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Finance industry shines spotlight on U.S. politicians

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U.S. political figures better get their financial houses in order.

As an increasing number of domestic politicians face corruption and money laundering charges, large institutions are developing policies that evenly apply to foreign and domestic political figures, a trend that signals a turning point in the industry's approach to risk.

Large financial institutions – including Goldman Sachs, JPMorgan Chase and Citigroup – are examining U.S. politicians far more than laws and regulations require.

"The more sophisticated and larger financial institutions are imposing the standards, and that suggests to me that it's becoming a best practice," said Ross Delston, managing director of Kalorama Partners consultants. "Do I expect it to become the norm? Absolutely. There's no logical reason why there's a distinction."

Senior political figures – also called politically exposed persons or PEPs – are risky customers because they earn "relatively low salaries" and hold powerful public posts prone to corruption, Delston said. "If they are coming to a financial institution with a high net worth, you'd want to know what the sources of their wealth are" no matter where they are located."

Section 312 of the USA Patriot Act requires financial institutions to craft "risk-based" procedures to identify all of their customers and assess their "relevant risk factors" to determine who deserves "enhanced scrutiny."

The rule explicitly compels banks to apply that same "enhanced scrutiny" to the accounts of current and former senior foreign political figures, their family members and close associates to detect if any funds "involve the proceeds of foreign corruption," including the misappropriation, theft, embezzlement of public funds, bribery, extortion or the conversion of government property.

Although financial services companies aren't obliged to pay as much attention to the accounts of domestic political figures, they still have to report suspicious activities and currency transactions of more than $10,000.

"We have not and are not saying that financial institutions should not watch out for domestic PEPs or accepting the proceeds of domestic corruption," said Anne Marie Kelly, spokeswoman for the U.S. Treasury Department's Financial Crimes Enforcement Network (FinCEN).

Proactive policies

That's a difficult task. Most companies verify customer names against sparsely compiled government and international blacklists of suspicious individuals and organizations. But the lists compiled by such organizations as the U.S. Office of Foreign Assets Control don't designate the individuals as PEPs or identify their associates and family members.

"There is no such thing as an official PEP list," said Brendan Cohen, director of North American operations for World Check, a U.K. database company. "Customer identification is a one-time process, but screening for PEPs is an ongoing process. If you're just checking government lists, you're horribly exposed."

That's one reason Goldman Sachs developed money laundering policies that "do not distinguish between foreign or domestic political figures," said Alistair Cowper, a compliance officer at Goldman Sachs in the Cayman Islands.

Goldman Sachs "scrubs" all of its clients against the Regulatory Database Corporation system every day to determine if they are political figures, close associates or otherwise high-risk. The company's anti-money laundering compliance department deciphers the hits for false-positives and sends risky profiles to its business intelligence group for evaluation.

"If we detect someone who is politically connected, we look very closely to make sure the money they are bringing to the firm is not the proceeds of any political impropriety," Cowper said. "The bigger banks can be more discerning."

At least one database, World Check, a computerized catalog of public records, news reports and government blacklists, provides written summaries about individuals and links to outside data and also flags politically connected individuals as PEPs.

Financial institutions can run all of their customers through the database every day or on as-needed basis. Users can generate reports to document their searches, but the confidential service does not retain records on its server or capture client information.

"It's important that the institutions assess their PEP coverage based on the standards they're going to be judged by," Cohen said. "It's like the blind leading the blind. The institutions don't know; the vendors don't know and, frankly, the examiners aren't exactly clear about what they're looking for."

PEPs breed corruption

Inside the United States' complex political structure, "even local officials can have the kind of clout that requires enhanced due diligence," Delston said. "That's a major issue in a country as big as ours" because they are harder to identify.

Crimes of corruption, as "specified unlawful activities" under federal law, can predicate money laundering prosecution. If financial institutions put the accounts of domestic political figures under a closer microscope, they could detect signs of political impropriety as the webs of political corruption are spun.

With a little enhanced scrutiny, financial institutions might have uncovered the misdeeds of Jack Abramoff, the once-powerful lobbyist now at the eye of a large-scale corruption scandal.

Abramoff pleaded guilty in January to defrauding four Indian tribal casinos of millions of dollars, evading taxes, conspiring to bribe public officials and conspiring to induce congressional staffers to violate a one-year ban on lobbying their former bosses.

