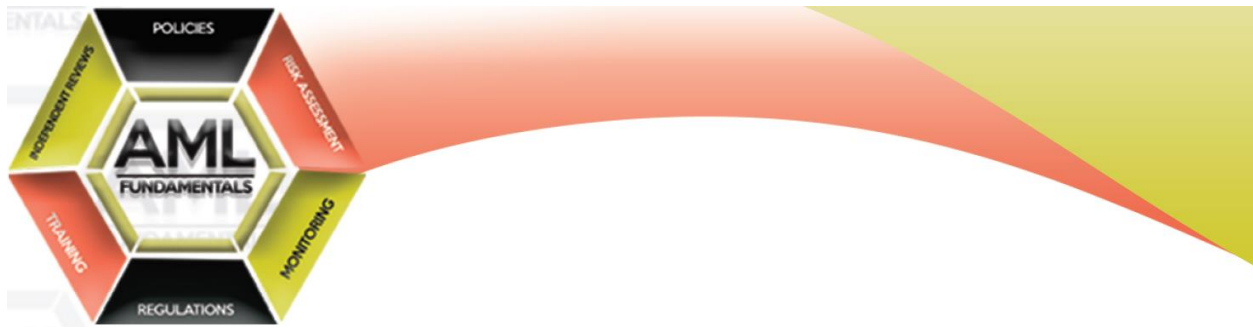




Derivative PEP Risk: Should Risk Assessments of Politically Exposed Persons (PEPs) be Graduated along the Risk Spectrum?

In the world of anti-money laundering compliance, global standards promulgated by the Financial Action Task Force (FATF), and adopted by FATF styled regional bodies such as the Caribbean Financial Action Task Force (CFATF), makes their way into the laws of countries, who as members of these regional offshoots of FATF, agree to adopt and implement in their local laws, the 40 Recommendations aimed at combating money laundering, terrorist financing and proliferation financing (AML/CFT/PL) as part of the global efforts to combat these activities.

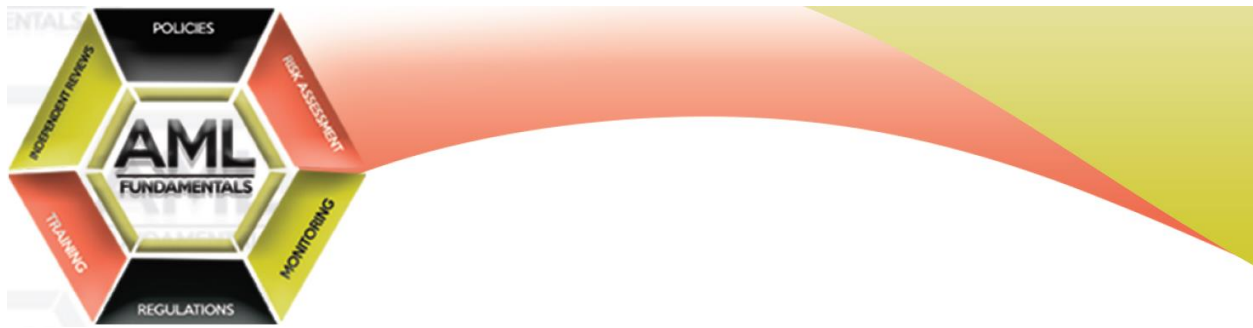
Within these Recommendations, politically exposed persons (PEPs) face increased scrutiny, as required by Recommendation 12 (R. 12). For greater context, the journey towards heightened focus on PEPs within the scope of the Recommendations, commences with R. 1, which calls for a risk based approach to applying the Recommendations. This means that a country and financial institutions within a country must be aware of their AML/CFT/PL risks, which should then inform how effectively they give effect to the Recommendations within their legal framework through their policies. R. 1 also influences R. 10, which speaks to the customer due diligence/know your customer (CDD/KYC) provisions which financial institutions, as well as designated non-financial, businesses and professionals (DNFBPs) must implement. R. 12 then singles out PEPs for increased scrutiny, beyond what is required by R. 10.

Who is a PEP and why is there a need for increased scrutiny in relation to them?

A PEP, simply put, is one who holds or has held public office or one entrusted with a prominent public office. By association, close family members of PEPs, as well as close associates are also included in this definition. The 'why' in this matter can be summed up in one word, corruption! PEPs are the subject of increased scrutiny because the role comes with a propensity for office holders to become involved in acts of corruption, exploiting the reach and power of their office, and those closely connected to and/or associated with them, to engage in AML/CFT/PL infractions. While not all PEPs will engage in acts of corruption knowingly, there also exist the probability that actors with ulterior motives may seek to befriend a PEP with the intent of exploiting the PEP through the reach he or she has, in keeping with the office held. Therefore, a PEP through their associations, could expose themselves to acts of corruption by way of innocuous arrangements. One recent example of a PEP prosecuted for money laundering offences is the former premier of the British Virgin Islands, Andrew Fahie, who according to insightcrime.org, was found guilty of drug trafficking and money laundering by a jury on February 8, 2023, in the Southern District of Florida.

PEP Treatment Distinction

As a subscriber to several newsletters from different sources dealing with anti-money laundering, I was alerted to a distinction in the treatment of PEPs in one jurisdiction, which came into effect in January 2024.



The United Kingdom's (UK) Money Laundering and Terrorist Financing (Amendment) Regulations 2023 gave effect to a differentiated treatment of PEPs in that jurisdiction. These regulations, which came into effect on January 10, 2024, make it mandatory for domestic PEPs to be treated at a lower risk level than non-domestic PEPs. It further specifies that in the absence of any "enhanced risk factors" any enhanced measures to be taken in relation to the domestic PEP, should be less than that to be applied to a non-domestic PEP.

