Handbook of Anti Money Laundering
By Dennis Cox

17 POLITICALLY EXPOSED PERSONS

17.1 WHAT IS A POLITICALLY EXPOSED PERSON?

Politically exposed persons (PEPs) are, quite simply, a high-risk category of individuals that have been identified internationally as requiring enhanced due diligence to be conducted. The general concern is that persons that hold high-profile political positions and those related or associated with them will pose a higher money-laundering risk to firms, as their position makes them vulnerable to corruption. The obvious risks are that the politically exposed person may take some form of facilitation payment to enable a third party to win a contract with government, receive some form of inappropriate commission, abscond with government funds or receive funds to bias legislation in favour of third parties. In the United Kingdom, the Bribery Act brings this into clear focus.

Of course, the majority of PEPs will not actually be conducting illegal activity. All that the requirements ask is that any relevant firm that identifies a customer or potential customer as a PEP should undertake additional procedures commensurate with the level of risk that the relationship poses to the firm. The next issue is what work a firm should do to identify PEPs, and, as we shall discuss, we would recommend that firms take a broad definition of such relationships. The only risk that is posed to a firm through undertaking analysis on more relationships than the minimum requirements is that some element of unnecessary due diligence will have been conducted. This would not appear to represent a significant waste of resources, since, in such cases, enhanced due diligence would normally be required anyway. It may result in the reputation of the firm being additionally protected.

From the point of view of the financial institution, it is clear that being involved with a politically exposed person will inevitably result in a higher level of potential public scrutiny and a consequent increased risk of possible adverse publicity if inappropriate activity is reported or investigated by journalists or authorities. This would result from public disclosure through newspapers or electronic media of a firm or person having obtained an illegal advantage through biasing a PEP which had been, or should have been, identified by a financial institution.

The question as to who really is a politically exposed person is a significant issue for any regulated firm. Someone may suddenly become a politically exposed person having been a client of the firm for many years through deciding to stand in, and then winning, an election. In many countries, independents have risen to public office from roles which would not have previously resulted in their being identified as PEPs. This means that a firm must continually review existing relationships to see if anyone has become a PEP and therefore requires a higher level of ongoing due diligence monitoring.

Others may be in power and operating entirely legally for many years, only having the opportunity to act illegally at some later stage. They have actually been politically

exposed throughout the period, but have only undertaken inappropriate activity when the opportunity presented itself, perhaps just before they leave office. This highlights the importance of continuing to monitor such relationships throughout the period after a customer has first been identified as a PEP.

Remember that a customer having PEP status does not incriminate the individual in itself; the status does, however, put such customers into a high-risk category. The Third EC Directive, as well as the JMLSG's Guidance notes, particularly identifies PEPs as an area of concern in the fight against money laundering. Accordingly, regulated firms should have both a clear definition as to who is a PEP and have clearly documented the additional procedures that should be undertaken on PEP transactions and relationships. It is incumbent on the firm to be able to demonstrate to its regulators that appropriate and consistent procedures have been conducted, with adequate documentation of these additional procedures being maintained.

17.2 THE DEFINITION OF A POLITICALLY EXPOSED PERSON (PEP)

The UK's money-laundering regulations define a PEP as:

> *"an individual who is or has, at any time in the preceding year, been entrusted with prominently public functions and an immediate family member, or a known close associate, of such a person."*

The UK's definition also applies to those holding such a position in a state outside the UK, or in a community institution or an international body. This is actually quite a limited statement. It means, for example, that someone who stands for public office but loses in an election is not a PEP within the definition of the term. However, many firms will actually use a wider definition, which we would recommend. This bases itself on the firm's ability to know who can significantly influence functions of importance, regardless of whether or not they are entrusted with a public function. It is often the person with influence who can be most easily bribed.

There is also a limitation in the UK definition, in that an individual ceases to be recognised as a PEP after they have left office for one year. There is clearly an argument that such a time limit is far too short, since the individual will clearly remain high profile even if they are no longer a public official. Consider the position of former US Presidents or UK Prime Ministers, for example. The way that the UK rules operate to deal with this is, in part, by encouraging the implementation of a risk-based approach. This is a series of policies and procedures implemented in the firm that enables the firm to identify what might be considered higher risk relationships, regardless of whether they are or are not with PEPs. All relationships with PEPs are, by definition, higher risk relationships, but not all higher risk relationships are with PEPs. All higher risk relationships will require enhanced due diligence and continual monitoring, and we would recommend that former officials should be regularly reviewed until such time as their ability to influence has waned to such an extent that it is inconceivable that they might be undertaking illegal, or at best inappropriate, activity.

