From Potentates to Politically Exposed Persons

It is 25 years since the term "Politically Exposed Persons" was first used publicly, and it came from the Chairman of the Swiss Banking Regulator in an address to the Basel Committee on Banking Supervisors in Basel on 21st September, 2000. The need for such a term and to ensure collective international action arose from the experiences of Banks and Banking and their exposures to funds derived from grand corruption largely overseas, dating back to the 1970's though to the end of the 1990's. It is instructive to review the timeline that both led to the genesis of the term "Politically Exposed Persons" which could instead have been "Potentate Risk". The experiences in Switzerland in particularly and the reaction by Swiss Regulators cannot be overstated to ensure it was internationalised first via the Basel Committee on Banking Supervision in 2001 and by the FATF in 2003 (First used as a term by FATF in May 2002). Whilst it was the Chair of the Swiss Financial Banking Commission that gave the speech on the 21st September, 2000, it was the Director and Head of the SFBC, Daniel Zuberbuhler (appointed 1986 Deputy Director and 1996 as Director) who did most to bring this about.

Background and Context:

During the 1970's following a number of corruption scandals in the USA, The Foreign Corrupt Practices Act (FCPA) was enacted in 1977 to combat bribery of foreign officials and ensure transparency in accounting practices. It comprises two key provisions: anti-bribery and accounting requirements, which apply to U.S. companies and foreign entities operating within U.S. jurisdictions. The FCPA prohibits offering, promising, or providing anything of value to **foreign officials** to influence their decisions in securing or retaining business. It also requires companies to maintain accurate financial records and implement internal controls to prevent corruption. The definition of **foreign officials**[1] is extremely broad and is not limited to cases of grand corruption.

During the 1980's and the 1990's, Banks in particular had been identified as involved in operating accounts and moving funds suspected to have been misappropriated from state funds by foreign Presidents. For example in 1986, following **President Ferdinand Marcos'** removal from power in the Philippines, significant assets (US$680 million) were identified in Swiss Banks, which would be frozen and ultimately returned to the Philippine government.

This scandal plus the Duvalier (Haiti) scandal led the Swiss Federal Banking Commission (SFBC) adopting a practice recommendation in 1987[2] requiring that decisions within banks to establish business relationships with a ***"prominent political figure"*** should only be taken at the highest management levels. There was no further guidance on who would be judged as a "prominent

political figure", and whilst the Swiss Banks were left to make this judgement themselves, they were also informed by subsequent cases publicised in this respect.

The Global AML standard setter, the Financial Action Task Force's original 40 Recommendations were published in 1990[3], when drug trafficking and money laundering were the focus of the FATF, following on from the adoption of the Vienna Convention of 1988[4]. Whilst the term PEP is not included in any of the then 40 Recommendations, there is a section titled "C*ustomer Identification and record keeping rules*" which states [Extracts] that:

> *Recommendation 12 - "Crucial to the fight against money laundering through the financial system, are the ability of financial institutions to* ***screen undesirable customers****, and the ability for law enforcement authorities to conduct their enquiries on the basis of reliable documents about the transactions and the identity of clients". and*
>
> *Recommendation 13 - "Hence, Financial Institutions should take reasonable measures to* ***obtain information about the true identity of the persons on whose behalf an account is opened*** *or a transaction is conducted if there are any doubts as to whether these clients or customers are not acting on their own behalf".*

Even in 1990, there was a clear expectation that Banks should be able to *"screen undesirable customers", and "to obtain information about the true identity of the persons on whose behalf an account is opened",* recognising that customers may not be the true beneficial owner or controller of funds.

In 1996[5], the FATF updated its 40 Recommendations, but didn't include anything on "**public functions**".

In 1997 Also during the 1990's, global leadership on combating corruption was largely delegated to the OECD which published its landmark **OECD Anti-Bribery Convention[6] in 1997,** in no small part due to the leadership of Professor Mark Pieth was a law professor in Basel, Switzerland, but he was also Chairman of the OECD Working Group on Bribery and Corruption and a former member of the Swiss delegation to FATF with Daniel Zuberbuhler. The convention however used the term "*foreign official*", which is a very broad definition and includes all public officials, which was too broad to be used for AML purposes, where the problem was so far considered to relate to a subset of public officials, being the most senior ones, particularly foreign ones from countries with higher levels of perceived corruption.

In 1998[7], the SFBC, issued *special instructions regarding the handling of funds of "**prominent political figures**".* As a result and in response regulators began to consider these risks and to react, non more so that the Swiss regulator, the Swiss Federal Banking Commission. It began pushing Banks to adopt stricter controls when dealing with So called "**Potentate clients**"[8]. These controls were adopted in particular by Swiss Banks.

In December 1998[9], the Bank for International Settlements' Basel Committee on Banking Supervision (BCBS) published a Statement in the "***Prevention of criminal use of the banking system for the purpose of money-laundering***", which "*encourages banks' management to put in place effective procedures to ensure that all persons conducting business with their institutions are properly identified*". **It didn't mention PEPs.**

In November, 1999[10] the SFBC, began an investigation following the death of Nigerian dictator, **General Sani Abacha**, which led to around US$660 million in likely misappropriated funds being identified and then frozen in 19 Swiss banks. The accounts were linked not only to Abacha but also to his relatives and associates. This was the most consequential case in understanding the emergence of the term "politically exposed persons" which would emerge just a few years later.

Also in November 1999[11], the **US Senate Permanent Subcommittee on Investigations** published a report which exposed how private banks facilitated grand corruption, from Pakistan, Mexico, Nigeria, Indonesia, Venezuela, and Gabon using the services of Citibank.

In 1999[12], in response to "*findings of an internal survey of cross-border banking in 1999, the BCBS identified deficiencies in a large number of countries' know-your-customer (KYC) policies for banks. Consequently, the BCBS asked the **Working Group on Cross-border Banking**".* As a result a these findings and the work of the Working Group requirements regarding "politically exposed persons" would be agreed after a consultation period.

