

The Challenge of PEPs



The Origins of the Concept of PEPs



In November 1993, General Sani Abacha seized power in Nigeria and ruled the country with an iron fist for much of the decade. During his time in office, he was able to exploit his powerful position to raid the country's coffers and launder funds into Europe in a heist that has rarely been matched in either breadth or criminal ambition.

On his watch, between \$3-4 billion was stolen from the Nigerian Central Bank and laundered overseas.

This was done — as the general's representatives later articulated — for a variety of opaque "state and security purposes."

A total of \$750 million was paid into Nigerian bank accounts and then transferred into various European bank accounts owned by Abacha and his associates. In addition, a company beneficially owned by General Abacha and his business partners purchased bills of exchange that the Nigerian Central Bank guaranteed and later repurchased by the

Nigerian Ministry of Finance on Abacha's instructions in a deal that left the beneficiaries in profit of approximately DM 500 million. As part of this theft, an English company owned by Abacha connections sold vaccines to a Nigerian family support program — a program ultimately owned and managed by General Abacha's wife — at an alleged profit of about \$80 million. The laundered funds were then deposited in overseas bank accounts located in Switzerland, the United Kingdom, France, Luxembourg, Liechtenstein, and other jurisdictions, all controlled by Abacha, his family and close business associates.

Following the general's death in 1998, the new Nigerian government made strenuous efforts to recover the stolen funds and, in 2001, began to lodge complaints with several European authorities, including the Federal Office of Police of Switzerland. In response, the Swiss launched a series of major investigations into dozens of Swiss banks, and eventually, some of the money — certainly far from all — was returned to Nigeria.

It was in the context of this high-profile and very public international investigation into repatriating Abacha's stolen monies that the concept of politically exposed persons (**PEPs**) emerged as distinct from criminals and terrorists



(though politically exposed persons may be both) and their connection to money laundering and other financial offenses gained traction.

Of course, Abacha was not alone in exploiting a political position and role to partake in corruption, bribery, and, ultimately, money laundering. Many leaders in public roles have exploited political positions and connections to enrich themselves and those around them.

In 2003, the United Nations Convention against Corruption (UNCAC), while not directly using the term “politically exposed persons,” highlighted the particular susceptibility of public and foreign officials holding legislative, executive, administrative, or judicial positions to the possibilities of bribery and embezzlement, money laundering, misappropriation, trading in influence, abuse of functions, concealment and obstruction of justice. Article 20 of UNCAC, which deals with illicit enrichment, imputes criminal behavior to individuals whose assets cannot be explained in relation to their lawful income. Article 52 calls upon State Parties to take measures, inter alia, to enhance scrutiny “of accounts sought or maintained by or on behalf of individuals who are, or have been, entrusted with prominent public functions and their family members and close associates.”

This enhanced scrutiny aimed to detect suspicious transactions, especially corruption, and to report such suspicions to competent authorities. It was nevertheless emphasized that this scrutiny should not be construed as an effort to discourage or prohibit financial institutions from doing business with any legitimate customer.

Concomitantly, in 2003, the Wolfsberg Group, a set of global banks committed to combating financial crime, issued guidance (later updated) on how to treat politically exposed persons. Similarly to UNCAC, the Wolfsberg Group’s emphasis was on the detection of “grand corruption,” which is defined by Transparency International as “acts committed at a high level of government that distort policies or the central functioning of the state, enabling leaders to benefit at the expense of the public good.” Other instances of corruption, including those found within the private sector, were to be identified through the financial institution’s risk-based approach — specifically during the client onboarding and customer due diligence process, as well as later by way of ongoing monitoring of the client relationship with the institution.

However, the concept of PEPs and the measures financial institutions must undertake to combat the financial threat posed by such persons received its most comprehensive articulation in Financial Action Task Force (FATF) guidance. FATF first approached this problem in June 2003 as part of its 40 Recommendations. The focus then was on foreign PEPs, their family members, and their close associates. In February 2012, FATF sought to align its approach with that of UNCAC and began adding domestic PEPs and PEPs linked to international organizations to its ambit of attention.

