

# Exposing the politically exposed

With the release of the so called “Panama Papers”, 11.5 million leaked documents became public property; revealing arrangements carefully set up by the owners of more than 200,000 offshore entities. The leaked documents were created by Panamanian law firm and corporate service provider, Mossack Fonseca, with some dating back to the 1970s.

The release provided a spotlight on how offshore companies are used by the rich and famous from countries all around the world. Of course this is not against the law, provided offshore companies are not being used to hide income or illicitly generated wealth. The headlines suggested though that for public figures or Politically Exposed Persons (PEPs), the very fact of having an offshore company could itself warrant suspicion. The media focused intensively on companies held by five then-heads of state or government from Argentina, Iceland, Saudi Arabia, Ukraine, and the United Arab Emirates, as well as more than 60 government officials, close relatives and close associates of heads of government of more than forty other countries. The Prime Minister of Iceland, Sigmundur Davíð Gunnlaugsson was quickly forced to resign as his countrymen considered such arrangements, albeit legal, as inappropriate for their head of state. Pakistan’s supreme court has also removed the Prime Minister, Nawaz Sharif, from office in relation to corruption allegations unleashed by the leak of the Panama Papers.

Although the proportion of PEPs in the Panama papers has been small when compared to the total number of individuals named, there has quite rightly been a significant focus on investigating whether PEPs have used any of these companies for any wrongdoing. Investigations into these companies are possible because international standards require meticulous records when establishing and running an offshore company, which creates a paper trail and a way to track those companies to their beneficial owners. As a result, tracing asset movements through offshore companies is in many ways easier than it would be had funds moved through vehicles such as cash or diamonds.

Nonetheless, the level of public scrutiny and outcry over the PEPs

named in the Panama Papers demonstrates the very high standards of transparency expected of those in high office. And rightly so. Corruption remains a significant issue in many countries, and one that has a very real impact on the people who live within them. Large corruption investigations have recently brought down the ruling Presidents in both South Korea and in Brazil, media reporting of the 1MDB case suggests suspicions of corruption against those close to the Malaysian Prime Minister, and former Nigerian Oil Minister Diezani Alison-Madueke has been charged in the UK and Nigeria with corruption and money laundering.

**Banks have a key role to play in combating this sort of grand corruption. They have had to raise their games in relation to PEPs since PEP regulations were introduced in the early 2000s, following scandals such as the one that implicated a number of banks in laundering monies stolen by dictators such as Sani Abacha from Nigeria.**

PEP rules require banks to identify clients whose prominent public functions or relationships offer them opportunities for corrupt enrichment so that they can apply appropriate controls to avoid handling the proceeds of corruption. Controls include additional levels of due diligence, which now extends to corroborating the source of the client’s wealth, and heightened monitoring. These controls may well be one reason that more PEPs weren’t found within the Panama papers. According to media reports, many of the clients of Mossack Fonseca were referred by large European banks which have longstanding policies designed to screen and monitor PEP risks and to prevent money laundering.

## Targeting the risk: the importance of identifying the right clients

The cases cited above prove that the most stringent controls are still required for those that are genuinely in senior, prominent public positions, and who have substantial authority over policy, operations or funds, as well as their family members and close associates. These controls are of great value in preventing the laundering of the proceeds of grand corruption.

Current trends though threaten to shift the focus away from grand corruption and towards a broader, catch-all approach to PEP risk. As a result of new laws (including applying the PEP definition to so-called domestic PEPs), more prescriptive regulatory expectations and the fear of regulatory sanction, many banks have been designating more customers as PEPs than ever before. This has even extended

to corporate clients which may have a PEP on the board of directors.

A particular concern has arisen around the treatment of State Owned Entities (SOEs), given the tendency by many Banks to classify them as PEP-linked clients due to the number of PEPs who sit on their Boards. While the assets of State Owned Entities may in some cases be misappropriated by management, in other cases the PEP is simply a salaried employee within the organisation and poses no significant corruption risk. As such, blanket rules which classify all SOEs as PEP-linked because of their public ownership run contrary to a proper risk based approach that should examine each SOE individually. Similarly, a PEP on the board of a large corporate, which may be

listed on a stock exchange or regulated by financial services regulators, is unlikely to introduce the risks of handling the proceeds of corruption into the relationship with that corporation.

As well as banks, watch list providers have significantly grown the size of their own lists which banks use to match customer data and identify PEPs. In practice, the interpretation of “prominent” now includes public function holders who really should not be caught by the PEP regime, but rather by the banks’ risk assessment process which have also been considerably enhanced since start of the 2000s. This PEP “proliferation” drives up the costs of compliance, and presents challenges when opening new accounts and maintaining existing ones.

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## The negative effects of PEP ‘Proliferation’

This PEP proliferation trend has the potential to move the focus from those PEPs who have the ability for large-scale, high-level abuse of power, for which the controls were intended, to one more diluted and burdensome which will inevitably identify individuals with lower level public functions. Whilst low level bribery and corruption are often predicate offences for money laundering, they are not the type of activity that the PEP regime was designed to combat.

Unless we reverse these trends, we will continue to see unintended and negative consequences. For Governments and for Banks, it risks reducing the effectiveness of the policy response to grand corruption. In the worst case, banks risk arriving at a situation where we cannot see the “wood for the trees,” - a situation in which the focus on identification, assessment and risk mitigation for those PEPs presenting true grand corruption risks is replaced with a more a “tick box” approach employed to deal with a volume problem.

For customers, this adds an often unnecessary administrative burden, extending sometimes to individuals losing access to banking services. This has recently been picked up by members of the UK Government who are calling for a more proportionate application of the PEP regime, in particular for so called Domestic PEP’s.