On 4 September 2000[13], after completing its Abacha investigation, the Swiss regulator criticised a number of Banks summarised in its report, "***Abacha funds at Swiss banks - Report of the Swiss Federal Banking Commission***". In particular, the regulator had found that some Banks had not adequately recognised that "*Abacha and his associates were high risk political figures".* It should be noted that Abacha money was subsequently identified in other jurisdictions too. Towards the end of the report, the regulator stated that, *"As far as the SFBC can judge on the basis of the information available to it, Switzerland is the first country to have comprehensively investigated the conduct of the banks under its supervision and taken measures against the Bangs at fault. Switzerland is also the only country so far to have a set of regulations for funds from prominent public figures. Switzerland and the SFBC are for these reasons anxious to ensure discussion of the*

issue of monies from prominent political figures in all appropriate international forums and to try to ensure the minimum international standards are created. Appropriate steps have already been taken".

On 21 September 2000[14], Dr. Kurt Hauri, Chairman of the Swiss Federal Banking Commission published remarks he made to the International Conference of Banking Supervisors (ICBS) in Basel, titled, *"**The Financial Industry in the 21st Century - Transnational Commercial Bribery and Corruption: a Challenge for the Financial Industry, Regulators and Supervisors**".* He referred to the Abacha Report published on the 4th September 2000 (see above) and summarised the measures being taken by the Swiss Regulator, but felt the need to comment on the international context, for example stating that, "*very substantial amounts of money have been wire-transferred to and from Switzerland, from and to banks in various respectable financial centres. As an always increasing number of financial institutions are acting globally they become a global target for abuse. No doubt that this is a very demanding challenge for international banks, for international regulatory bodies as well as supervisors in all countries".* He further stated that, *"**International banks** have to make sure that their compliance standards are on the highest level worldwide. Otherwise they may not effectively monitor and manage their reputational, operational and legal risks. The banks are well advised if they address in these compliance standards also the issue of proceeds from corruption even though not all jurisdictions where the international bank is carrying out its business have identical, or even comparable, standards. To avoid regulatory arbitrage it would be highly desirable if the major international players in private banking could agree upon a common set of rules to be complied with on a worldwide basis". He then went on to state that, "on a international level, there is a need to address adequately various issues related to the abuse of the financial sector by corrupt politicians and government officials. The "**potentate risk**" is truly global. One of the objectives would be an internationally coordinated understanding that banks should not accept proceeds from corruption. So far, rules on how financial institutions should handle business relations with **politically exposed persons** are lacking on the international level. "Know your customer" rules need to be harmonised to avoid regulatory arbitrage".*

On 30 October 2000[15], the Wolfsberg Group[16], published its "***Global Anti-Money-Laundering Guidelines for Private Banking - Wolfsberg[1] AML Principles***", which included the term "***Public officials***" *who were defined as "Individuals who have or have had positions of public trust such as government officials, senior executives of government". These were one class of customers that were set out in Section 2 titled - "Client acceptance: situations requiring additional diligence / attention".*

In November, 2000, Switzerland led an initiative, hosting a first meeting of representatives from judicial and banking supervisory bodies in the G7 countries and Switzerland which took place in

Lausanne in November 2000. The meeting focussed on the PEP issue and discussed what had been learned from the Abacha case. The recommendations on the handling of accounts linked to PEPs drawn up subsequent to the meeting ("Supervisors' PEP working paper 2001[17])" written by Switzerland, France, Germany, U.K. and Canada. Switzerland was heavily involved in the formulation of these standards. It was on Switzerland's initiative that the rule specifying that business relationships with politically exposed persons, or PEP, could only be entered into with the express approval of senior management was incorporated into the BCBC standard that was published in January and October 2001 and would be included in the revision of the FATF's Forty Recommendations[18] in 2003 (see below).

In January 2001[19], the BCBS published as a consultation paper, "Client Due Diligence for Banks", which included In "Section 2.2.3 Potentate risk - Business relationships with ***individuals holding important public positions and with persons or companies clearly related to them*** *may expose a bank to significant reputational and/or legal risks. Such persons, commonly referred to as "****potentates****", include foreign heads of state, ministers, influential public officials, judges and military commanders. There is always a possibility, especially in countries where corruption is widespread, that such persons abuse their public powers for their own illicit enrichment through the receipt of bribes, embezzlement, etc"* and that, *"There is a compelling need for banks considering a relationship with a potentate to identify that person as well as people and companies that are clearly related to the potentates".*

On 16 January 2001[20], An interagency memo was published by ***US Supervisors*** *(OCC, FDIC, FED, OTS) guidance to help U.S. financial institutions avoid transactions that may involve the proceeds of foreign official corruption. The guidance encourages U.S. financial institutions to apply enhanced scrutiny to their private banking and similar high dollar-value accounts and transactions where such accounts or transactions may involve the proceeds of corruption by* ***senior foreign political figures,*** *their immediate family or close associates. The guidance provides a set of suggested account establishment and maintenance procedures designed to help institutions obtain more appropriate information on accounts held by such persons, as well as a list of potentially suspicious transactions that may warrant enhanced scrutiny. This guidance is not a rule or regulation and should not be interpreted as such".* The guidance defined a senior foreign political figure as*," any member of a senior foreign political figure's "immediate family," and any "close associate" of a senior foreign political figure. A "senior foreign political figure" is a senior official in the executive, legislative, administrative, military or judicial branches of a foreign government (whether elected or not), a senior official of a major foreign political party, or a senior executive of a foreign any corporation, business or other entity that has been formed by, or for the benefit of, a The "immediate family" of a senior foreign political figure typically includes the figure's A "close associate" of a senior foreign political figure is a person who is widely and publicly known to*

maintain an unusually close relationship with the senior foreign government-owned corporation. In addition, a "senior foreign political figure" includes senior foreign political figure. parents, siblings, spouse, children and in-laws. political figure, and includes a person who is in a position to conduct substantial domestic and international financial transactions on behalf of the senior foreign political figure".