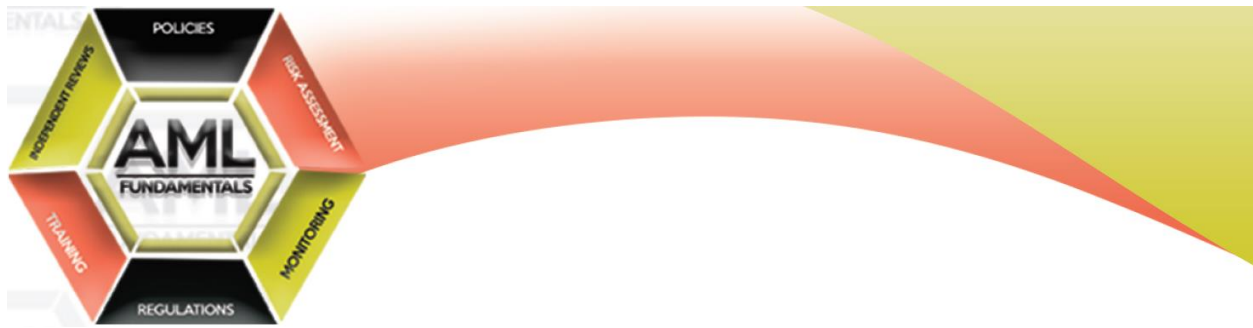
Emergence of Derivative PEP Risk Assessment

At an AML/Financial Crimes conference I attended earlier this year, one of the presenters mentioned PEP risk assessment. At the time I found it a bit curious, as I was still in the place where a PEP is considered as high risk and should be treated as such, regardless of the imperatives of the risk-based approach. In essence, I did not consider the need for a customer risk assessment to be conducted on a PEP, as globally, to my mind, the standard in keeping with FATF's guidance on PEPs would require enhanced due diligence (EDD). However, I was wrong. If we are to be true to the risk-based approach, why should PEPs not be risk assessed to determine the extent of their individual risk? The FATF's guidance on PEPs based on my reading, in principle, does not appear to be far from the UK's amendment to their regulations to introduce a derivative treatment of PEPs based on risk exposure. In fact, I would argue that the guidance supports this approach at paragraph 5 which reads, "*for domestic PEPs and international organization PEPs, financial institutions must take reasonable measures to determine whether a customer or beneficial owner is a domestic/international organization PEP, and then assess the risk of business relationship. For higher risk business relationships with domestic PEPs and international organization PEPs, financial institutions should take additional measures consistent with those applicable to foreign PEPs.*" Were this not sufficient support of the UK's amendment, then paragraph 27 of said guidance surely nails it by indicating, "*if the risk assessment establishes that the business relationship with the domestic/international organization PEP presents a normal or low risk, the financial institution and DNFBP is not required to apply enhanced due diligence measures*".

Notwithstanding the foregoing, and while arguing that FATF's guidance supports, in principle, the direction of the UK's amendment concerning the treatment of domestic PEPs, the amendment is effectively mandating that the starting point for a domestic PEP is low risk. Excluding the need for a risk assessment runs counter to the guidance which states at paragraph 30, line 4 that "*jurisdictions should not assume that the risk for all domestic/international organization PEPs is the same, and that the risk is always lower for domestic/international organization PEPs*".

The Way Forward

The UK has taken a bold step to amend its regulations to state categorically that domestic PEPs should be treated at a lower risk, requiring lower enhanced due diligence, unless prevailing risk factors says otherwise. In its explanatory memorandum, 2023 No. 1371, at paragraph 7.5, His Majesty's Treasury highlights the concerns among PEPs that financial institutions were treating all PEPs as equally high risk, despite guidance issued on the lower treatment for domestic PEPs. From my personal experience within anti-money



laundering compliance (Jamaica, the Cayman Islands, the United States, and the United Kingdom), most financial institutions adopt the equal treatment of PEPs in relation to their enhanced due diligence. This audacious move by the United Kingdom, may become the foundation on which other jurisdictions around the world, reconsider their approach to PEPs, as they seek to give effect to the spirit of R. 12, with fidelity to the risk-based approach.

Financial institutions will be challenged in obtaining credible information on PEPs, which would allow them to conduct a credible risk assessment, in determining if they should be treated as lower risk domestic PEPs. In Jamaica's case for example, financial institutions do not have access to statutory declarations completed and submitted to the Integrity Commission by PEPs, which would provide useful information as part of a PEP risk assessment. Most institutions rely on disclosures made by such individuals, and information publicly available – which might not point to credible risk factors which ought to be accounted for – to determine treatment as domestic or non-domestic PEPs. Additionally, with the enactment and implementation of Data Protection laws, access to information now also becomes more challenging, particularly in the absence of consent from data subjects.

No doubt, PEPs the world over, may view the United Kingdom's amendment as a win, and may now push for their jurisdiction to consider amendments to their own local legal framework, to alleviate themselves from 'unnecessary' enhanced due diligence request from financial institutions. Regulators on whom the burden falls to issue guidance to their licensee, in concert with the political directorate, should be keen on ensuring that their guidance is explicitly codified on how risk assessments for domestic versus non-domestic PEPs should be carried out, to avoid interpretation deficits between the regulator and licensee, as well as among licensee in their application of the law.

Finally, the overwhelming burden rests on financial institutions to demonstrate their comprehension of the law, as evidenced by their risk adjusted policies in respect of PEPs; low, medium or high. What say you?

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