Industry Working Group on
Prevention of Money Laundering and Terrorist Financing

FAQs on Politically Exposed Persons

Preamble

This paper provides guidance to authorized institutions (AIs) on issues relating to anti-money laundering (AML) and counter-terrorist financing (CFT). It has been developed by the User Sub-group on Customer Due Diligence Process (Non-retail Accounts) established under the auspices of the Industry Working Group on Prevention of Money Laundering and Terrorist Financing (IWG).

The IWG is convened by the Hong Kong Monetary Authority (HKMA) and comprises representatives of the Joint Financial Intelligence Unit (JFIU) and some twenty AIs in Hong Kong. Its mandate is to provide a forum for the exchange of views on topical AML/CFT issues, and to develop guidance to AIs on any such issues.

The practices recommended in this paper do not form part of the formal regulatory requirements of the HKMA. However, the HKMA considers that the adoption of these practices would strengthen an AI's systems and procedures for combating money laundering and terrorist financing. The HKMA therefore expects every AI to give full consideration to the adoption of these practices. In cases where the management of an AI decide not to follow the recommended practices, they should satisfy themselves that either the recommended practices are not applicable to their institution, or their institution has adopted alternative control measures which are equally effective and which enable their institution to fully comply with the HKMA's AML/CFT guidelines and circulars.

Introduction

Financial relationships involving politically exposed persons (PEPs) may present a higher risk to AIs, as there is the possibility that individuals holding such positions may misuse their power and influence for personal gain and advantage or for the gain or advantage of family or close associates. Examples of such activity may include bribery and corruption and can be difficult to detect when funds are transferred to other jurisdictions and concealed through private companies, trusts, foundations or under the names of family members and close associates. It is, however, important to remember that the majority of PEPs do not abuse their position.

This paper seeks to provide AIs with guidance, in the form of FAQs, on how to address issues related to PEPs. It has borrowed heavily from similar guidance issued by the Wolfsberg Group[1].

This paper should be read in conjunction with section 10 of the HKMA's Supplement to the Guideline on Prevention of Money Laundering (Supplement).

1. What is a PEP?

The Supplement defines PEPs as "individuals being, or who 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 public organisations, and senior political party officials." The definition extends to "persons or companies clearly related to them (i.e. families, close associates, etc.)"[2]. Families and close associates are discussed in FAQ 6 below.

It is worth noting that some jurisdictions and groups have put forward differing definitions of PEPs. For instance, the definitions in the United States and European Union only refer to 'foreign' individuals, and the Wolfsberg Group's definition includes "members of the ruling royal family, and senior and/or influential representatives of the religious organisations (if these functions are connected with judicial, military or administrative responsibilities)".

2. Why are PEPs considered to be an increased risk for money laundering activity?

The risk is that PEPs may use their influence to illegally enrich themselves at the expense of the State. For example, PEPs often have direct or indirect control over the disbursement of public funds – and are therefore in a position to misappropriate the funds for their own use or benefit. PEPs can also be in a position to grant favours in exchange for bribes. So, while a PEP status itself does not incriminate the individual, it does potentially present incremental risk to an AI, and this must be properly managed and controlled.

[1] http://www.wolfsberg-principles.com/faq-persons.html
[2] Section 10.2 of the Supplement

3. How senior must the role or job title of the individual be in order to qualify as a PEP?

There is no standard test to determine PEP status, and it will vary between AIs. The aim is to identify those people who are in positions where they may have the potential to misappropriate funds or accept bribes, and then use the relationship with your AI to move or safe keep the funds.

While the focus tends to be on senior functions at the national level, individuals serving in a public capacity at more local levels can still be considered as PEPs if their position brings with it sufficient prominence and influence (e.g. at the provincial or city level). An AI may adopt a risk based approach, taking into consideration the political environment and other relevant information (e.g. the Transparency International Corruption Perceptions Index [3]) in particular jurisdictions.

4. Must the individual be serving in an elected position to be considered a PEP?

No. It is irrelevant whether the role is one in which the individual is elected or appointed.

5. Must the individual be serving in the position currently to be considered a PEP?

No. The definition in the Supplement states that PEPs are individuals who are, **or have been**, entrusted with prominent public functions. Some PEPs may have reached such heights of popularity and influence while in power that they can continue to exert influence and demand favours long after leaving office. AIs may take a risk based approach as to how long after PEPs leave their position before they stop being considered as PEPs.

The most prominent PEPs may need to remain a PEP for an even longer period after stepping down from public positions. When considering relationships with family and close business associates, a decision as to whether, and for how long, they should remain PEPs should be based on:

- information available to the AI, both from public sources and its own relationship with the PEP; and

- the jurisdiction to which the PEP is connected.