In October 2001[21], the BCBS published its final paper, "Client Due Diligence for Banks", which included for the first time in public the "*Politically exposed persons"* term replacing the previous term, "Potentate risk" in the prior consultation draft stating in *"Section 2.2.5* ***Politically exposed persons*** *- Business relationships with individuals holding important public positions and with persons or companies clearly related to them may expose a bank to significant reputational and/or legal risks. Such politically exposed persons ("PEPs") are* ***individuals who are or have been entrusted with prominent public functions, including heads of state or of government, senior politicians, senior government, judicial or military officials, senior executives of publicly owned corporations and important political party officials****. There is always a possibility, especially in countries where corruption is widespread, that such persons abuse their public powers for their own illicit enrichment through the receipt of bribes, embezzlement, etc*". This Section 2.2.5 also included the following statements, namely that, "*There is a compelling need for a bank considering a relationship with a person whom it suspects of being a PEP to identify that person fully, as well as people and companies that are clearly related to him/her*" and that "*Banks should gather sufficient information from a new customer, and check publicly available information, in order to establish whether or not the customer is a PEP. Banks should investigate the source of funds before accepting a PEP. The decision to open an account for a PEP should be taken at a senior management level"*.

On October 26, 2001, the **US Patriot Act** was passed by the US Congress. Section 312 required that U.S. financial institutions holding a private banking account for a non-U. S. person (1) ascertain the identity of the nominal and beneficial owners of, and the source of funds deposited into, such account; (2) report any suspicious transactions with respect to such account; and (3) conduct enhanced scrutiny of any account requested or maintained by, or on behalf of, a **senior foreign political figure** reasonably designed to detect and report transactions that may involve the proceeds of foreign corruption.

On 29 November 2001[22] the "**Supervisors' PEP working paper 2001**" was published. The stated purpose of the paper was, "*to assist supervisors in their approach to the question of identification of customers which may pose high levels of risk in terms of handling the proceeds of corruption and abuse of public funds. The paper also provides guidance on the steps which can be taken to manage such types of business relationship".* The working paper also included a Definition at Section *"4 Definition of a Politically Exposed Person - Politically exposed persons - PEPs are*

individuals who are or have been entrusted with prominent public functions, for example Heads of State or of government, senior politicians, senior government, judicial or military officials, senior executives of publicly owned corporations, important political party officials*. The definition is not intended to cover middle ranking or more junior individuals in the foregoing categories.* ***Business relationships with family members or close associates of PEPs may involve reputational risks similar to those with PEPs themselves****. The definition includes any legal vehicles such as trusts and special purpose companies or corporate vehicles operated by these individuals or of which they have beneficial ownership".*

In May 2002[23], the Wolfsberg Group, updated its "***Global Anti-Money-Laundering Guidelines for Private Banking - Wolfsberg[1] AML Principles****",* which now replaced the previously used term "*Public officials"* with the term *"Politically Exposed Persons" (frequently abbreviated as "PEPs) referring to* ***individuals holding or having held positions of public trust, such as government officials, senior executives of government corporations, politicians, important political party officials, etc., as well as their families and close associates****".* These were classified as before under Section *"2 Client acceptance: situations requiring additional diligence / attention"* and stating in *"2.1 General - In its internal policies, the bank must define categories of persons whose circumstances warrant additional diligence. This will typically be the case where the circumstances are likely to pose a higher than average risk to a bank",* and *"2.2 Indicators - The circumstances of the following categories of persons are indicators for defining them as requiring additional diligence".*

On 31 May 2002[24], the FATF published a ***Consultation draft relating to its review of it's Forty Recommendations*** *which were expected to be revised by mid 2003. "Section 3.3. deals with three categories of customer or transactions where there is a higher risk:* ***politically exposed persons****, correspondent banking and electronic and other non face-to-face financial services. Each part identifies the nature of the risks applicable to the customer or transaction, and suggests options for dealing with those increased risk". According to Swiss regulators "within the framework of the review of the Forty Recommendations, the Swiss FATF delegation is actively advocating international standards at the same high level of Swiss provisions[25]", which included PEPs. It stated that "3.3. Higher risk customers or transactions - 3.3.1. Politically Exposed Persons - Corruption and abuse of public funds by some government leaders and public sector officials - often collectively referred to as Politically Exposed Persons (PEPs) – has become a subject of growing concern, internationally and in individual countries, in the last couple of years. Several high-profile investigations (e.g., Abacha, Montesinos, Marcos) have highlighted not only the enormous scale of illegal wealth acquired by some corrupt leaders and officials but also that the proceeds of corruption are typically transferred to a number of foreign jurisdictions and concealed through private companies, trusts or foundations, or under the names of relatives and close associates of*

the PEP. There are various concerns. Corrupt acquisition of state assets or wealth causes damage, both social and financial, to the countries concerned, many of which are relatively poor. At the same time, there is increasing awareness of the risks posed to banks and financial systems that handle the proceeds of corruption or abuse of public funds. In accepting and handling funds from such sources, financial institutions must recognise the implications, which include: reputational damage; restitution claims from national governments or private individuals; significant legal and compliance costs; enforcement action by the regulatory authority; and criminal charges of money laundering against employees of the financial institution or the institution itself. Furthermore, to the extent that the proceeds of corruption are routed through a number of firms in the same financial centre, then that centre may itself suffer reputational damage and loss of public confidence in its business standards. There seem to be two schools of thought on the issue of PEPs. On the one hand, it is argued that no special guidance to financial institutions is needed in respect of handling accounts linked to PEPs. If customer due diligence procedures are properly applied at the account opening stage, and transactions through PEP accounts duly monitored against what is known of the customer's legitimate business or personal activities, then corruption or misuse of public funds should be readily picked up and reported to the criminal authorities. In broad terms, the argument continues, PEPs as a topic is part of a general risk management framework, albeit an important part. On the other hand, it is arguable that PEPs are different from other categories of customer, for the reasons referred to above and because of the high public profile (notably in the Abacha case) when failings were found to have occurred. The authorities of three FATF jurisdictions have issued relevant guidance to their financial institutions. There now appears to be a growing consensus that PEP guidance should be part of a wider international agenda for action. Some work on appropriate guidance has recently been undertaken informally by a group of supervisors from several countries, which could form the basis for setting appropriate international standards or guidance. This guidance embodies the following broad sub-headings: definition of a PEP; identifying PEPs during account opening; decision to open an account for a PEP; enhanced diligence in monitoring PEP accounts; and review of ordinary accounts in order to identify PEPs". The first issue to decide is whether an explicit reference to PEPs is necessary or desirable in the revised FATF 40. It is worth noting that the Basel CDD paper dealt with the issue specifically – see section 2.2.5 of the Basel CDD paper. If it is necessary, how could this best be done? ***Option 1*** *would be to have a general statement in the Recommendations about minimum standards applicable to all account relationships, followed by a reference to the need for higher standards in certain high-risk areas like correspondent banking and PEPs. This might be considered enough on its own.* ***Option 2*** *would be to supplement the first option with a cross-reference to the Basel CDD paper. However, a legitimate question is whether the Basel text, albeit an excellent summary of the risks, provides sufficiently detailed guidance to stand on its own.* ***Option 3*** *would be to include some concise text within the FATF 40, possibly as part of a new 'Customer Due Diligence' Recommendation. That could cross-refer to a much more detailed guidance paper that would include a variety of detailed 'CDD' issues*

– including correspondent banking, reliance on third parties to perform identification functions, etc."

