



Politically Exposed Persons at Riggs A View from "PEP Central"

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SUMMARY

"Politically Exposed Persons" or "PEPs," now more commonly referred to as "Senior Foreign Political Figures," present unique risks to institutions. Many regulators and enforcement officials equate PEPs with political corruption. While most PEPs most certainly are not engaged in nefarious activity, the few who are tend to garner sensational headlines. Several such PEPs made Riggs Bank notorious. The author is the former head of Compliance and Investigations at Riggs and oversaw the uncovering of several of the more sensational PEP schemes in recent history. The paper includes some background on those instances and guidance on how institutions can implement programs to protect themselves from the risks posed by political figures.

ABOUT THE AUTHOR

David Caruso, CEO of the Dominion Advisory Group, has more than 15 years of experience creating and implementing comprehensive Anti-Money Laundering (AML) programs. As CEO, David is responsible for providing strategic leadership and industry expertise to ensure clients receive the best possible solution for regulatory compliance issues. Prior to forming Dominion, Caruso was the Executive Vice President of Compliance for Riggs Bank.

PEPs, Riggs...Where to begin? For over 20 years Riggs' primary business goal was to establish accounts with all the foreign embassies and military missions in Washington, DC. By 2003, nearly 95% of them did bank with Riggs. Along with the official embassy accounts came hundreds of PEPs, including two of the bank's more notable customers, Augusto Pinochet of Chile and Teodoro Obiang of Equatorial Guinea.

From 2003 through 2005 I saw first hand the risks posed by PEPs if banks fail to implement strict policies and procedures detailing account opening documentation, verification of wealth, and daily monitoring of accounts.

First, some observations on PEPs I've learned from personal experience: PEPs are different than most of us. They expect to be treated differently (catered to and fawned over). Where many come from they are royalty or celebrities (if you're princess, you want to be treated like one). Many come from places where public service is the path to riches (hint, they're corrupt!). Some who are "elected" still wear their general's get up, and some who are generals wear Armani. Most have minions who just stand there and smile (if you're lucky), while some have lackeys who stand there and scowl (if you're not so lucky). Many come from places where the idea of an election is laughable, but given the opportunity they will lecture you on good governance or how the world "really works."

For those who bank embassies or military missions, some other lessons I learned: If you bank a country that is corrupt and represses political opposition, then the ambassador to the U.S. is typically a manifestation of that corruption and repression. If the despotic ruler of country

needs to select an ambassador to Washington DC (the world's most sought after diplomatic post) he is going to pick someone from his inner circle. Guess how they got to the inner circle? By being corrupt, repressive, and loyal to the ruler...and now they are your customer.

It's no secret that embassies often serve as a base of operations for foreign intelligence services. The problem is, they don't identify themselves that way. Instead, they may be labeled the "cultural mission" or the "commercial mission" and they also need bank accounts in the U.S. Banks may consider it disturbing that foreign intelligence agencies, whose primary mission is to gather information about the secrets of the U.S. and to engage in activities that are harmful to U.S. interests and its citizens, are opening accounts with domestic financial institutions.

Defining a PEP

The risks of banking PEPs are obvious and must be mitigated. An initial step to managing possible PEP relationships is to determine a bank's official definition of a Politically Exposed Person. Using the Wolfsberg Principles as a guide, Riggs used the following:

"A Senior Foreign Political Figure who is or has been entrusted with prominent public functions, i.e. Heads of State, or of a government, i.e. senior politicians, senior government, judicial or military officials, senior executives or state owned corporations, or important political party officials."

This definition includes ambassadors and military attaches as well as spouses, children, parents, siblings, and the parents of a PEP's spouse. A "close associate" is a person who is widely and publicly known internationally to maintain an unusually close relationship with senior foreign political figures. It also includes a person who is in the position to conduct substantial domestic and international financial transactions on behalf of senior foreign political figures. The Riggs PEP policy also stated that a person is a PEP if they fall into any of the above definitions during any period in the previous three years.

Now the hard part, how does a bank identify PEPs? The method Riggs found most effective was to purchase a filter that scanned the bank's customer base to identify potential PEPs. Riggs subscribed to World-Check and models its policy after the methodology used by World-Check to identify PEPs. A PEP filter is applied in a similar manner to the way many banks use an OFAC filter – customer information files can be batched and run against World-Check on a regular basis in order to identify potential PEP hits. Like an OFAC process, banks must then develop a work flow or business process by which potential matches are resolved. For instance, is the account holder an exact PEP match? If so, is he "flagged" or distinguishable from the general population?

What to do with PEPs?

When crafting a PEP definition and deciding which PEP filter to purchase, financial institutions must also make a more significant strategic decision – determining the institution's tolerance for PEPs and their accounts. For some banks, it may make sense to greatly limit or perhaps prohibit certain types of PEP accounts. If banks do not have the systems in place to identify and monitor PEP accounts, having them is a pending disaster.

Many other banks, especially those that operate in Washington DC, New York, Miami, and Los Angeles, may find it difficult to have overly prohibitive PEP policies being that those cities have large populations of foreign political figures and their close associates. It is these banks that need to implement robust PEP programs.

A Program for Mitigating PEP Risk

A program to mitigate PEP risk has at least 10 components.

1. Policy – Defining a PEP
2. A filter to identify PEPs
3. Procedures to verify a PEPs true identify, address, and network of associates
4. Procedures to document and verify source of wealth and source of funds
5. Procedures to aggressively monitor a PEP account's transaction activity
6. A list of "red flag" transaction unique to PEPs (i.e. any payment from a multinational corporation into a PEP account).
7. A PEP approval process – perhaps a PEP committee for account acceptance/approval for those banks with large number of PEP accounts
8. A select group of account officers to manage PEP accounts
9. An aggressive compliance testing and internal audit testing PEP program
10. Procedures for periodically reporting PEP accounts and transaction activity to Board of Directors

These are the core elements of an effective PEP identification and monitoring program. Implementing these, and perhaps additional, measures can be costly and a bank must determine if the benefits of banking PEPs outweigh those costs. Moreover, banking PEPs will likely to lead to heightened regulatory scrutiny and potential reputation risk.

These program steps may seem a bit reactionary and burdensome, but speaking from first hand experience, banking PEPs is a challenge even with a well defined compliance program. And if that challenge is not met the consequences will be severe.

ABOUT THE DOMINION ADVISORY GROUP

Dominion Advisory Group is the leading provider of comprehensive and sustainable anti-money laundering programs and critical investigations services for top domestic and international financial institutions, law firms, and other organizations. Dominion Advisory Group has 15 years of extensive experience in banking, compliance, law enforcement, regulatory oversight, technology, and consulting to help financial institutions and corporations navigate the complex regulatory environment and address the needs of regulators, customers, and the institution.

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