

PEPs: Moving Forward!

A discussion paper by David Leppan
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David Leppan founded World-Check in 2000 in order to assist the Swiss financial industry meet their KYC requirements, currently World-Check provides its global database of heightened-risk individuals and businesses to more than 2,800 institutions in 155 countries, including 47 of the world's 50 largest financial institutions and hundreds of government agencies. The database is updated daily in real-time by World-Check's international research team and is derived from hundreds of thousands of public sources. World-Check offers market leading coverage on money launderers, fraudsters, terrorists, organised crime and sanctioned entities amongst others. In addition, World-Check tracks PEPs and their relationship networks plus individuals and businesses from many other categories. World-Check offers a downloadable database for the automated screening of an entire customer base, as well as a simple online service for quick customer screening. A 97-98% client renewal rate year on year, bears testimony to the unparalleled depth, reliability and coverage of this database. World-Check's leadership within the industry has given David Leppan a unique perspective and insight on the issues faced not only by financial institutions but also by those that regulate them.

INTRODUCTION

From the very earliest days of World-Check, I recall much industry discussion on PEPs, the risk of doing business with them and the lack of an internationally accepted definition. There were even calls post the introduction of PEP requirements for regulatory authorities to produce PEP lists. Whether it was thanks to General Abacha or to the Riggs Bank scandal, the financial community has come to accept PEP checking is here to stay. This discussion paper serves to provide an opinion on how we could perhaps better address certain PEP issues and how this subject may need to evolve.

Outlined in this paper you will find ideas and comments on the following PEP related subjects

- The lack of precise PEP definition: the root of several issues.
 - PEP legislation hijacked to fight widespread national corruption.
 - Shortsighted 'foreign' PEP screening only.
 - Expiration of PEP status.
 - Suggestions on how long different PEPs should remain labeled.
 - How we could deal with those 'exposed' and their PEP term.
 - Extension to PEP 'business partners'.
 - Reactions to a lack of appetite to bank PEPs.
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"...individuals who are or have been entrusted with prominent public functions in a foreign country, for example Heads of State or of government, senior politicians, senior government, judicial or military officials, senior executives of state owned corporations, important political party officials. Business relationships with family members or close associates of PEPs involve reputational risks similar to those with PEPs themselves. The definition is not intended to cover middle ranking or more junior individuals in the foregoing categories."

Financial Action Task Force

‘Remind me why we PEP-check?’

Many appear to have either forgotten or perhaps were never aware of why we started PEP checking in the first place. PEPs were recognised by the authorities and regulators as posing a potential heightened risk for bribery, embezzlement and corruption and as such legislation was first drafted requiring the financial community to be aware of which PEPs they were banking and more importantly to be more diligent in their financial transactions with them.

The emphasis however was always on ‘Senior’ PEPs and FATF clearly outlined that its definition did not cover ‘middle ranking and more junior individuals’. PEP legislation as such was first introduced to fight high level, ‘big ticket’ corruption, embezzlement and bribery. It was never intended to provide a ‘be all’ solution to wider spread, endemic national corruption *at all levels*.

The industry’s first stumbling block with the FATF definition resulted in a call for better definition of where ‘Senior’ stopped and ‘Middle’ started. Unfortunately no official response was ever provided and so the industry and pioneers like us attempted to feel our way around the topic.

Early conversations I had with senior bankers in Switzerland on this subject evolved around, for example, mayors. The clear industry opinion was that mayors were not ‘Senior’. However when I raised the question of the possible inclusion of the mayors of all capital cities most felt this would be relevant. Realising however that St Petersburg, Lagos, Johannesburg and New York were not capitals but very influential and wealthy cities led to the inclusion of mayors in most major cities. And so the definition was ‘rounded’ by industry opinion instead of official definition.

The lack of desire by officials and think tanks to precisely define where ‘Senior’ ends and ‘Middle’ starts has resulted in a more serious issue, namely that some countries have ‘hijacked’ the PEP requirements in order to fight their societies greater problem of endemic corruption.

PEP legislation to fight ‘all evils’ at a national level?

Of great concern to me has been the adoption by certain countries of PEP legislation to fight corruption, endemic to their societies, at all levels. Some countries have over-extended national definitions of PEPs to include what internationally would be considered ‘Medium’ and indeed ‘Low’ ranking officials. They have even, at least in practice, asked the banking community to only concentrate on ‘home PEPs’. Such tunnel vision is very risky.