On 21 June 2002[26], the FATF published its **Annual Report 2001-2002** which included the following: *"Private banking has been characterised in the recent past as being particularly vulnerable to laundering by certain high-profile criminals, in particular **politically exposed persons (PEPs)**. Although PEPs were discussed at some length during the typologies exercise, it should be noted that these individuals are not the only ones who may attempt to use private banking services to conceal their illegal financial activities. Vulnerabilities in this sector may be due to inadequate due diligence policies or procedures with regard to high net worth customers. A few experts indicated that there is nevertheless a fundamental difficulty for financial institutions to identify PEPs easily. Various international efforts are beginning to address these issues, particularly the Basel Committee on Banking Supervision, and the FATF is likewise looking at the relevant issues in the review of the Forty Recommendations".*

On 20 June 2003[27], the FATF published its **Annual Report 2002-2003** which included the following: *"The major task conducted by the FATF in 2002-2003 was the review of the Forty Recommendations. In October 2002, a forum with the private sector representatives was organised to discuss the issues raised in the May 2002 Public Consultation Paper. Further consultation with the industry took place at the beginning of April 2003. The revised Forty Recommendations adopted by the FATF on 18 June 2003 introduce a number of substantial changes to strengthen the measures to the extension of the Customer Due Diligence process for financial institutions; as well as enhanced customer identification measures for higher risk customers and transactions". It also stated that, "Politically exposed persons and correspondent banking (Recommendations 6 & 7) – the FATF identified these two areas as requiring additional due diligence measures, due to the risks of money laundering or terrorist financing. The extra steps will help to ensure that financial institutions have the necessary information and the systems required to deal with the enhanced risks".*

Also on 20 June, 2003[28], the FATF published a significantly revised set of **Forty Recommendations.** The new Recommendations set out extended basic principles to prevent money laundering and drew heavily on the Basel Customer Due Diligence Principles. The need for a risk-based approach was also specifically recognised and the inclusion of PEP's into its recommendations, which remain to this date. Recommendation 6 stated that: *"Financial institutions should, in relation to **politically exposed persons**, in addition to performing normal due diligence measures: a) Have appropriate risk management systems to determine whether the customer is a politically exposed person, b) Obtain senior management approval for establishing business relationships with such customers, c) Take reasonable measures to establish the source of wealth and source of funds, d) Conduct*

enhanced ongoing monitoring of the business relationship". In the glossary, it stated that *"**Politically Exposed Persons** (PEPs) are 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".*

In October 2003[29], the **UNCAC** was adopted (coming into force in 2005). It stated in "*Article 52. Prevention and detection of transfers of proceeds of crime; 1. Without prejudice to article 14 of this Convention, each State Party shall take such measures as may be necessary, in accordance with its domestic law, to require financial institutions within its jurisdiction to verify the identity of customers, to take reasonable steps to determine the identity of beneficial owners of funds deposited into high-value accounts and to conduct enhanced 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**. Such enhanced scrutiny shall be reasonably de signed to detect suspicious transactions for the purpose of reporting to competent authorities and should not be so construed as to discourage or prohibit financial institutions from doing business with any legitimate customer".*

In 2003, the Wolfsberg Group published Guidance on **Politically Exposed Persons** (PEPs).

From 2004 - 2025:

In October 2006[30], the Wolfsberg Group published a **Statement titled Guidance on a Risk based Approach for Managing Money Laundering Risks**, and suggests this is best done on a customer by customer basis but with risk criteria and risk variables being included. The risk criteria include customer, country, and services risks and within customers risk PEP's are included but then applying factors that may increase or decrease the risk as appropriate.

In June 2007[31], the FATF published its **Guidance on the Risk Based Approach to Combatting Money Laundering and Terrorist Financing.** This Guidance was informed from the first public and private sector working group established in March 2006, Co chaired by Philip Robinson (UK FCA) and Rick Small (GE Capital). Despite best intentions and a paper which reflected the idea that risk was not uniform, and FATF's approach was evolving to accept risk-based approaches in devising policies and measures to address money laundering, their general adoption did not however triggered a shift away from the blanket imposition of PEP provisions to foreign PEPs.

On 7 May 2008[32], the Wolfsberg Group published "***Revised Frequently Asked Questions (FAQs) on PEPs***". The 2008 FAQs replace the original 2003 version. The 2008 FAQs are not solely focused on the private banking and wealth management sectors (as the 2003 FAQs were), but have been extended to other financial services sectors, and reflect the current UK and EU risk-based approach to anti-money laundering compliance. The Group stated that, "*Continued regulatory focus on the risks associated with PEPs contributed to the Wolfsberg Group's decision to update its original FAQs, issued in 2003. These revised FAQs reinforce the position that only individuals holding senior, prominent or important positions with substantial authority over policy, operations or the use or allocation of government-owned resources can be PEPs (and that "Close Associates" and "Close Family" of PEPs should be included in the control framework for PEPs). In addressing practical issues that commonly confront financial institutions the FAQs take account of the now widely accepted Risk Based Approach, including guidance on: Assessing whether an individual is a PEP – considering that there is no universally agreed definition, Managing PEP relationships other than in a private banking context, Dealing with PEP involvement in operating companies and state owned enterprises, Managing individuals and related entities once the reason for their PEP designation is no longer applicable".* The Wolfsberg Group also notes that *"financial institutions should consider a range of factors when determining whether a particular holder of a public function has the requisite seniority, prominence or importance to be categorised as a PEP. Relevant factors include examining the official responsibilities of the individual's function, the nature of the title, the level of authority the individual has over government's activities and other officials, and whether the function affords the individual access to significant government assets and funds or the ability to direct the awards of government contracts or tenders. The Wofsberg Group also indicates that heads of international organisations may fall within the definition of PEPs".*