FATF guidance on Politically Exposed Persons (Recommendations 12 and 22) was published in June 2013 and, while essentially non-binding, strongly informs national and institutional efforts to combat the danger of such persons exploiting their positions for personal enrichment. These globally sourced guidelines provide the foundation for national PEP identification and response efforts. While national approaches inevitably vary, core elements of their strategies remain similar across jurisdictions.

What Constitutes a PEP?

FATF defines a PEP as an individual who is or has been entrusted with a prominent public function other than a middle-ranking or junior official. A consequence of this position and influence is the emergence of particular financial risks because such persons may potentially act to abuse their roles to commit money laundering crimes and related predicate offenses, including corruption, bribery, and terrorist financing. Financial institutions, non-financial institutions, and the professions are thus obliged to implement specific measures to detect this type of misuse of the financial system when it occurs.

Specifically, the FATF guidance requires countries to enact legislation requiring institutions to adopt measures beyond normal customer due diligence to determine if the institution — financial or non-financial — is doing business with a PEP and what level of risk those transactions pose. Steps to protect the institution against such threats may need to be adopted. In certain circumstances, the relevant authorities may need to be notified.

Implementing PEP identification requirements has, in practice, proven to be a very difficult, time-consuming, and expensive challenge for state authorities and financial and non-financial institutions. This stems from several reasons, including:

- There is no single global definition of what constitutes a PEP. Available definitions are open to a significant degree of interpretation.
- The PEP definition has been broadened to include family members and close associates, ambiguous terms.
- An enormous number of persons potentially fall within these definitions.





- Traditional databases designed to capture all potential PEPs are limited.
- Legacy databases struggle to ingest and process updates at the required pace, especially as power changes hands constantly.
- It's often difficult to find secondary data points to identify a PEP.
- It's unclear to what extent an individual that has stepped down from their post is still considered a PEP.

What actual functions are considered when determining PEPs? Take, for example, the list provided in Section 35 (14) of the UK's Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017, which identifies PEPs as:

- a. Heads of state, heads of government, ministers, and deputy or assistant ministers.
- b. Members of parliament or similar legislative bodies.
- c. Members of the governing bodies of political parties.
- d. Members of supreme courts, constitutional courts, or any judicial body where decisions are not subject to further appeal except in exceptional circumstances.
- e. Members of courts of auditors or the boards of central banks.
- f. Ambassadors, *chargés d'affaires*, and high-ranking officers in the armed forces.
- g. Members of state-owned enterprises' administrative, management, or supervisory bodies.
- h. Directors, deputy directors, and members of the board or equivalent function of an international organization.

This represents a standard list of general PEP functions. It is to be expected, however, that not all financial or non-financial institutions will employ identical frameworks to classify or manage PEP relationships, as such categorizations will be a function, *inter alia*, of the services offered and the jurisdictions in which the institution operates.

EU Directive 2005/60/EC provides a risk-based approach to treating PEPs where public functions exercised at levels lower than 'national' should normally not be considered

prominent. However, where their political exposure is comparable to that of similar positions at a national level, institutions and persons covered by the directive should consider, on a risk-sensitive basis, whether persons exercising those public functions should be considered politically exposed persons.

As the United States Financial Crimes Enforcement Network (FinCEN) points out, “[t]he definition of senior official or executive must remain sufficiently flexible to capture the range of individuals who, by virtue of their office or position, potentially pose a risk that their funds may be the proceeds of foreign corruption. Titles alone may not provide sufficient information to determine if an individual is a PEP, because governments are organized differently from jurisdiction to jurisdiction.”

Canada goes into more depth when defining a PEP. Guidance from FINTRAC defines a PEP as “a politically exposed person or the head of an international organization entrusted with a prominent position that typically comes with the opportunity to influence decisions and the ability to control resources.” This ‘influence’ and ‘control’ puts them in a position to impact policy decisions, institutions, and rules of procedure in allocating resources and finances, making them vulnerable to corruption. The Accounting and Corporate Regulatory Authority of Singapore and the Hong Kong Monetary Authority (HKMA) exclude public roles held by middle-ranking or junior officials. Other jurisdictions sometimes classify these roles as Level 4 PEPs in accordance with FATF standards.