An example of this is the recent case of the Duchess of York, the former wife of Prince Andrew, who was recorded by a newspaper offering access to Prince Andrew in exchange for a cash payment. She claimed that any payment to her would be repaid tenfold through access to her ex-husband, who works as a UK trade envoy. Prince Andrew was not, in any way, implicated by the disclosure. This highlights that someone who, in this case, is divorced from a person holding a high-profile position remains in a position of influence regardless of the rules, and in this case clearly requires enhanced due diligence.

It would make little sense from a risk point of view for a firm to cease conducting additional enhanced monitoring of transactions or activity at the end of an additional one-year period. The main consideration that the firm should take into account is whether the risks associated with an individual's previous position have adequately abated, or whether they do, in fact, continue. This may need to be considered on a case-by-case basis, as opposed to one generic approach. The idea is that, regardless of the rules that apply locally, the firm would wish to know that the account it is maintaining is not being operated inappropriately such that at some time in the future its reputation could be impacted.

17.3 AT WHAT LEVEL IS SOMEONE A PEP?

It is generally recognised that public functions exercised at a lower than national level should not normally be considered to be prominent. However, there can be cases where persons that hold such positions may experience political exposure which is comparable to that of persons with similar positions at national level. An example of this could well be the Mayor of a large city such as London or Paris. In moving towards local politicians of lesser importance, the firm will need to judge whether they could be involved in inappropriate activity and whether such activity could be of such importance that the person should have been considered a PEP and subject to enhanced monitoring procedures.

Given the number of cases where inappropriate, or at best dubious, payments have been made to officials involved in local planning decisions, the firm may well choose to include all such officials in the enhanced due diligence regime. Of course, fraud does not need to be conducted at the most senior level. In a 2009 case in Toronto, Canada, nine city staff were removed from office after it was discovered that over half a million dollars may have been fraudulently claimed by employees and contractors. Examples of abuse included an employee who claimed $50,000 worth of unwarranted overtime, another who cancelled parking tickets for friends and family and a pair of staff who used counterfeit passes to take advantage of $550 worth of recreational programming.

This highlights that fraud can clearly operate at all levels of public functions, but for a really high-level case to result in adverse publicity, the culprit would need to be at a senior level. In this example, the issues were identified by the financial institution acting as administrator, which shows that they at least were undertaking due diligence on all such cases.

Once again, the key requirement will be for firms to implement a risk-based approach, using some form of consistent modelling and criteria to establish whether persons

exercising those public functions should be considered PEPs. We would recommend that a standard scoring system be implemented which sets key attributes for the identification of a PEP, with weighted scoring then applied. This will enable consistent application of relevant due diligence approaches to be undertaken and provide the necessary supporting evidence to justify the approach adopted. Of course, a scoring system will not replace judgment, instead it provides a structure within which judgment can be consistently applied, justified and adequately documented.

17.4 PROMINENT PUBLIC FUNCTIONS

The UK regulations state that prominent public functions include:

- Heads of State, heads of government, ministers and deputy or assistant ministers;
- Members of Parliament;
- Members of supreme courts, of constitutional courts or other higher level judicial bodies;
- Members of courts of auditors or of the boards of central banks;
- Ambassadors, chargés d'affaires and high-ranking officers in the armed forces;
- Members of the administrative, management or supervisory boards of State-owned enterprises.

As such, these are pretty typical of the rules that are implemented globally.

Take, as an example, a 2009 case from South Africa, in which 923 government officials were caught undertaking fraud. In this case, 40,000 houses across the country were demolished or rectified because of poor workmanship. Two of these collapsed, causing the deaths of a 13-year-old youth and a woman. Those involved included 800 national officials, 123 local government officials and five people from the legal profession. This highlights that what is completely unacceptable behaviour may become normal in a group which has perhaps different ethical standards to those which might have been expected. The situation followed from questionable contracts and building standards approved by government officials and implemented by the private sector.

This case clearly illustrates that local and provincial government officials can all be involved in inappropriate activity through the receiving of inappropriate payments (or graft). The laundering of such proceeds through bank accounts without the bank having considered whether they were legally earned could potentially lay the banks open to the risk of being caught within a money-laundering investigation.