*In 2010[33] a publication titled, "**Politically Exposed Persons by the World Bank**, covered a number of important areas stating that"*Family Members and Close Associates - Corrupt public office holders appear to be increasingly employing strategies to disguise their ownership of the corrupt assets, including using family members and close associates to launder their illicit funds. In many cases, members of a corrupt PEP's family, or their associates, undertake transactions and apply for goods and services on behalf of a PEP. It is, therefore, important that a PEP definition include close associates and family members in addition to the prominent public official. Of course, this raises the issue of how to define these two categories. Unfortunately, family and close associates are defined differently among the standard setters. UNCAC includes as close associates both persons and companies that are related to the individual entrusted with the prominent public function, whereas the FATF 40+9 Recommendations are silent on the issue.The Third EU Directive also provides additional clarification by adding joint beneficial ownership of legal entities or legal arrangements.Regarding family members, UNCAC and FATF do not limit the degree of relationship,

while the Third EU Directive focuses on immediate family members, which may not be sufficient in cultures and jurisdictions in which the extended family maintains very close ties.

In July 2011[34], FATF published a report titled, "**Laundering the Proceeds of Corruption**" which included details of 32 major grand corruption cases reviewed for typology purposes. Of the 32 analysed, ranging from the period 1971-2011, 25 had the involvement of family members or close associates as a factor.

In February 2012[35], the FATF published **Revised 40 Recommendations**, to cover issues such as the financing of weapons of mass destruction. This integrated the +9 Special Recommendations on terrorist financing with measures against money laundering, resulting in a comprehensive set of 40 FATF Recommendations. The following changes were of particular interest: **Risk-based approach**: There is a new recommendation providing that countries should identify, assess, and understand the money laundering and terrorist financing risks they face and take appropriate measures to mitigate those risks. **Tax crimes:** The list of designated predicate offences, the underlying crimes that give rise to money laundering, has been expanded to include tax crimes. **Financing of proliferation**: There is a new recommendation providing that countries should apply UN targeted financial sanctions to persons and entities that finance the proliferation of weapons of mass destruction. Another recommendation calls on countries to ensure national cooperation and coordination among their competent authorities, *inter alia*, in the prevention of the financing of proliferation. **Anti-corruption:** Following calls from the G20, the revised recommendations place a greater emphasis on action against corruption. The FATF also expanded the mandatory requirements to domestic PEPs and PEPs of international organisations, in line with Article 52 of the United Nations Convention against Corruption (UNCAC).

In June 2012[36], the FATF published a report titled "***Specific Risk Factors in the Laundering of Proceeds of Corruption****" which* was written to assist reporting institutions to better analyse and better understand specific risk factors that may assist them in identifying situations posing a heightened risk of corruption-related money laundering risk. As Laundering the Proceeds of Corruption noted, corrupt PEPs will take great pains to disguise the identity and the source of the funds in order to place corrupt money in the financial system without suspicion. Therefore, an effective AML scheme requires an assessment of corruption-related risk and protecting against the laundering of corruption proceeds across the spectrum of customers and business relationships, regardless of whether a FATF-defined PEP is involved.

In 2012[37], the Wolfsberg Group updated their **Private Banking Principles**, which maintained their stance as requiring PEPs to go through enhanced due diligence and to be required to warrant senior management approval. The definition of PEP was refreshed as, "*Politically Exposed Persons,"*

frequently abbreviated as "PEPs," referring to individuals holding or, as appropriate, having held, senior, prominent, or important public positions with substantial authority over policy, operations or the use or allocation of government-owned resources, such as senior government officials, senior executives of government corporations, senior politicians, important political party officials, etc., as well as their close family and close associates. PEPs from different jurisdictions may be subject to different levels of diligence.

In June 2013[38], FATF published ***Guidance on*** **politically exposed persons** (recommendations 12 for Banks and FI's and 22 for DNFBPs). It stated that, "A politically exposed person (PEP) is defined by the Financial Action Task Force (FATF) as an individual who is or has been entrusted with a prominent public function. Due to their position and influence, it is recognised that many PEPs are in positions that potentially can be abused for the purpose of committing money laundering (ML) offences and related predicate offences, including corruption and bribery, as well as conducting activity related to terrorist financing (TF). This has been confirmed by analysis and case studies. The potential risks associated with PEPs justify the application of additional anti-money laundering / counter-terrorist financing (AML/CFT) preventive measures with respect to business relationships with PEPs. To address these risks, FATF Recommendations 12 and 22 require countries to ensure that financial institutions and designated non-financial businesses and professions (DNFBPs) implement measures to prevent the misuse of the financial system and non-financial businesses and professions by PEPs, and to detect such potential abuse if and when it occurs".

The definitions are also set out. "*In particular, the following definitions, which do not cover middle ranking or more junior individuals, apply to this guidance paper: Foreign PEPs: individuals who are or have been entrusted with prominent public functions by 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. Domestic PEPs: individuals who are or have been entrusted domestically with prominent public functions, 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. International organisation PEPs: persons who are or have been entrusted with a prominent function by an international organisation, refers to members of senior management or individuals who have been entrusted with equivalent functions, i.e. directors, deputy directors and members of the board or equivalent functions. Family members are individuals who are related to a PEP either directly (consanguinity) or through marriage or similar (civil) forms of partnership. Close associates are individuals who are closely connected to a PEP, either socially or professionally".*

It also stated that, as regards Family Members and Close Associates*, "Recommendation 12 applies also to family members and close associates of the PEP. The Recommendation does not define the scope of the terms family members and close associates, as this depends to some extent on the social-economic and cultural structure of the country of the PEP. Identifying such persons is also challenging, since the number of persons who qualify as family members and close associates is fluid, and may change significantly over time. It is best practice for countries to provide financial institutions and DNFBPs with working definitions or examples of close associates and family members. When doing so, it should be kept in mind that such working definitions and examples should not be interpreted too narrowly or too widely.*

For family members, this includes such relevant factors as the influence that particular types of family members generally have, and how broad the circle of close family members and dependents tends to be. For example, in some cultures, the number of family members who are considered to be close or who have influence may be quite small (e.g., parents, siblings, spouses/partners, and children). In other cultures, grandparents and grandchildren might also be included, while in others, the circle of family members may be broader, and extend to cousins or even clan".

