

“reliance can and should be used to complement and ease some of the burdens for customer due diligence” and “could have a number of benefits.”

IBFed says it would eliminate duplication of effort, delays and barriers for customers and help streamline CDD, adding that “failure to increase use of reliance will hamper efficient and effective banking services, both domestically and internationally.” But it warned that third party CDD did not work well across borders as

“financial institutions do not feel comfortable relying on the customer due diligence performed outside the local jurisdiction” while the concept “is not used extensively in either the UK or the US.”

More work to be done then before third party reliance becomes a standard tool in the equipment available to the AML forces, but the FATF changes will surely help it along.

Unclear targets – PEPs

Mutual evaluation reports on countries’ compliance with the Financial Action Task Force 40+9 reveal inconsistencies in the approach to Recommendation 6 on politically exposed persons (PEPs). The differences, in part, reflect deficiencies in implementation [1] but ambiguity and incompleteness in the FATF standard are also to blame, says Sevinj Novruzova.

Foreign PEPs – wherever they are?

The FATF Glossary defines PEPs as “individuals who are or have been entrusted with prominent public functions in a foreign country...” It is clear that currently only foreign PEPs fall within scope but does this mean only those who *live outside* the jurisdiction or should it cover foreign PEPs who live inside as well? While this imprecision exists in the standard countries may feel entitled to follow the narrower interpretation: Germany, Greece, Luxembourg and the Netherlands were all marked down on compliance with Recommendation 6 during their evaluations for exempting foreign PEPs living within their borders from enhanced due diligence even though this approach is envisaged by the Third EU Money Laundering Directive (art 13, para 4). [2]

Identification of PEPs – whoever they are

The FATF proposal to revise Recommendation 6 to impose an obligation on financial institutions (FIs) to determine not only if a customer but also the beneficial owner of an account is a PEP is sensible. [3] The FATF Methodology used by mutual evaluation assessors also refers to ‘potential customers’ – those who have applied to open an account – but the same phrase does not feature in the current Recommendation 6 proposal: it should.

Always a PEP or risk-based after a year

The language of Recommendation 6 suggests an open-ended approach, not setting any limit on how long an individual should be viewed as a PEP once they have left office. However, a one-year interval post departure is to be highlighted in the Interpretative Note on PEPs, which accords with the time-frame in the implementing measures for the Third EU Directive [4] and the Austrian one-year model that was identified as best practice during an FATF plenary [5]. After a year enhanced due diligence would only be mandatory if the regulated entity believed that the ex-PEP continued to represent a higher risk. The RBA may, in time, come to replace the notion of ‘once a PEP always a PEP’.

Rationalising the inner circle

The FATF Glossary definition of a PEP does not include family members and close associates; instead it states that business relationships with these parties involve similar reputational risks to those encountered when dealing with PEPs. In view of the fact that a corrupt PEP’s family members or close associates will often undertake transactions and apply for goods and services on their behalf, these categories of persons [6] should be explicitly included in the PEP definition as secondary PEPs [7]: uncertainty over how far EDD should extend will persist as long as they are not. Proportionality could be built into the ‘Methodology for Assessing Compliance with the FATF 40 Recommendations and FATF 9 Special Recommendations’ by specifying EDD on secondary PEPs only if the transaction has a direct link to a PEP.

Qualification of family members of PEPs is a persistent challenge since the composition may change significantly and without notice. A customer’s own situation may also alter – he or she may become a PEP

following promotion, election or marriage. Failure to apply enhanced due diligence may result, equally, from ineffective KYC by the regulated entity or a deliberate concealment by the individual of their occupation or social status.

Higher and higher

Recommendation 6.2 does not specify a level of seniority for triggering the PEP requirements, which leaves open questions like whether the manager of a local bank branch – an important figure in many communities – should be treated as a PEP and the circumstances in which senior management should seek advice from compliance about taking on a customer. Some jurisdictions have either not provided any interpretation or simply said that approval may be determined at compliance, branch, or board of director level. [8]

In some jurisdictions, the AML/CFT compliance officer may also be a senior manager. The AML/CFT compliance officer should be involved in the PEP approval process, at least in cases of higher risk, for two important reasons: first, they are often best-placed to advise why a person should not be accepted, regardless of the size of the account; and second, it ensures proper engagement and information-sharing between the business and compliance. The AML/CFT compliance officer will have access to broader information on the customer base; suspicious transaction reports filed across the group, terminated customers, and, in some cases, those who have been denied accounts. It is not clear if the role of senior management is intended to be limited to the initial approval or whether it extends further into the customer relationship, for example, to removing a name from a PEP list.

Onboarding is just the beginning

The term “enhanced ongoing monitoring” is not explained but the FATF could do so via its methodology for assessing compliance with the 40+9. It would likely reflect the expectation of continuing review of the PEP customer’s transactions against their anticipated account activity profile as well as periodic updating of client information. Enhanced ongoing monitoring should also entail senior management reappraisal of all PEPs; maintenance of PEP relationships should, ultimately, be their direct responsibility. [9]

Notes

1. ‘Horizontal Review of Moneyval’s Third Round of Mutual Evaluation Reports’, December 2010, p64 (www.coe.int/t/dghl/monitoring/moneyval/publi

- [cations/3rdHorizontalreview_en.pdf](http://www.coe.int/t/dghl/monitoring/moneyval/web_ressources/WB_PEPs_en.pdf)); ‘Stolen Asset Recovery: Politically Exposed Persons’ – A Policy Paper on Strengthening Preventive Measures, World Bank, p53. (www.coe.int/t/dghl/monitoring/moneyval/web_ressources/WB_PEPs_en.pdf)
2. See the FATF mutual evaluation reports of Germany (19 February 2010), Greece (29 June 2007), Luxembourg (19 February 2010) and the Netherlands (25 February 2011) available at www.fatf-gafi.org. Article 13, para 4 of the Third EU Directive only requires enhanced due diligence on “politically exposed persons residing in another Member State or in a third country” (http://eur-lex.europa.eu/LexUriServ/site/en/oj/2005/l_309/l_30920051125en00150036.pdf)
 3. The Forty Recommendations, Annotated with current agreed outputs from Expert Groups (version of 6 July 2011), p5 – not publicly available.
 4. http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/l_214/l_21420060804en00290034.pdf
 5. Recommendation 6: Implementation Issues, FATF Working Group on Terrorist Financing and Money Laundering, p5 – not publicly available.
 6. FATF is silent on the definition of ‘close associates’ but both the United Nations and EU have addressed it. Under the UN Convention Against Corruption (UNCAC), the term encompasses persons or companies clearly related to individuals entrusted with prominent public functions. [See UN General Assembly, ‘Interpretative notes for the official records (travaux préparatoires) of the negotiation of the United Nations Convention against Corruption’ (A/58/422/Add.1), para 50.] Directive 2006/70/EC says ‘close associates’ shall include: (a) any natural person who is known to have joint beneficial ownership of legal entities or legal arrangements, or any other close business relations with a PEP; (b) any natural person who has sole beneficial ownership of a legal entity or legal arrangement, which is known to have been set up for the benefit de facto of a PEP.
 7. In contrast to the FATF 40+9, the Directive 2005/60/EC and UNCAC PEP definitions include family members and close associates.
 8. See Mutual evaluation report of Germany (19 February 2010).
 9. See approach advocated in ‘Stolen Asset Recovery: Politically Exposed Persons’, *ibid.*, p7, 13.

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