It is therefore clear that, regardless of the actual rules that have been implemented, in cases where the relationship results in additional levels of risk, the bank should undertake procedures which are commensurate with this potential risk. What this is likely to mean in practice is that the bank will analyse its relationships in four distinct groups:

- PEP accounts as defined by the local rules and regulations;
- Accounts which represent an enhanced risk of inappropriate activity;

- Other accounts, considered as standard risk;
- Accounts considered by the local rules and regulations as being low risk.

In these terms, a low-risk account could, for example, be an account set up by an employer purely for the salary of an employee.

Of course, not all inappropriate conduct will be identifiable by a financial institution. With public officials, relatively small amounts of inappropriate activity can result in adverse publicity for the person involved. The series of revelations regarding UK MPs' expenses in 2009 represents a clear case of such items. For example, a five-foot-tall floating duck house was claimed from the public purse by Tory grandee Sir Peter Viggers. The £1,645 pond feature, modelled on an 18th century Swedish building by a firm selling elaborate garden follies, sits in the pond at the Gosport MP's Hampshire home. Clearly, a single payment of £1,645 would be unlikely to be identified by a financial institution. Other claims by other MPs included submissions for jellied eels, fluffy dusters and horse manure. It would be unreasonable to expect all cases of inappropriate conduct by government officials to be identified by financial institutions.

17.5 THE IMMEDIATE FAMILY RULES

Generally, the rules applied will require that the immediate family members of a PEP are also included with the PEP in the additional monitoring regime. In the UK this is required, but in other countries it may be difficult or legally impossible to consider such connections. The issue is again clear, it may well be that the PEP transfers the inappropriate funds to a family member rather than taking them directly, or that the family member is able to exert undue influence on the PEP. There could, of course, be cases where the PEP undertakes inappropriate conduct but asks for the facilitation payment to be made to their spouse or children. In such cases, it will only be picked up through monitoring the spouse or child's account.

When it is possible to undertake such monitoring, the definition of immediate family members generally includes:

- A spouse
- A partner (including a person who is considered by his national law as equivalent to a spouse)
- Children and their spouses and partners
- Parents.

What the requirements do not generally include is brothers and sisters, nor any more remote members of the same family. Whether a firm would wish to extend the definition of family to people beyond this list is, of course, purely a matter for the individual firm to consider through the application of the risk-based approach. By complying with the local requirements, they will have met the regulators' expectations. However, they may choose to undertake additional procedures on a wider group of people due to the risks that they pose to the institution itself.

17.6 THE ASSOCIATE RULES

It is normally also important to include the associate of a PEP with the PEP when considering enhanced money-laundering-deterrence procedures. These requirements are intended to identify people with a close business relationship with a PEP that might potentially also be involved in inappropriate activity due to their relationship with, for example, a local official. A firm will need to define clearly what constitutes an associate, using a definition that includes anything that is within the local regulatory definition. Such definitions will typically include the following:

- Any individual who is known to have joint beneficial ownership of a legal entity, or any other close business relations with a person who is a PEP.
- Any individual who has sole beneficial ownership of a legal entity which is known to have been set up for the benefit of a person who is a PEP.

In determining whether a person is an associate of a PEP, the firm generally only needs to consider any information which is in its possession, or which is publicly known. It does not have to go out of its way to find out additional non-public information. Therefore, the obligation of having to obtain knowledge of such a relationship does not presuppose that active research should be conducted by the firm.

Again, the firm should implement a risk-based approach in determining associates of PEPs, and the enhanced due diligence measures which should then be conducted. If there is a known associate who is not actually a joint owner of anything with the PEP, then it would still be wise for the firm to consider them as an associate. It is to such relationships that the PEP might turn to undertake illegal activity, or for them to receive illicit funds on their behalf and therefore disguise their original source.

A recent example of the involvement of three businessmen in an official's fraudulent activities is a February 2010 UK case. This represented a complex fraud which left Yorkshire council tax payers with a bill of £13.6 million. A high-profile council employee who was an international expert in metrology, the science of calibrating weighing equipment, set up agreements with three businessmen to supply falsely inflated invoices relating to the supply of calibration equipment. He paid the invoices from company funds then conspired with the businessmen for them to pay an invoice for non-existent "calibration work".