The paper also includes information on sources of information for the determination; of PEPs, the family members and close associates, stating*, "Determining whether customers or beneficial owners are PEPs and/or finding out who are their family members and close associates can be challenging, particularly when dealing with foreign PEPs for whom current information may not be readily available. Another implementation issue is determining whether existing clients of financial institutions and DNFBPs have become PEPs since the business relationship began. PEP-related corruption case typologies and supervisory reports (see Annex 2) show that, in many cases, the financial institutions and DNFBPs knew within at least a year after the relationship began that they were dealing with a PEP, yet failed to apply the appropriate risk classification and mitigation procedures. It is important that financial institutions and DNFBPs periodically monitor their existing client base against changes in the PEP universe and not just at the time of client on-boarding. It is important to stress that customer due diligence is the key source of information for the purpose of determining that a customer is a PEP, as required by Recommendations 10 and 12. For example, a key factor in this ongoing process is the customer's principle occupation, or employment. However, there are several other sources of information that can be used by financial institutions and DNFBPs to assist in determining if a client is a PEP. Financial institutions and DNFBPs should consider using additional sources of information, particularly when determining if a client is a foreign PEP, for the reasons noted above. Unlike law enforcement and supervisors, financial institutions and DNFBPs have access to a valuable source of information: the customer. They should utilise this rather than relying on third party providers. However, financial institutions and DNFBPs will often need to use more than one of these sources of information to support CDD and/or to*

gather other information required by Recommendation 12 (such as on the source of funds and the source of wealth). As is indicated for some of the sources the disadvantages of using some sources to help determine that a customer is a PEP may outweigh potential advantages. As a general starting point to enable an assessment of risk of specific customers, risk management systems or other internal control mechanisms should draw on a range of sources for establishing ML/TF risk and take this information effectively into account. This should not be limited to international instruments, Recommendations and guidelines, but should be extended toFATF, FATF-style regional bodies, IMF/World Bank and non-governmental organisation (NGO) reports and assessments, whether mutual evaluations, or assessments and analyses of AML/CFT compliance, governance, corruption, revenue management and transparency (including natural resource revenue management and transparency)".

In 2014[39], the FATF published its **Guidance for a risk Based Approach for the Banking Sector.**

In 2017[40], the Wolfsberg Group issued **Guidance on PEPs**, which stated that "*While Financial Action Task Force (FATF) guidance[3] recommends that all foreign PEPs should automatically be classified as high risk, the Wolfsberg Group advocates for the application of an RBA for all PEPs, whether foreign or domestic. In recent years, the lack of a globally accepted definition of a PEP, a focus on applying a consistent level of Enhanced Due Diligence (EDD) to all PEPs, irrespective of the risk of committing serious crimes against society, as well as the significant numbers of entries on PEP lists (including PEPs, their relatives and associates, close or otherwise), have considerably diluted both the application of an RBA and the effectiveness of PEP screening. In jurisdictions where the adoption of an RBA is permissible, an FI may consider a number of factors that may impact the risk posed by PEP relationships when determining the appropriate controls. Where an RBA is applied, the risk factors associated with PEPs are simply additional factors that need to be considered as part of an FI's standard customer risk assessment, rather than being considered in isolation. These additional factors may include the political environment and the vulnerability of the PEP's country of political exposure to corruption, the rationale for wishing to open an account in a jurisdiction beyond where political office is held, the products or services being sought, the individual circumstances of the customer and, where appropriate, the source and amounts of the customer's funds and wealth. It is therefore reasonable that not all FIs will apply the same framework to classify and manage PEP relationships as this will depend on the types of products and services offered by the FI. For example, a private banking/wealth management business may have a different framework from a high volume, low value, retail or insurance business. FIs may conclude that a PEP whose political position and country of political exposure has a low risk of corruption, who has a genuine business need for their financial product and against whom there is no indication of higher levels of risk, can be subject to a lower level of due diligence requirements. In such lower risk circumstances, it would not be necessary to obtain additional due diligence from*

the customer themselves. Likewise, in compliance with the RBA, it may be reasonable for a low risk business to screen its customer base against PEP lists at a lower frequency than a higher risk business. In certain jurisdictions, local regulatory requirements may require, for example, the application of a broader PEP definition or specific control requirements (e.g. with respect to de-categorisation of a PEP). In such cases an FI's standards will need to be augmented or changed to meet local regulatory requirements".

It also included the "Definition of "Close Family Members" and "Close Associates" of a PEP" and stated that, "PEPs may abuse their power and position for their personal gain and advantage by use of close (immediate) family members or close associates to conceal funds or assets that have been misappropriated as a result of abuse of their official position, or resulting from bribery and corruption. It is therefore important to define "Close Family Members" and "Close Associates" and include them within the control framework established for PEPs. While "Close Family Members" and "Close Associates" may be subjected to levels of EDD, it should be clear that they are not the ones holding a prominent public function and it is not necessarily appropriate in all cases that they be classified as PEPs, or indeed receive the same due diligence treatment as the political officeholder themselves. In addition to the statutory or regulatory definitions that may apply, the FI should consider factors such as degrees of familial separation from, the level of exposure to, and the length of the relationship with, the political officeholder in determining whether a "Close Family Member" or "Close Associate" should be classified as a PEP and the level of due diligence they require. Close Family: will include a PEP's direct family members, their spouse (or a person considered to be equivalent to a spouse), their children and their spouses, parents and the siblings of the PEP. Close Associate: will include a PEP's widely- and publicly-known close business colleagues or personal advisors, in particular persons acting in a financial fiduciary capacity. In any of these cases there may be circumstances which suggest that those in the categories above do not have a close relationship with a PEP, and that would mean it is not appropriate to subject them to the same control framework. Such circumstances include separation, estrangement or the end of a business relationship between the PEP and the close associate. Equally certain ethno-cultural religious links may require the above definition of "close family members" to be extended. These circumstances could be considered as part of the risk assessment process and documented accordingly"