In India, amendments to the Prevention of Money Laundering Act 2002 were made in March 2023 with the introduction of the Prevention of Money Laundering (Maintenance of Records) Amendments Rules 2023. A new clause defines PEPs as “individuals who have been entrusted with prominent public functions by a foreign country, including the heads of States and Governments, senior politicians, senior government or judicial or military officers, senior executives of state-owned corporations and important political party officials.” The purpose of the amendment is to show conformity with the 2002 circular on KYC published by the Reserve Bank of India.



A PEP may still be at high risk when they leave their position. Former PEPs may maintain a degree of influence and pose a money laundering risk, especially if they were serving as senior public officers or heads of state.

Australia's AUSTRAC and the UK's Financial Conduct Authority (FCA) consider a person or their family members or close associates not to be PEPs once they leave their high-profile position. The HKMA takes a different approach and considers a PEP is always a PEP, even once they've left public office.

Depending on the jurisdiction involved, local regulatory demands may require a broader PEP definition than that described above. The lack of a single universally accepted PEP definition is an ongoing challenge. Although the United Nations Convention against Corruption, FATF and/or the EU AML Directives provide similar definitions used in most jurisdictions, they are not identical.

Further, there are still areas of ambiguity. For example, what constitutes a state-owned enterprise could vary from jurisdiction to jurisdiction and may even be left up to the financial institution. Along those lines, does 'state-owned' refer only to those companies where the government has a controlling stake at the national level, or does it also apply at a regional or local level?

Other examples include a high-ranking position within the military or what should be classified as an international organization.

Even where the definition may be the same, the practical application for client onboarding and ongoing monitoring purposes may differ markedly.

For example, the FCA stresses that the definition of "prominent public function" will vary according to the nature of the function held by a person. The FCA expects "firms to understand the nature of the position held and whether the function gives rise to the risk of large-scale

abuse of position." If an individual holds a position in a jurisdiction assessed as having a lower risk of large-scale corruption, then only those with true executive power should be considered to hold a prominent public function. Whether institutions in the UK or internationally will employ the same interpretation and resulting due diligence standards is unclear.

That a high degree of subjective analysis is inevitably involved in PEP analysis is also reflected in interpretations of who is not a PEP. As noted above, FATF excludes those who are junior or mid-ranking from the definition of PEP. Yet, Canada has decided to include all Canadian mayors, regardless of the size of their municipal locality, within its definition of a PEP.

Also, as the FCA again notes, "a firm should be alive to the potential that middle-ranking and more junior officials could act on behalf of a PEP when assessing the overall risks a customer might present; where it assesses there might be a risk, a firm should consider what additional measures it needs to take." This involves sophisticated local knowledge and time-consuming analysis that may not always be present.

The Wolfsberg Group attributes the lack of an accepted definition of what constitutes a PEP and the existence of regional and local differences in interpretations as part of the reason the efficacy of PEP screening has been diluted.


Calls to standardize approaches to PEPs have sought to address problems of classification and interpretation. The **Wolfsberg Group**, for example, has recommended that FATF encourage its members to produce lists of senior and prominent political posts or the holders of public function, as this would help financial institutions focus their limited resources on high-risk scenarios. And indeed, the Fifth Anti-Money Laundering Directive (**5AMLD**) requires European Union member states to compile a functional PEP list that features positions considered politically exposed, though not the names of persons fulfilling the functions. The European Commission also intends to produce a list of prominent public functions that they will make public. Such functional lists will aid smaller compliance teams in identifying PEP vulnerabilities and may also help standardize approaches to this problem.

PEPs and Risk

The purpose of identifying PEPs is to determine both the level of risk posed to an institution and the steps that need to be taken to protect the institution from the threat posed by criminal conduct undertaken by a client PEP, the ultimate beneficial owner who is a PEP, or family or close business associates of that PEP. To that end, it is important to recognize that not all PEPs pose an equal threat.

