includes sections focusing on PEPs and Due Diligence, has been designed by a specialist board of compliance consultants, solicitors, chartered accountants, tax advisors and regulatory consultants. We believe that we are the only firm which offers training created by this range of qualified advisors.

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