The lack of control, policing and the failure of the judicial process to stamp out corruption at all levels within a society should not and cannot be made the financial community’s problem. Corruption and bribery at the lowest levels will very seldom ever enter the banking system and even if it did, it is simply

unreasonable and I would argue impossible for the financial community to police all corrupt funds within a society.

We must be reminded that the very purpose of PEP screening is to fight corruption at the very highest international levels. We are talking about very large amounts of money being moved across borders, not small bribes paid to a municipal officer, as is the case under Mexican PEP legislation.

By hijacking PEP screening to fight (only) nationwide endemic corruption at all levels, bankers and financial institutions will simply drown in their task. Instead of being able to concentrate on ensuring due diligence of the highest degree is carried out on the most 'Senior' PEPs, compliance officers will be left wading through thousands of less relevant and 'small ticket' junior and middle ranking PEP corruption issues. I am not saying that corruption at lower levels should be ignored but rather that PEP legislation on the banking community is not the way to most effectively address a far larger issue within a society.

In addition, asking bankers to only screen national PEPs means that corrupt PEPs in, say Brazil, banking in Mexico, would never appear on the radar. This would be a major setback in fighting serious, high-level corruption.

Having hijacked the very purpose for PEP screening and made it only a national issue has raised an additional and most serious problem for banks that operate internationally. The concept of PEP screening now has an even greater level of disparity.

Screening for 'foreign' PEPs only?

The next stumbling block the financial community faced with the FATF definition was the concept of needing to *only* screen 'foreign' PEPs. This is a misconception. Many but not all financial institutions have come to realise and accept that national as well as foreign PEPs may pose a heightened risk and should be identified and treated with the same level of due diligence. No one can argue successfully that national PEPs bring no risk to institutions. Such a position would be very shortsighted and frowned upon by most regulators. So once again the industry has had to 'round' the definition.

Either position – using PEP legislation to look at only national PEPs but with far broader **parameters** (low, middle and senior!) or only to look at foreign PEPs – is massively flawed. How any institutions can possibly keep risk relevant information up to date on PEPs in Middle & Low ranking positions is most questionable. We must not forget the very reason for PEP screening is to fight (high level) bribery and corruption, not simply establish that an individual is a PEP.

The greater financial community must continue to restrict itself to PEP screening only senior potentates and those exposed to them. PEP checking is not the solution to society's greater ills at all levels.

*'...the source for the funds that a PEP may try to launder are not only bribes, illegal kickbacks and other directly corruption-related proceeds, but also may be embezzlement or outright theft of State assets or funds from political parties and unions, as well as tax fraud. In certain cases a PEP may be directly implicated in other types of illegal activities such as organised crime or narcotics trafficking. PEPs that come from countries or regions where corruption is endemic, organised and systemic seem to present the greatest potential risk; however, it should be noted that **corrupt or dishonest PEPs can be found in almost any country**'.*

Typology Report by FATF, 2003/4

How long should a PEP continue to be a PEP?

In more recent times, as the compliance industry understanding of this matter has matured, we have started to consider how long a PEP should remain a PEP. Until the European Union's 3rd Money Laundering Directive was issued, no official definition had been provided on the duration of PEP status. Clearly this is an area that needs addressing as the wider industry still have no sense for how long someone should remain PEP-ed. Simply keeping someone labeled as such 'forever' makes no sense.

The Expiration of PEP status:

We must admit that although being a senior politician or official might have certain privileges it certainly doesn't make one's financial life any easier. The average person on the street can be heard complaining about how KYC has complicated their daily lives and so being labeled a PEP certainly brings with it additional challenges when banking, investing or buying property. As such we need to keep in mind the 'rights' and lives of those who carry this title. And we must continue to remind ourselves that being a PEP is not equivalent to being a criminal. At the same time we need to recognise that many institutions have no appetite for PEP risk!

The European Union's 3rd Money Laundering Directive suggests a PEP expiration of one year after leaving office. This is a totally unreasonable and nonsensical expiration term when put into practice. Consider for a moment whether one would wish to or indeed feel comfortable having a PEP policy that considers Helmut Kohl, Nelson Mandela, George Bush senior or Lady Thatcher as 'normal' clients and not PEPs. Could you imagine arguing the point with a regulator or enforcement officer that you don't consider General Pinochet, Salinas, Ferdinand Marcos or Joseph Estrada to be a PEP?

