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Politically Exposed Persons ('PEPs'): A Misconstrued Concept



Introduction

In a time where politicians and businessmen, amongst others, are constantly criticised, and rightly so, over their dealings in dodging taxes and trying to legalise illicit assets, the notion of who a PEP is becomes all more relevant.

Definition of PEP

PEPs are defined in local, EU and international law.

The definition of a PEP is a “***natural person who is or who has been entrusted with prominent public functions.***” The definition is far reaching and goes beyond the individual himself to include family members and close associates. According to the Fourth EU AML Directive the PEP status should be applied for a period of 12 months after they leave office. Middle-ranking or more junior officials are not included in this definition. After a risk assessment, the period could also be prolonged.

As the definition is quite broad. Refer the table of PEP risk categories below.

The Financial Action Task Force (FATF) guidelines go even further and argue that many PEPs hold positions that can be abused for money laundering and other offences. Where the EU directive and FATF guidelines agree is that due to the risks associated with PEPs ***enhanced due diligence*** measures need to be established prior (and during) to the commencement of a business relationship.

Once a PEP, always a PEP?

Where a PEP is no longer entrusted with a prominent public function by a Member State or a third country, or with a prominent public function by an international organisation, obliged entities shall, **for at least 12 months**, be required to take into account the continuing risk posed by that person and to apply appropriate and risk-sensitive measures until such time as that person is deemed to pose no further risk specific to politically exposed person. The above also apply to family members or persons known to be close associates of politically exposed persons.

Having said the above, it can be assumed that a year after a PEP leaves office then he/she can be declassified by the organisation, service provider and so forth from being a PEP. This may appear a logical assumption to make but still the wrong assumption to make. The key word is the phrase "...on a risk-sensitive basis...".

The length of time after which a PEP has ceased to hold public position is not indicative of the relative money laundering risk associated with the business relationship. Time limits are always artificial and pose problems as they can convey a false sense of security that a client no longer poses an increased risk of money laundering.

The timing for PEP declassification from ceasing to hold public position should be considered case by case in terms of what was the previous public position for the said individual, as the risk is significantly different if the individual was a middle level government official and different in the case the individual was a head of state. Where the risk identified is low, it may be considered to declassify the relationship, but only after careful consideration of the risks still present and also getting senior management approval.

The 4 Quadrants of Risk

High Risk – Level 1 PEPs	Medium Risk – Level 2 PEPs
Heads of State & Government	Senior officials of the military, judiciary, and law enforcement agencies
Members of Government	Senior officials of other state agencies and bodies of high-ranking officials

Members of Parliament	Senior members of religious groups
Heads of military, judiciary, law enforcement and board of central banks	Ambassadors, consuls, high commissioners
Top ranking officials of political parties	
Medium Risk – Level 3 PEPs	Low Risk – Level 4 PEPs
Senior management and board of directors of state- owned businesses and organisations	Mayors and members of local, city and district assemblies
	Senior officials and functionaries of international organisations

Final comments

Classifying a potential client as a PEP does not mean a company cannot work with them at all. Discovering a client is a PEP just forms part of the process that allows financial institutions and DNFBPs (Designated Non-Financial Businesses and Professions) to make a wholesome assessment on risks.

While EU and international law agree that the status of PEP carries out risks and appropriate protective measures need to be put in place to mitigate AML/CTF risks nevertheless these requirements are preventative and not criminal in nature *and “should not be interpreted as meaning that all PEPs are involved in criminal activity”*.

When considering whether to establish or continue a business relationship with a PEP, the focus should be on the level of the money-laundering or terrorist-financing **risk** associated with a particular PEP, and whether the DNFBP has adequate controls in place to mitigate that risk so as to avoid being abused for illicit purposes, should the PEP be involved in criminal activity. PEPs by default are categorised as high risk, this calls for the application of enhanced due diligence and necessitates the matter not only be reviewed by the DNFBPs directly involved in managing and auditing the entities, but also by the DNFBP’s senior management.

Our Compliance Services

- Initial basic assessment of existing and new clients
- Drafting and advising on policies and procedures
- Drafting and advising on Anti Money Laundering Manuals
- Advising management, summaries of legislation and legal compliance audits
- Implementation of AML procedures, risk assessments, compliance officer's reports
- Regulatory consulting
- Legal due diligence procedures & client acceptance assessments/reports
- Implementation of Know Your Client (KYC) and Anti Money Laundering (AML) procedures

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