Hierarchies of PEPs: In practice, there is a spectrum of PEPs, from those who have significant control over resources and assets in any particular country — and which might pose the highest risk to the institution — to those who are to be located just above junior or middle-ranking officials. Consequently, some categorization models differentiate between genuinely prominent functions, such as heads of state, ministers, senior judicial officials, high-ranking officers, senior executives, and senior officials of major political parties, and a set of functions that may be considered to fall within the definition but could also be excluded depending upon the level of corruption within a given jurisdiction. This latter group may include city mayors and governors, leaders of federal regions, members of parliament, and heads of supranational bodies. Ultimately, a risk-based approach should be employed to determine where a particular individual is to be found on a PEP spectrum and the level of risk presented to the institution.





Foreign and Domestic PEPs: Approaches to identifying and dealing with PEPs often differentiate between foreign PEPs and domestic PEPs. The consensus is that foreign PEPs are more dangerous than domestic ones, not least because an institution may not have firsthand knowledge of the circumstances of a foreign PEP. FATF admits that “it is extremely difficult for financial institutions and [non-financial institutions] to determine which customers would be considered PEPs in a foreign country.” The largest risks are when a PEP seeks to establish a relationship with a financial institution outside its home jurisdiction without any discernible explanation or business rationale. Of course, it is not always the case that domestic PEPs present more risk than the foreign category, especially for smaller financial institutions with limited exposure to overseas financial markets. It should be noted that some jurisdictions are not required to search for domestic PEPs. This lack of focus in several countries may reflect political pressures where too much self-analysis, especially in financial affairs, is regarded as unwelcome. The Wolfsberg Group states that financial institutions should assess the risk posed by PEPs regardless of whether they are foreign or domestic and apply appropriate due diligence standards.

Dealing with the PEP Risk Level

Alongside identifying a PEP, an institution will need to determine the level of risk posed by that PEP. High-risk PEP threats will demand enhanced due diligence. In responding to low-level threats, simplified due diligence may suffice.

Institutions will need to deploy appropriate risk management systems and proactive steps to help them determine if a customer or the beneficial owner of a customer is a foreign PEP. Such a system will depend upon the nature of the institution's business, client profile, and expected transactions, among other factors.

This is because foreign PEPs are, in most cases, considered high-risk and will require the institution to apply enhanced due diligence measures — similar to those required in other high-risk situations — beyond the normal customer due diligence process. The institutional decision to onboard such a high-risk client or to continue the business relationship with this type of PEP must also be taken at the senior management level, to which the decision must be escalated.

Examples of this enhanced due diligence include acquiring additional information on the foreign PEP; obtaining

additional information on the intended business relationship and the underlying reasons for the relevant transactions; obtaining information about the PEP's source of funds and source of wealth; and conducting increased monitoring of the business relationship, including increasing both the timing and number of applied controls as well as making an effort to identify transactions that require further investigation. As noted above, the decision to onboard such a client needs to be escalated and taken at a senior level of management. This escalation would also be required when there is a need for a decision to continue business with an existing client that is or becomes a PEP.

Concerning domestic PEPs and international organization PEPs, the approach is initially more relaxed. According to FATF, institutions are required to take reasonable measures to determine if a customer or beneficial owner constitutes such a PEP. A risk assessment of the PEP's business relationship will have to be conducted. Such a risk assessment should determine if the institution's business relationship with the PEP is low or higher risk. The assessment will consider



customer risk factors, country risk factors, products, and any service transaction or delivery channel risks. To this analysis will need to be added an assessment of the nature of the political function that the PEP holds, including the PEP's level of seniority and access to public funds. If the risk is low, enhanced due diligence can be avoided. If not, the approach to foreign PEPs should be replicated, and enhanced due diligence be undertaken for the domestic or international organization PEP.

In any event, it is conceivable that even if a business relationship is deemed initially to be low risk, it can, over time, transform into a high-risk one. Ongoing monitoring is, therefore, a key requirement when maintaining or deciding to continue a PEP relationship.