Corruption, embezzlement and bribery very often only come to the fore once an individual has left office or indeed once they are deceased. Why would we, if the

very purpose for PEP screening is to fight serious, high level corruption, want to let 'bad PEPs' off the hook one year after leaving office?

Corruption cases often continue decades after someone has left office or indeed is no longer with us. The most recent high profile cases ongoing or only recently concluded include Ferdinand and Imelda Marcos, Josef Estrada, Gen. Abacha and his family, the late General Pinochet and his family and even the late Benazir Bhutto.

As such I would like to encourage the community to consider the following ideas and to view these as discussion points, not hard and fast standards which should be accepted without debate.

Firstly, let us consider PEP expiration for those who actually choose to hold a position within government as opposed to those 'simply' exposed to them:

Heads of State (elected and hereditary):

For those few individuals ever to have held the most powerful of positions within our societies we should consider their PEP status 'for life'. In real terms this would amount on average to perhaps a PEP term of approximately 25-30 years for a small but very influential number of individuals. No one can argue that a President or Prime Minister loses all influence simply by leaving office. In fact within most societies we continue to treat former heads of state with reverence and respect, providing armed escorts, diplomatic immunity and full pensions for life. As such PEP status should be extended for an equal term, in other words 'life'. Some may argue this is too harsh a position however we must be aware that these individuals, and we are not talking about very many, chose to run for office and are ultimately elected or seized power. Transparency of their financial lives is an entirely appropriate 'cost' for holding such a position.

Cabinet Ministers, Secretaries of State and similar very senior level potentates:

Although not Heads of State, individuals who hold or held such positions of influence and command in such vast departments should equally be considered PEPs for a lengthy period of time; perhaps as a minimum 3 election terms, which in most cases would mean a PEP status lasting approx. 12 years after leaving office.

Members of Parliament/Senate/House of Representatives:

One can understand how some members of parliament, especially those representing some of the world's largest or wealthiest cities may not have access to but may well be in a position to influence large amounts of money and who is granted local or regional government contracts. In comparison though to

Ministers, Members of Parliament for the majority represent a very wide cross section of society and constituencies. I would suggest a PEP status lasting two election terms after leaving office. This would on average be 8 years before their PEP status would be lifted.

For those **high level potentates** that are not elected by the public one might consider a similar time frame to the Members of Parliament, namely 8 years.

With running for office and indeed being elected, comes great reward but also great responsibility. PEP regulations hold individuals who have chosen to place themselves in such positions of power and influence financially accountable if they involve themselves in bribery or corruption. As such a measured period of PEP status post-leaving office is understandable.

With regards those 'exposed' to potentates and senior officials we must recognize that they have never chosen to be elected or held positions of influence. Their PEP status has come about through a parent, spouse, family member or business partner. As such I would argue we need to deal with the 'exposed person' differently to an actual office holder with regards the term of their PEP status after the office holder has left his or her position. I have the following suggestions to make:

Spouses of those holding office:

The spouse of an individual in any of the categories listed above should remain PEP-ed for half the time the officeholder carries the PEP status.

The only exclusion perhaps would be the spouse of a Head of State. Although there are very few if any spouses who truly have any (financial) influence after their partner leaves office, they are almost always treated with great respect within our societies for the rest of their lives and they are extended all the privileges their partner would be entitled to. As such there could be some argument to continue to deal with them under a PEP status 'for life'. This category of Spouses of Heads of State would include Imelda Marcos, Nancy Reagan, Dennis Thatcher (dec) and Cherie Blair for example.

What about PEP children?

One of the primary drivers for this discussion paper is because there is a need to be 'fair and just' in dealing with those who never held office and became PEPs simply through being exposed by one of their parents. Children clearly should not carry the label of PEP 'for life' although current definitions certainly include them while the officeholder is still in office. Even this is an area one could improve upon.

One could consider:

Children of Officeholders under the legal age

At the time their parent/s leave office, should not be considered PEPs. If they subsequently enter politics then they expose themselves in their own right to PEP status.

Children of Officeholders who are the legal age

At the point at which their parent/s leave office, should be considered PEPs for a maximum period of 3 - 4 years, the equivalent of one term in office. Naturally this should only be the case as long as the child has not actively entered into the political arena or assumed a senior role within a State Owned Enterprise. The case of a son following a father as president or leader of a country would of course automatically render the child a PEP in their own right.