Here it is clear that the business associates were instrumental in the fraudulent activity and therefore should clearly have been identified and monitored were it clear to the financial institution that they were actually associates of the official. It is the difficulty in knowing the total extent of an official's associates which lies at the heart of the problems that a firm is likely to face in practice. All that a firm can do is conduct a standard set of documented procedures which attempt to undertake the investigations that a relatively diligent institution would be expected to conduct, and to maintain sufficient records to justify any decisions taken.

17.7 WHAT IS THE RISK-BASED APPROACH?

There is no single definition of what constitutes the risk-based approach, and firms will need to consider their own local circumstances in developing appropriate criteria

to apply in practice. Actual identified cases of PEPs being involved with local money laundering or terrorist financing can be used to back test any criteria that have been developed. This is done by taking cases of known money laundering and then applying the criteria adopted within the firm's documented enhanced due diligence procedures. They should be able to see if the case would have been identified by their systems as one requiring enhanced monitoring.

Generally, the requirement here is for the firm to develop a series of policies and procedures to ensure that the firm:

- Has appropriate risk-based procedures to determine whether a customer is a PEP;
- Obtains appropriate senior management approval for establishing a business relationship with a customer;
- Takes adequate measures to establish the source of wealth and source of funds which are involved in the business relationship or occasional transaction;
- Conducts enhanced ongoing monitoring of the business relationship.

17.8 THE RISK-BASED APPROACH TO DETERMINING PEPS

The extent to which PEPs themselves affect a firm's money-laundering obligations will depend on the nature and scope of the firm's business and whether the PEP would have a significant impact on the public perception or reputation of the firm were a case of money laundering or terrorist financing to be identified.

When applying a risk-based approach, it would be appropriate for the firm's resources to be focussed on particular products or transactions which are characterised by a high risk of money laundering. This will be determined through knowledge of money-laundering transactions that are generally conducted within the local jurisdiction and would typically, for example, focus on cash-based and non-face-to-face transactions.

A firm will first have to identify whether a PEP exists as part of its customer base. When applying specific checks, firms may be able to rely on an internet search engine, or consult relevant reports and databases regarding public officials. There are also corruption risk indices published by specialised national, international, non-governmental and commercial organisations. The Transparency International Corruption Perceptions Index, for example, ranks approximately 150 countries according to their perceived level of corruption. Clearly, such an index helps firms in assessing risk, since a politician from a high-risk country would clearly need to receive enhanced monitoring procedures.

It is also important to remember that whilst new and existing customers may not meet the definition of a PEP, they may subsequently become one during the course of the business relationship. In this respect, firms must, as far as is practically possible, be alert to public information regarding the possible changes in the status of its customers with regard to political exposure. In practice, this will mean conducting reviews on a regular basis to see if the PEPs identified are, in fact, a complete population of such accounts, or whether an existing customer has become a PEP and should now be subject to enhanced monitoring. After an election for office it is clear that an additional review should be conducted to identify newly elected PEPs who will now require additional monitoring.

The identification of the PEP, family member or associate is only the first stage in the process. Once a PEP has been identified, firms must then be clear as to the enhanced due diligence procedures that they should conduct in order to minimise, where possible, their risk of being involved with an account which actually constitutes money laundering or terrorist financing.

17.9 TRANSPARENCY INTERNATIONAL

Transparency International is an international organisation that works to fight against corruption and produces an annual global corruption report, The Transparency International Corruption Perceptions Index. The 2011 Corruption Perceptions Index measures the perceived levels of public sector corruption in 183 countries and territories around the world. The current list is included as an appendix to this book.

Transparency International provides a series of clear definitions that should prove of assistance to people drafting money-laundering-deterrence or terrorist-financing policies. Within these definitions, Transparency International specifically defines political corruption, and the problems involved with it are explained in depth. Political corruption is defined as the abuse of entrusted power by political leaders for private gain, with the objective of increasing power or wealth. It does not need to involve money changing hands; it may take the form of "trading in influence" or granting favours for the intention of receiving benefit. In any country where there is a high perceived risk of corruption, you would expect a firm to conduct a higher level of enhanced due diligence on any PEPs that have been identified.

Political corruption involves a wide range of crimes and illicit acts committed by political leaders before, during and after leaving office. It is distinct from petty or bureaucratic corruption insofar as it is perpetrated by political leaders or elected officials who have been vested with public authority and who bear the responsibility of representing the public interest. There is also a supply side to political corruption – the bribes paid to politicians – that must be addressed.