The Wolfsberg Group, of which Standard Chartered Bank is a member, has also been considering the appropriate response to the PEP question, and has made a strong call for a return to a risk-based approach to the classification of PEPs. In May 2017, the Group issued a [set of updated PEP principles](#) that reflects evolving industry practises and regulatory expectations, and calls on all involved parties to focus on proportionate responses to improve effectiveness and efficiency.

## The end of the peer

In a recent debate in the UK House of Lords, several Lords expressed unhappiness that they had been denied access to banking services simply as a result of being a member of the UK’s unelected upper chamber.

“Even before the fourth directive has come in, many Members of this House and their relatives are being treated as PEPs. I myself and my son were unable to access an ATM and my brother was unable to exercise a joint power of attorney. What steps is the Treasury taking to show Members of Parliament in both Houses that in future they will not be treated in exactly the same way as a deposed dictator or a political pariah?” Lord Clement-Jones

In reply, the Government Minister responsible at the time, Lord Deighton, advocated the risk based approach set out in this article:

“In the main UK parliamentarians should be assessed as low risk and, frankly, treated in precisely the same way as any other customer. The problem is when banks do not apply the right kind of risk-based assessment and instead revert to inappropriate box-ticking approaches.”

## Royal baby put on crime watchlist

In December 2016 the British Press reported that one of the major watchlist providers had put Miss Maud Windsor onto its PEP watchlist, as she was 47th in line to the British throne. Miss Windsor was at the time 9 months old.

## Standard Chartered Bank’s approach to PEPs

At Standard Chartered Bank, we have established a specialist PEP and Sensitive Client Unit within Financial Crime Compliance. This unit focuses on identifying risks posed by PEPs, in particular the risks that they may use banking services to launder the proceeds of grand corruption, as opposed to petty corruption, which is managed by our normal risk based controls. There are three core elements to the approach:

- An enhanced, risk based PEP definition. While there are some public functions whose holders will always be classified as PEPs (such as Heads of State and Government Ministers), others will only be classed as PEPs if the position leaves them vulnerable to grand corruption.
- Reliance on judgement of compliance experts rather than watch lists to decide who meets that definition, and working with our Vendor Watch List supplier to focus more on the quality of data included in lists and the identification of truly prominent public position holders, rather than on exponentially expanding the numbers caught in an overly broad net.
- Tighter controls and ongoing management of the highest risk.

PEPs, for example more senior PEP’s, PEP’s from countries with high corruption levels, and / or PEP’s with opaque or overly complex financial arrangements.

Those clients that pose the very highest inherent risks are reviewed by senior management and by our independent PEP and Sensitive Client Unit and enhanced controls are employed to address the risks.

The benefit of this approach is that control frameworks can become more sophisticated for those who genuinely pose a high inherent corruption risk. Product offerings can be differentiated, and the higher risk products withheld (a head of state with a credit card in their home country is less likely to be laundering proceeds of corruption through that product than one with offshore wealth management products. For any PEP clients beyond our risk tolerance, we actively avoid any dealings.

The question of how best to manage the risk posed by PEPs is therefore fully integrated into the overall Risk Based Approach as part of a holistic customer risk assessment process.

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### The future of the PEP regime

Whilst banks play an important role in helping to fight corruption, we believe that a multi stakeholder approach and public private partnership remains the best strategy. We believe that there is more that Banks can do including fully implementing the new PEP guidance issued by the Wolfsberg Group. However, beyond the banking sector, others have a bigger role to play in creating a more risk based, efficient and effective PEP regime.

Parties who could further drive forward the fight against corruption include:

- Watchlist providers, who can adopt a more risk based definition to ensure that those on the lists really do hold prominent positions, and can provide guidance on which positions in countries prevent the holder from holding offshore accounts.
- Governments, who could issue country PEP lists; make clear what their expectations are for the senior PEPs in their own countries in terms of holdings and disclosures of foreign accounts and assets; and more broadly ensure anti corruption measures are strengthened.
- Media and NGOs, who could highlight the most corrupt countries, regimes and credible evidence of corruption exists.
- Law enforcement, who could increase prosecutions and or civil forfeiture actions or similar; acquire the tools to seize assets such as unexplained wealth orders which would

increase the level of assets seized; share more typologies and insights on the evolving nature of the risks and how the laundering of corrupt funds is being undertaken;

- Regulators, who could adopt a more risk based approach to the way they assess compliance with a PEP regime, ensuring that it is not a tick the box exercise but assesses whether a bank is really assessing and managing risks properly. A recent example of thoughtful approaches distinguishing the risks of different types of PEP relationships has recently been suggested by the UK FCA in their recent [Guidance document](#).
- Policy makers, who could bring greater clarity to the objectives for PEP regimes and identify where resources are most needed to achieve those objectives. This includes solid frameworks for cooperation and information sharing between law enforcement and the private sector. Pilots of joint work in the United States and the UK have been a positive step in this regard, but information sharing amongst banks should also be considered, with appropriate safeguards.

Working together in this way will further strengthen the financial system and make it a more hostile place for those who seek to enrich themselves at the expense of the societies they once pledged to serve.

### PEPs and fighting financial crime

“The abuse of high level power for personal gain has ruinous social and economic effects on countries, causing a breakdown in the contract between governments and their citizens and creating societies where inequality and poverty are rife. Banks have a duty to make sure that the minority of leaders who engage in such corruption are not able to launder the proceeds of their criminality. The best way to do so is through an effective risk based regime that imposes the toughest controls on the highest risk clients, but which also recognises that most of those in public life have neither the opportunity nor the intention to abuse their position to benefit themselves.”

**Lucy Rahal | Head, Financial Crime Compliance, PEP and Sensitive Client Unit**