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Bankers Urged to Create Procedures for Closing PEP Accounts

By Matt Squire

Dropping the account of a politically exposed person (PEP) can be an administrative burden for banks requiring thorough documentation to satisfy bank examiners. But banks looking to close an account for a particularly sensitive PEP need a much more involved plan of action to stem any potential reputational damage from customers and the media, say consultants.

For instance, when Riggs Bank hired **David Caruso** in 2003 to head its beleaguered anti-money laundering compliance division, he made a decision to close over 100 PEP accounts.

Caruso quickly learned that not all PEPs are created equal. “When you’re closing the account of Prince Bandar bin Sultan, the Saudi Ambassador to the U.S., the process that we went through to do that was much more elaborate,” said **Caruso**, now the chief executive officer of **Dominion Advisory Group** in Centerville, Va.

Under the Patriot Act, financial institutions are required to conduct “enhanced scrutiny” on private accounts for politically exposed persons – defined as individuals who perform state functions, such as government officials, and their family members and close associates – and report transactions that may involve funds derived from foreign corruption.

Banking for PEPs can carry unique risk/reward relationships. While PEP accounts can provide a bank with a solid revenue stream, PEPs often expect to be able to bank using practices similar to those of their home countries, such as making large withdrawals to pay embassy staff salaries in cash. Such practices, while not inherently suspicious, can make a bank uncomfortable enough to drop the account.

Banks close accounts for PEPs either due to risk aversion or because of suspicious activity associated with the account. But banks also take the account’s profitability into consideration, noted **Caruso**.

In tackling Riggs’ PEP account problems **Caruso** said, “One of the things we focused on, and in fact were encouraged to look at by the regulators, was ‘Are these relationships even profitable?’”

In 2003, Washington, D.C.-based Riggs Bank was slapped with a regulatory consent order and in the following year was fined \$25 million for failing to report suspicious transactions made with accounts for governments and PEPs from several countries, including Saudi Arabia and Equatorial Guinea. Riggs was also found to be hiding accounts for Chilean dictator Augusto Pinochet. The bank's regulatory woes led to the institution agreeing to sell itself to PNC Financial Services Group in 2004.

Being stung by regulators also influenced Riggs' decision to drop its entire embassy banking business prior to the sale. **Caruso** said that the vast majority of Riggs' embassy accounts did not pose suspicious activity risk, "but the fire storm created by the few bad apples made the bank too risk adverse to the business."

Before a bank goes forward with its decision to drop a PEP account, consultants stress that the bank must have in place written account closing policies and procedures. It must then make sure that it adheres to them.

Caruso said that account closing decisions need to consider the full scope of the account relationship across all products and services, as well as the bank's regulatory obligations.

"That's important because in the early days of this many banks just closed the deposit relationship but didn't realize that they had a consumer loan or mortgage [for the customer]."

The next step in closing a PEP account is to make sure that the entire closing process is thoroughly documented.

"It's a matter of having documents, having your compliance officer keep good notes about conversations about the accounts and what the decisions were and what the basis of the decisions was. That's what the examiners are going to want to see," said Judith Lee, a partner with Washington, D.C.-based law firm Gibson, Dunn & Crutcher LLP.

Documentation should include any list of Suspicious Activity Reports (SARs) filed on the account with the Financial Crimes Enforcement Network (FinCEN), detailed memos of conversations and meetings between compliance officers and the account holders, and documentation of discussions between management and senior management, or even the board of directors, on the decision to close the account. In addition, the bank should provide an analysis of the account to determine if the decision to close was based on suspicious activity or profitability.

"Something that shows a deliberation within the bank that led to the result," said Lee. "[Examiners] may not agree with the final decision but at least you have a paper trail showing that it was seriously considered."

Consultants also suggest keeping the government in the loop during the process, while keeping the PEP in the dark about SAR filings.

That includes caution in closing an account, since closing it can tip off a PEP that he or she is being investigated and compromise a government investigation, said Lee. “[Also] to close [a PEP account] in such a way that the PEP knows that there have been SARs filed could be a government violation, so it can be tricky.”

Lee recommends that a bank contact FinCEN and ask it to act as a liaison with law enforcement before closing the account. “The government may want the account to stay open so it knows what’s going on in the account.”

Caruso agreed. “It would be in my view a bad decision to close an account that you know law enforcement has an interest in without giving law enforcement the opportunity to request the account remains open.”

Both Lee and **Caruso** said that government requests to keep suspicious PEP accounts open can be obtained in written form to further enhance the bank’s documented due diligence process.

Closing an account for a particularly influential PEP should involve more of a bank’s time and resources beyond thorough documentation, said **Caruso**.

In the case of closing the account for the Saudi ambassador to the U.S., **Caruso** said Riggs worked to create contingencies in a number of areas. Since the closings could have created allegations of bias, Riggs worked closely with its communications and public affairs staff to develop plans to deal with any resulting media coverage, **Caruso** said.

To make the closing process as amicable as possible for the PEP, **Caruso** recommends that contact between the bank and the customer be tightly scripted.

“Usually it’s scripted in what the bank would say to the client so as not to put the bank in any legal, regulatory or reputational jeopardy. And normally it’s scripted to explain that this is a business decision by the bank,” said **Caruso**.

“If you have a lot of those types of accounts, which we did, we were also concerned about other PEPs [and whether] there could be an exodus of that type of customer,” said **Caruso**. To stem the potential loss of non-embassy PEP accounts that the bank wanted to keep, **Caruso** said that Riggs conducted customer outreach programs that explained its decision.

And finally, **Caruso** said that Riggs developed protocols for the removal of the customer’s funds from the bank.

After closing the PEP accounts, **Caruso** stressed the importance of sharing information with other banks.

By law, banks may not share SAR filings with other institutions. However, under Section 314 (b) of the Patriot Act., banks are allowed to share information on suspected terrorist or money laundering activities.

“It’s the most powerful, useful tool that the Patriot Act gave the industry,” said **Caruso**. “The investigations that we did at Riggs on the Equatorial Guinea relationship and the Augusto Pinochet relationship could not have been completed without the use of that tool.”