Also included is the *"Identification of a PEP or their "Close Family Member or Close Associates". FIs should apply an RBA to identifying whether a prospect or an existing customer is a PEP. The following measures may be appropriate and effective when seeking to identify and risk assess a PEP: Making enquiries regarding the PEP status of prospective customers during the account opening process; Screening new and prospective customers and key principals of the overall customer relationship against a database of such persons. These databases may be developed*

internally or provided by an external service provider; In certain circumstances, searching for publicly available information from reputable sources; The inclusion of appropriate PEP training to relevant staff. This may form part of regular anti money laundering (AML) training. Despite the reasonable efforts of an FI, it may be difficult to identify a PEP, particularly if the customer fails to provide important information, provides false/inaccurate details, or their circumstances change during the course of the relationship. In seeking to mitigate this, an FI will utilise their customer identification procedures and associated due diligence processes to try to detect such connections and relationships alongside publicly available information. The level of detail available to an FI will also vary by product or service. In a retail relationship, there will be less opportunity to establish such connections than in a private banking/wealth management situation. The difficulties of identifying Close Family Members and Close Associates are typically greater than for identifying PEPs because, unlike the PEP themselves, any political exposure may not be immediately apparent through the due diligence obtained from the customer.

Another section focusses on *"PEP Screening".* It states that, "*PEP screening is the screening of customer names and associated details against PEP information at certain points during the customer relationship. While some relevant, competent authorities do publish PEP lists, this is the exception rather than the norm as PEP lists are usually compiled internally or sourced from vendors/list providers. Regulatory requirements usually require FIs to adopt reasonable, risk-based measures to identify PEPs. While this could include PEP screening, the decision as to the manner in which screening should be conducted will depend on the size, scale, footprint and capability of each given FI and on the inherent risk of PEPs using the FI's products and services to launder the proceeds of crime. Where deemed to be an appropriate control, PEP screening should be automated. However, manual screening may be acceptable where deemed appropriate for the size of the business and the materiality of the inherent risk posed by PEPs. PEP screening should occur in accordance with an FI's risk appetite applying an RBA and take place at least: As part of the onboarding process, At periodic customer review, When there is a trigger event which warrants a customer due diligence review. It should be noted that, in many instances, PEP screening is not the primary control for identifying PEPs. The responsibility for PEP identification remains with business lines who have direct contact with the customer and should be embedded within a firm's CDD processes as outlined above".*

A section also refers to PEP List Providers. *"As indicated above, depending on its size and geographical footprint, an FI may choose to source its PEP data for screening purposes from a third party vendor. Some FIs may choose to develop their own internal database. Minimum data quality standards required for effective PEP Screening. In order to carry out effective and efficient screening, FIs should have complete and accurate electronic customer data records and the PEP database used for screening should contain sufficient unique identifying data. Without this*

information, PEP screening will result in irrelevant alerts, which is not only ineffective and inefficient, but inconsistent with an RBA. Unique identifying data, whether maintained by vendors or determined internally by an FI, should include the following: 1) Name (all known names and aliases), 2) Date of Birth, and where this isn't available, Year of Birth, 3) Country of political exposure, 4) Gender (where available), 5) Politically exposed role(s), and date(s) or year(s) of appointment, 6) Date or year that the PEP left their position (where applicable). In addition, should a PEP be deceased, it would be helpful to have that appropriately recorded. The accuracy and completeness of the PEP data should be subject to regular review and changes in personal details and political positions should be reflected in a timely manner".

In October 2025[41], the FATF published their updated 40 Recommendations. It states that, "12. Politically exposed persons - Financial institutions should be required, in relation to foreign politically exposed persons (PEPs) (whether as customer or beneficial owner), in addition to performing normal customer due diligence measures, to: (a) have appropriate risk-management systems to determine whether the customer or the beneficial owner is a politically exposed person; (b) obtain senior management approval for establishing (or continuing, for existing customers) such business relationships; (c) take reasonable measures to establish the source of wealth and source of funds; and (d) conduct enhanced ongoing monitoring of the business relationship. Financial institutions should be required to take reasonable measures to determine whether a customer or beneficial owner is a domestic PEP or a person who is or has been entrusted with prominent function by an international organisation. In cases of a higher risk business relationship with such persons, financial institutions should be required to apply the measures referred to in paragraphs (b), (c) and (d). The requirements for all types of PEP should also apply to family members or close associates. In the Glossary, it states that, "Foreign PEPs are individuals who are or have been entrusted with prominent public functions by 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. Domestic PEPs are individuals who are or have been entrusted domestically with prominent public functions, 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. Persons who are or have been entrusted with a prominent function by an international organisation refers to members of senior management, i.e. directors, deputy directors and members of the board or equivalent functions. The definition of PEPs is not intended to cover middle ranking or more junior individuals in the foregoing categories".

Final Remarks

How to identify and manage "potentate risk" which became risk from "prominent public figures" and then became risk from "politically exposed persons" had been a journey that took 25 years. It

has also been 25 years since the term “politically exposed person” was born, and it remains still with us to this day, largely in tact, and remains as Recommendation 12 in the FATF 40 Recommendations. This despite the fact that it is in reality one of many potential customer risk indicators that Banks and FI’s take into account in determining actual client risk, which should be judged based on all the available information and on a case by case basis, but must also be judged based on the applicable AML regulations too.

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Endnotes:

[1] See: Under the FCPA, a foreign official is "any officer or employee of a foreign government or any department, agency, or instrumentality thereof, or a public international organisation, or any person acting in an official capacity for or on behalf of any such government or department, agency, or instrumentality, or for or on behalf of any such public international organisation" see: https://www.cliffordchance.com/content/dam/cliffordchance/briefings/2011/04/foreign-officials-under-the-foreign-corrupt-practices-act-it-means-what-the-doj-says-it-means.pdf#:~:text=Definition of Foreign Official

[2] See: https://www.finma.ch/finmaarchiv/ebk/e/archiv/2000/pdf/neu14a-00.pdf?utm_source=chatgpt.com

[3] See: https://www.fatf-gafi.org/content/dam/fatf-gafi/annual-reports/1990%20ENG.pdf

[4] See: https://www.fatf-gafi.org/content/dam/fatf-gafi/annual-reports/1990%20ENG.pdf

[5] See: https://www.fatf-gafi.org/content/dam/fatf-gafi/recommendations/FATF Recommendations 1996.pdf

