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Money Laundering Alert

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TECHNOLOGY - How to pick your PEPs: look for the middlemen in the shadows

A "Politically Exposed Person" (PEP) is a concept that all too often is left open to interpretation. By not following the very specific definitions put forth by the respective authorities and international bodies like the FATF, a financial institution faces a double-edged sword. Fall short and face the fines and reputational damage of having the wrong customers. Shoot long and overwhelm your institution with the costs and consequences of screening for the wrong individuals.

Defining an effective PEP screening process begins with understanding the historical facts of why and how these authorities came to their definitions of PEPs. The concept of a PEP originated with the Swiss. For more than 25 years, Swiss financial institutions have had a requirement for enhanced due diligence when dealing with senior foreign politicians and their families. Ferdinand and Imelda Marcos and their Swiss bank accounts were the original catalysts for what today is known as PEP checking.

Many institutions in the last quarter of a century have learned the hard and rather public lesson of not uncovering 'the man behind the man' when entering into a banking relationship. Reputational risk is certainly one of the primary motivations in getting this right going forward. But just what are we meant to be looking for? We should all be very aware of the FATF definition of a PEP. Several parts of the definition need to be carefully understood.

Separating the 'P' from the 'EPs'

A key misconception is that PEP checking involves identifying all political or government office holders. The FATF, however, clearly defines the 'P' in PEPs as being 'senior' and the "definition is not intended to cover middle ranking or more junior individuals." Of course, the 'P' stands for more than politicians and government functionaries. However, databases of tens of thousands of Russian or Chinese middle and low-ranking bureaucrats are of no value and go far beyond what regulations and common sense require.

But let's turn our attention to the 'EPs' in the PEP concept: family members and close associates. We have learned over the years that the likelihood of a questionable politician with something to hide sending his or her close family down to stand in the account opening queue at a bank is very rare. Senior government officials milking their country for millions of dollars will seldom put their spouse or children directly at risk. Nor would it make sense, if the goal is to hide one's identity, to send someone to the bank called Charles Taylor Jr. in the foolish hope that no one picks up on the name or questions the millions being transferred in haste from Liberia.

Since this is unlikely to happen, how do PEPs go about opening accounts? The real risky PEPs are the suits, the middlemen and the advisors – the men and women who stand in the shadows, broker the deals, know all the secrets, and are almost always the ones involved in account openings. The clever ones will bring a few respectable lawyers along to put on a good show and create an air of legitimacy. These people are the

PEPs you really need to look out for. In fact, I often argue that the political figure himself is the last person you need to watch.

Over the last four years I have been stunned by the pedigrees that some of these people hold. From diplomatic passports to UNESCO ambassadorships, the middlemen always cloak themselves in respectability. These PEPs know what to say and how to say it. They have answered prying questions a hundred times over and are well practiced in the process – after all, these are the kinds of individuals who negotiate billion dollar contracts. Don't believe they don't know how to handle a basic account opening procedure.

Identifying these most risky front men takes years of piecing together the global puzzle of relationship networks. There are no magical sources or Web sites that list them. I can reassure you, however, that the same names come up again and again. Each region has its handful of untouchables and it is with these "exposed persons" that your real PEP risk hides.

Another major misconception is that one should only be concerned about individuals when identifying PEPs. A FATF consultation paper from 2002 outlines that "the proceeds of corruption are typically transferred to a number of foreign jurisdictions and concealed through private companies, trusts or foundations." We are all well aware of the fact that PEPs with something to hide often do so using legal entities. Whether it's one of Benazir Bhutto's two-dozen trust companies or one of Roman Abramovich's, you are already most likely doing business with PEPs via a legal entity.

David Leppan is the founder and CEO of World-Check, which manages a database of PEPs, money launderers, fraudsters, terrorists and other known high-risk individuals and businesses for financial institutions and government agencies from around the world.

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