Businesspeople also sense the effects of political corruption. A survey by the World Economic Forum shows that businesspeople believe that legal donations have a high impact on politics, that bribery does feature as a regular means of achieving policy goals in about 20% of countries surveyed and that illegal political contributions are standard practice in nearly half of all countries surveyed. Political corruption points to a lack of transparency, but also to related concerns about equity and justice: corruption feeds the wrongs that deny human rights and prevent human needs from being met.

Transparency International also publishes a bribe payers' index. The 2011 Bribe Payers' Index ranks the likelihood of companies from 28 leading economies to win business abroad by paying bribes. Reproduced with the kind permission of Transparency International, the 2011 Bribe Payers' Index is shown in Table 17.1.

Countries are scored on a scale of 0–10, where a maximum score of 10 corresponds with the view that companies from that country *never* bribe abroad and a 0 corresponds with the view that they *always* do.

Table 17.1 The 2011 Transparency International Bribe Payers' Index

Rank	*Country/Territory*	*Score*	*Number of Observations*	*Standard Deviation*	*90% Confidence Interval*	
					Lower Bound	*Upper Bound*
1	Netherlands	8.8	273	2.0	8.6	9.0
1	Switzerland	8.8	244	2.2	8.5	9.0
3	Belgium	8.7	221	2.0	8.5	9.0
4	Germany	8.6	576	2.2	8.5	8.8
4	Japan	8.6	319	2.4	8.4	8.9
6	Australia	8.5	168	2.2	8.2	8.8
6	Canada	8.5	209	2.3	8.2	8.8
8	Singapore	8.3	256	2.3	8.1	8.6
8	United Kingdom	8.3	414	2.5	8.1	8.5
10	United States	8.1	651	2.7	7.9	8.3
11	France	8.0	435	2.6	7.8	8.2
11	Spain	8.0	326	2.6	7.7	8.2
13	South Korea	7.9	152	2.8	7.5	8.2
14	Brazil	7.7	163	3.0	7.3	8.1
15	Hong Kong	7.6	208	2.9	7.3	7.9
15	Italy	7.6	397	2.8	7.4	7.8
15	Malaysia	7.6	148	2.9	7.2	8.0
15	South Africa	7.6	191	2.8	7.2	7.9
19	Taiwan	7.5	193	3.0	7.2	7.9
19	India	7.5	168	3.0	7.1	7.9
19	Turkey	7.5	139	2.7	7.2	7.9
22	Saudi Arabia	7.4	138	3.0	7.0	7.8
23	Argentina	7.3	115	3.0	6.8	7.7
23	United Arab Emirates	7.3	156	2.9	6.9	7.7
25	Indonesia	7.1	153	3.4	6.6	7.5
26	Mexico	7.0	121	3.2	6.6	7.5
27	China	6.5	608	3.5	6.3	6.7
28	Russia	6.1	172	3.6	5.7	6.6
	Average	7.8				

Again, this list may be of benefit to firms in developing risk-based criteria. As you can see, the bribes are paid by people in countries which you might consider as being relatively well regulated. It is the countries that are poorly regulated which are the recipients of such funds.

17.10 THE GLOBAL NATURE OF CORRUPTION

Many of the cases we have referred to in this chapter have taken place in the UK or USA. This is purely due to the level of publicity that such cases make in these countries, rendering the cases publicly available. However, no country can be certain that it will not have an unscrupulous PEP. Consider the following recent Chinese case.

In September 2012, a township official in Beijing appropriated over 38 million yuan ($6.03 million) from a demolition compensation fund set up for two highway construction projects. He lent more than 178 million yuan of public money to several property developers, and abused his political power to help two companies get business contracts and land. In return, he was gifted access to 80,000 yuan as well as goods to almost twice that value.

People in public office sometimes appear to think that they can get away with it, or that they are in some way entitled to take advantage of their position. The concern for the financial institution is that they do need to do sufficient investigation and ongoing monitoring (see Chapter 22) to enable them to provide their regulators or enforcement authorities with sufficient evidence that they undertook adequate due diligence. If they have done what was expected, then they should not receive any sanction from the regulators. Accordingly, enhanced due diligence is clearly what is required to be conducted in such cases.