FATF thus emphasizes that institutions "should be satisfied, based on reasonable measures, that the domestic/ international organization PEP is not a higher risk customer, at the account opening stage or at a later stage." In practice, however, many institutions do not, at either their onboarding or ongoing monitoring phases, differentiate between domestic and foreign PEPs. One customer onboarding process serves all types of customers.

Some organizations might require prospective customers to answer a series of questions, including information about their PEP status. However, self-identification is not always reliable. The definition of a PEP is sufficiently complicated and open-ended that some PEPs might not realize their status. Some might also provide false information to avoid enhanced due diligence measures. The potential inadequacy of self-identification means that organizations must rely on a combination of checks for PEP identification. They can conduct their own, typically using searches on publicly accessible resources, and they can use databases provided by third-party vendors.

When institutions suspect or have reasonable grounds to suspect that the funds they are being asked to deal with are the proceeds of crime, they may need to file a suspicious transaction report to the relevant authorities.



Red Flags and Risk

Just because a client is identified as a PEP does not mean that they cannot be onboarded or that work cannot be undertaken for them. All it means is that actual risks must be identified and quantified. This will allow the institution to take the necessary steps to protect itself in any relationship with a PEP.

Indicators that the PEP may present a lower risk could include:

- **Geographical factors** – The PEP's function is within a jurisdiction with low corruption levels, strong state institutions, well-developed registries for owners, strong records for investigating political corruption, an independent judiciary, a free press, political stability, and fair elections.
- **Product factors** – The PEP wishes to access a product or service that the institution has assessed to pose a low level of money laundering risk.
- **Personal factors** – A PEP may present a low risk where they are subject to rigorous disclosure requirements or do not have executive responsibilities (for example, an opposition member of parliament).

In such circumstances, simplified due diligence may suffice at the onboarding phase despite the identification of a PEP. Conversely, indicators that a PEP may pose a higher risk include:

- **Geographical factors** – The PEP's function is within a high-risk country with high levels of corruption, weak anti-money laundering defenses, extensive organized criminality, limited free press, a criminal justice system that lacks independence, and limited transparency of registries.
- **Product factors** – The PEP wishes to access a product the institution has assessed as having a high risk of being exploited for money laundering purposes.
- **Personal factors** – The PEP may be identified as displaying a lifestyle or personal wealth that is inconsistent with legal sources of wealth or income, is subject to



(credible) allegations of financial irregularity, and can influence public procurement projects, especially where they are not subject to competitive tender, or can influence the allocation of valuable government licenses.

Red flags concerning PEP family members and close associates include:

- Wealth derived from the granting of government licenses.
- Appointments to public office that appear to be inconsistent with public merit.
- Wealth and lifestyle are inconsistent with known legal sources of wealth or income.
- Wealth is derived from sectors with a lack of competition or high barriers to entry.
- Wealth is derived from preferential access to the privatization of former state assets.

In these circumstances, enhanced due diligence of the type described above must be undertaken before the PEP is onboarded.

Time Limits

What happens when a PEP no longer holds a prominent public function?

FATF admits that the existing relevant language is consistent with an open-ended approach (“once a PEP, always a PEP”). However, it suggests that once an individual is no longer entrusted with a public function, there should not be prescribed time limits on the PEP treatment but rather a risk-based approach to when that person would not be treated as a PEP.

The risk-based approach in this context involves an assessment of (i) the level of informal influence the PEP still

exercises and the seniority of the position; and (ii) whether the PEP’s previous and current positions are linked (formally or informally) in any other way.

In practice, the general approach in many jurisdictions has been to apply enhanced due diligence measures for at least 12 months after the date on which the individual ceases to fulfill the public function or any longer period as may be considered appropriate.

With respect to family members and close associates, there is no extension period beyond the time that the PEP ceases to fulfill a prominent public position.



The Use of Databases

Firms are not required to conduct extensive investigations to determine whether a client is a PEP. Rather, they will need to have regard for information that is readily in their possession or publicly known. These can include:

- Public domain information, including official websites, websites of reliable news sources, reputable non-governmental organizations
- Public registers
- Commercial databases

Extreme care should be taken to ensure that the databases employed — public or commercial — are extensive, dynamic, and up-to-date.