[6] See: https://en.wikipedia.org/wiki/OECD_Anti-Bribery_Convention

[7] See: https://www.finma.ch/finmaarchiv/ebk/e/archiv/2000/pdf/neu14a-00.pdf and see also this referenced in https://www.iflr.com/article/2a63733ixysbvcl5p83qo/banking-switzerland-a-well-regulated-financial-centre-fully-aware-of-its-responsibilities

[8] See: https://www.fatf-gafi.org/content/dam/fatf-gafi/annual-reports/1990%20ENG.pdf

[9] See: https://www.bis.org/publ/bcbsc137.pdf

[10] See: https://www.finma.ch/finmaarchiv/ebk/e/archiv/2000/pdf/neu14a-00.pdf

[11] See: https://www.hsgac.senate.gov/wp-content/uploads/imo/media/doc/REPORT-Private Banking & Money Laundering (Nov 1999).pdf

[12] See: This was a joint group consisting of members of the Basel Committee and of the Offshore Group of Banking Supervisors

[13] See: https://www.finma.ch/finmaarchiv/ebk/e/archiv/2000/pdf/neu14a-00.pdf

[14] See: https://www.finma.ch/finmaarchiv/ebk/e/archiv/2000/pdf/neu15-00.pdf

[15] See: https://www.bahamasb2b.com/b2b/big_picture/download/Guidelines.pdf

[16] Wolfsberg was the location in Switzerland where an important working session to formulate the guidelines was held. The Wolfsberg Group was made up of the following Banks: ABN AMRO Bank N.V., Barclays Bank, Banco Santander Central Hispano, S.A. Chase Manhattan Corporation, Citibank, N.A. Credit Suisse Group, Deutsche Bank AG, HSBC J.P. Morgan, Inc. Société Générale and UBS AG. The banks collaborated with a team from Transparency International who invited two international experts to participate, Stanley Morris and Prof. Mark Pieth. Transparency International and the experts regard the principles as an important step in the fight against money laundering, corruption and other related serious crimes. Stanley E. Morris was an international Consultant on Anti Money Laundering issues. He was head of FinCEN and a member of the Financial Action Task Force on Money Laundering (FATF). Prof. Mark Pieth was a law professor in Basel, Switzerland. He was Chairman of the OECD Working Group on Bribery and Corruption and a former member of the Financial Action Task Force on Money Laundering (FATF). For more on the early day DPA of the Grouos, See: https://wolfsberg-group.org/resources/general/172

[17] See: https://www.finma.ch/finmaarchiv/ebk/f/archiv/2002/pdf/neu090702-03f.pdf

[18] See: https://www.finma.ch/FinmaArchiv/ebk/d/archiv/2003/20031030/m031030_02e.pdf

[19] See: https://www.bis.org/publ/bcbs77.pdf

[20] See: https://www.occ.gov/static/rescinded-bulletins/bulletin-2001-9.pdf

[21] See: https://www.bis.org/publ/bcbs85.pdf

[22] See: https://www.cbr.ru/Content/Document/File/124099/aml-principl-prbank.pdf. The Wolfsberg Group had by now expanded to include Bank of Tokyo-Mitsubishi Ltd and Goldman Sachs whereas Chase Manhattan Corporation was not included as it had merged with JP Morgan, and whose name was changed for this paper to J P Morgan Private Bank.

[23] See: https://www.finma.ch/finmaarchiv/ebk/f/archiv/2002/pdf/neu090702-03f.pdf

[24] See: https://www.fsrc.gov.ag/images/pdf/adf010_377c0868ced2441f91735ec06d71405f.pdf

[25] See: https://www.finma.ch/finmaarchiv/ebk/e/archiv/2002/pdf/gw_broschuere_engl.pdf

[26] See: https://www.fatf-gafi.org/content/dam/fatf-gafi/annual-reports/2001 2002 ENG.pdf

[27] See https://www.fatf-gafi.org/content/dam/fatf-gafi/annual-reports/2002 2003 ENG.pdf

[28] See: https://www.fatf-gafi.org/content/dam/fatf-gafi/recommendations/FATF Recommendations 2003.pdf

[29] See: https://www.unodc.org/documents/brussels/UN_Convention_Against_Corruption.pdf

[30] See: https://db.wolfsberg-group.org/assets/d7747549-5dca-40a9-aaf7-d9d83df67fd0/15.%20Wolfsberg_RBA_Guidance_(2006).pdf

[31] See: https://www.fatf-gafi.org/content/dam/fatf-gafi/guidance/High%20Level%20Principles%20and%20Procedures.pdf.coredownload.inline.pdf

[32] See: https://db.wolfsberg-group.org/assets/b1d0530e-628a-4fd8-930a-0dfbda6c8d54/112. PEP-FAQ-052008-Press.pdf

[33] See: https://documents1.worldbank.org/curated/en/611261468155103854/pdf/542500PUB0Expo101Official0Use0Only1.pdf

[34] See: https://www.fatf-gafi.org/content/dam/fatf-gafi/reports/Laundering the Proceeds of Corruption.pdf.coredownload.pdf

[35] See: https://www.fatf-gafi.org/content/dam/fatf-gafi/recommendations/FATF Recommendations 2012.pdf.coredownload.inline.pdf?nocache=true

[36] See: https://www.fatf-gafi.org/content/dam/fatf-gafi/reports/Specific Risk Factors in the Laundering of Proceeds of Corruption.pdf.coredownload.pdf

[37] See: https://db.wolfsberg-group.org/assets/7d384fb4-8c82-4669-acb8-621aed03e928/Wolfsberg Private Banking Principles.pdf

[38] See: https://www.fatf-gafi.org/content/dam/fatf-gafi/guidance/Guidance-PEP-Rec12-22.pdf

[39] See: https://www.fatf-gafi.org/content/dam/fatf-gafi/guidance/Risk-Based-Approach-Banking-Sector.pdf.coredownload.pdf

[40] See https://db.wolfsberg-group.org/assets/3867d9cf-7c9b-41bc-9fad-6685bbabd52c

[41] See: https://www.fatf-gafi.org/content/dam/fatf-gafi/recommendations/FATF Recommendations 2012.pdf.coredownload.inline.pdf?nocache=true