[3] http://www.transparency.org/policy_research/surveys_indices/global/cpi

There is therefore no set time frame, but by using a risk based approach, an AI can make an informed decision.

6. Why do family and close associates of PEPs also qualify as PEPs, and how is each term defined?

Families and close associates of PEPs qualify as PEPs themselves because they could either benefit from their relationship with the PEP or be entrusted to execute transactions on the PEP's behalf.

As the definition of a PEP differs around the world, so does the definition of both family and close associates.

Essentially, any parties closely connected to PEPs, whether by blood or otherwise, could be considered as PEPs themselves. How broad this definition becomes depends on the specific risk factors of each PEP customer; however, examples could include parents, children and spouses, widely and publicly-known close business associates or advisors.

7. Can a legal entity (company, partnership, trust) be a PEP?

Yes. If PEPs have significant control over a legal entity, those entities should be considered as PEPs, since they may be used by the PEPs to disguise or otherwise launder their illicitly obtained assets.

The PEP process (as discussed below) will apply whenever a PEP (this includes immediate family, close associates and entities associated with the primary PEP) is the direct contracting party of the AI.

The PEP process will also apply in the following scenarios:

- Whenever a PEP is the controlling owner of the assets of the individual or entity with which the AI is dealing. For example, they may be the majority shareholder/effective controller or the settler of a trust. Particular attention should be paid to this shareholding/control aspect when the line of business dealing with the individual or entity is inherently high risk (e.g. Correspondent Banking or Money Services Business).

- Whenever a PEP has power of disposal over the assets of the individual or entity with which the AI is dealing.

8. Are government owned entities PEPs?

No. The individuals who manage and run the government entity at senior levels would qualify as PEPs if they are to seek a direct relationship with the AI on their own behalf, or wish to use the account to move personal funds. Government owned entities, however, are not PEPs. That is not to say that all government owned entities are low risk; there is a need to assess other risk factors such as product, geography risk and potential negative press to determine the level of due diligence to be performed.

9. Are political parties considered to be PEPs?

Political parties do not necessarily fall within the definition of "Politically Exposed Person". However, AIs should consider whether they pose a higher money laundering risk, and therefore warrant the application of enhanced due diligence.

10. How can we recognize or identify a potential customer as a PEP, or as a family member or close associate of a PEP?

Recognising PEPs can be a difficult undertaking, particularly if the customer fails to provide important information or even gives false information. Despite all the AIs' efforts at recognising PEPs, it is a fact that they do not have the necessary powers, means, nor the information at their disposal to detect all such persons. AIs are restricted in what information they can obtain, often relying on information provided by customers and what can be gleaned from business documents and the media. The task is particularly difficult when close associates or families of PEPs open a business relationship with an AI, as it is often impossible to establish that relationship as a "PEP relationship" on the basis of the information available. What is important is that AIs should be able to demonstrate that they have taken reasonable steps to satisfy themselves the customer is or is not a PEP.

The following factors may - in addition to standardised know your customer procedures - be considered when seeking to recognise PEPs:

- Whether customers or other persons involved in the business relationship perform a political function. It may be appropriate to have this assessment form part of the standardised account opening process, especially in the case of customers from corruption prone countries (the Transparency International Corruption Perceptions Index is one useful tool to use to decide on a definition). Other questions that may be asked include the source of the customer's funds and wealth, and their occupation or employment;

- Enhancing awareness of the risks posed by PEPs in regular AML training; and

- Using external databases of PEPs, which include their family and close business associates.

11. Must every customer that qualifies as a PEP be considered as a high risk customer?

It depends. AIs may risk rank PEPs in the same way as all other clients and undertake a specially tailored procedure to ensure that sufficient information on PEPs is obtained. Alternatively, AIs may decide to risk rank all PEPs as high risk, and perform standard enhanced due diligence procedures.

12. With respect to an AI's non-individual customers, which individuals' names need to be screened (shareholders, directors and ultimate beneficial owners, etc.) to ascertain their PEP status?

To the extent that the names of the entity's principals are identified through the normal risk-based customer acceptance process, set out for that particular entity type, AIs should also consider whether such names present a PEP risk. One way to accomplish this is to filter such names through an external PEP database.

13. What enhanced processes should be applied for PEPs accepted into the AI?

In addition to the normally applicable customer acceptance requirements and processes, and the standard transaction monitoring protocols covering the products being used by the PEP customer, the following enhanced processes should apply:

- the AI should ascertain the customer's source of funds;

- a proper approval process should be followed before accepting the PEP as a customer;

- the transactions of the PEP customer should be reviewed on a periodic basis commensurate with the risk, with attention paid to any unusual or inconsistent behaviour that may require further investigation; and

- the AI should maintain a list of all PEP customers and ensure that all such names are periodically reviewed. Derogatory information known to the AI may require further investigation and escalation.

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