I realise 'de-Pepping' a child of legal age (i.e. an adult) might be one of the trickiest area's we need to consider. Certainly examples like Sir Mark Thatcher, Tommy Suharto or even General Abacha's sons or Gen. Pinochet's children would provide ample examples of why a very senior PEP's children should remain PEPs for lengthy periods. Apart from the children of such senior political office holders, the vast majority of PEP children should not be held accountable for any great length of time by being labeled a PEP for a position their parent/s held.

Some within the industry might even argue that the children of the hundreds of thousands of 'average' members of parliament from around the world should never be PEP-ed at all. A position I would support.

Extended family members:

Official PEP definitions have come to include parents, 'in-laws' including brothers and sisters and even in some cases aunts and uncles. I would suggest that all of these individuals at a maximum carry PEP status for only as long as the officeholder's spouse.

Business partners:

This is recognised as one of the higher risk areas when it comes to 'bad PEPs' concealing their ill-gotten gains. The usage of 'respected' middlemen and trusted business partners, especially those awarded government contracts, is common practice. One might therefore consider that business partners of all Heads of State and all Cabinet Ministers/Secretaries of State should maintain their PEP status for as long as the officeholder's spouse does.

In addition the area of business partners certainly requires expansion to include those who donate large sums to a candidate's election campaign.

Additional consideration on de-listing of PEPs:

Certainly FATF encourages one to consider the geo-political conditions of a country and region when dealing with PEPs. By using industry recognised and accepted third party standards for the risk ranking of countries, one might consider either reducing or extending the period a person remains PEP-ed as part of a risk based approach.

Lost PEP appetite:

One of my greatest concerns is that more and more PEPs end up being excluded from our banking system. We must be very aware of this issue. PEPs pose only a potential risk. They are not terrorists, money launderers, narcotics traffickers or necessarily high risk to any institution. They are to be identified and their account activities monitored for any form of bribery or corruption but they remain bankable as long as one has the relevant PEP policies and procedures in place.

We certainly have seen and it is very much understandable post the Riggs scandal that some banks have simply decided they have no appetite for PEP risk and as such will not bank PEPs. In the aftermath of Riggs, much of the Washington based foreign diplomatic community found themselves without bankers and U.S. officials had to step in and encourage and/or reassure banks they could and should bank these foreign dignitaries.

A high level of ignorance and/or indeed incompetence in some institutions results in PEP business being turned away because they don't understand the complexities of the issue. Taking such a position will lead to a reaction from the powers that be within our society and to an evolution of how corrupt PEPs have to deal with their financial matters.

We have seen '*PEP backlash*' to the way the financial community has dealt with PEPs or more correctly stated, not dealt with them. I am aware of at least 2 cases in Asia. The first relates to a junior employee of a European bank that turned down a loan application because the applicant was a PEP and then faced public ridicule when this matter was discussed in parliament and the bank subsequently had to rather publicly relent. The second case, although difficult to imagine happening in downtown Chicago or Central London saw supporters of a politician ransack a bank branch in reaction to the way 'their man' had been maltreated by the bank in question.

Corrupt PEPs with money to hide will evolve their tactics and will be forced 'underground'. What I mean by this and what we have witnessed in many jurisdictions is a move by 'bad' PEPs to hide their identities and manage their

wealth through trusts, corporations and even charities. And we are all too aware that identifying the beneficial owners of a trust is a KYC challenge. Forcing PEPs underground will only make our task within the compliance community more difficult. As such we must find a way to fairly and justly deal with PEPs – the good, the bad and the ugly ones.

Final Comment:

A combination of the lack of a precise definition, flawed interpretation, overstretching and indeed 'nationalising' of the PEP definition and simply forgetting the very reason why we PEP check has resulted in the issues outlined above. In addition, the industry has started to mature and questions of great relevance to the expiration of PEP status are now being asked. By no means do my comments or suggestions in this paper reflect our current policy at World-Check to incorporate or indeed de-list PEPs. However our longstanding commitment as pioneers and industry leaders places us in a unique position to identify what compliance issues lie hidden just below the surface. In light of the limited official response on so many of these subjects, I have been encouraged to speak out and raise some of these issues in the hope that the industry as a whole will start to consider the way forward on PEPs. This discussion paper would be a good starting point, in my humble opinion.