Under his plea deal, Abramoff agreed to turn over evidence incriminating numerous members of Congress, their staffers, Bush administration officials and other lobbyists of accepting cash bribes, campaign contributions, fundraisers, luxury trips, jobs for their spouses, entertainment and free meals in exchange for votes and legislative favors. The next day he pleaded guilty to conspiracy and wire fraud stemming from his 2000 purchase of SunCruz Casinos.

That kind of scrutiny might have also reduced risks associated with former House Majority Leader Tom DeLay. The Republican congressman, who once described Abramoff as one of his "closest and dearest friends," was indicted in Texas last year for money laundering and conspiracy to engage in money laundering – charges stemming from alleged violations of election laws in 2002.

During an online demonstration, a World Check search for Abramoff returned summaries of both Abramoff and DeLay, their family members, associates and mutual connections, and flagged them as PEPs.

"We haven't seen all of the fallout from the Abramoff case," Delston said. "We don't know what the end result will be or what cases will be brought. Do these domestic PEPs pose a higher risk to U.S. financial institutions? My answer is emphatically yes. In these cases, I can imagine the Feds saying, ‘you should have known.’”

‘Reputation is everything’

In an increasingly tough regulatory environment, financial institutions pay the price for servicing risky clients – political figures or otherwise. And they know it.

U.S. regulators no longer hesitate to levy civil enforcement actions, including cease-and-desist orders and pricey financial penalties, on companies that violate the Bank Secrecy Act or turn a blind eye to illegal activities. In recent years, the Justice Department has intensified those punishments with criminal charges and forfeitures.

Those actions – and the accompanying publicity – not only dent their pocketbooks, but also tarnish their reputations.

“We don’t think it’s a good idea to do business with a client if we don’t have to,” Cowper said. “Reputation is everything. All it takes is one bad apple and negative press to take a hit. That’s your biggest risk.”

The easiest way to avoid risk is to “simply not take the customer on,” Delston said.

That tactic, though, may be easier for larger financial institutions that don’t have to compete than for smaller institutions that have to rely on less-than-ideal clients to survive.

“I think a lot of people would like to be doing it, but it’s a cost factor,” Cowper said. “Smaller brokerage houses with small budgets may not have the money for more expansive AML screening. So they may have to outsource to companies like RDC or World Check.”

International standards

Although the Treasury Department first mentioned the term “senior foreign political figure” in guidance to U.S. financial institutions during the Clinton administration, global legislation on the issue didn’t mount until the Financial Action Task Force later urged countries in its 40 Recommendations to pass laws requiring financial institutions to scrutinize the accounts of foreign PEPs. Those recommendations do not require any measures for domestic PEPs.

Most countries “take the easy way out” and require only the minimum standards, Delston said. “Remember who passes these laws. Is it reasonable to only target foreign PEPs if you’re serious about targeting money laundering?”

Mexico, however, seems to be serious about the task. The country’s government updated its money laundering regulations to combat domestic corruption. Under the new anti-money laundering laws that took effect this year, financial institutions are required to identify and scrutinize the accounts of local PEPs.

That includes anyone who holds public positions ranging from the president to prosecutors, to national, provincial and local lawmakers, and companies partially owned by state and national credit unions, whose owners are considered PEPs.

Canada’s Finance Department suggested similar measures last year, but, so far, no legislation has been formally introduced to Parliament.

The department proposed amending the Proceeds of Crime (Money Laundering) and Terrorist Financing Act of 2001 to require financial institutions to conduct special due diligence procedures when there are “reasonable grounds to suspect” an account belongs to a foreign or domestic PEP. Officials drafted the proposal after signing the United Nations’ Convention Against Corruption, which requires nations to create measures to trace, freeze and seize the proceeds of corruption or bribes by public officials.

The Finance department is reviewing more than 50 comment letters from affected financial institutions, department spokesman Greg Scott said.

The proposed amendment drew both fire and support from the Canadian Bankers Association. In a September 2005 letter to the Finance Department, the association wrote the proposal is "unclear" because many terms, such as "domestic PEP," "reasonable measures" and "enhanced ongoing monitoring" are not defined.

However, it also confirmed the need for such policies. "It seems clear to us that the need to identify foreign and domestic PEPs is a much higher standard than what is provided for in the European Union's Third Directive or in U.S. regulations," the letter stated. "This proposal might be easier to implement if an official PEP list were to be issued from time to time, just as is done with terrorist names."

Such a list could help those institutions that cannot afford the costs of additional precautions.

"If you're talking about doing something ahead of the pack, most people are going to say it's not necessary until everybody has to do it," Delston said. "Within a few years, everybody will be doing it. It's not an issue that's going away."

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