

# Executive Summary and Principal Recommendations

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Over the past 25 years, the whole world has learned about the gross abuses of corrupt “politically exposed persons” (PEPs), and through outrageous examples, the way in which they plunder state assets, extort and accept bribes, and use domestic and international financial systems to launder their stolen assets. In this paper PEPs include individuals who are, or have been, entrusted with prominent public functions and their family members and close associates.

We do not know the amount of public assets stolen or extorted by prominent public office holders—referred to as *grand corruption*—and mostly laundered through financial institutions, in particular, through banks. Attempts to estimate the sums of money being laundered are hindered by the fact that it is a mostly hidden crime for which accurate statistics are unavailable. At the same time, the “guesstimates” available on overall corruption and bribery offenses help to give an idea of the order of magnitude: The World Bank estimates that more than \$1 trillion is paid in bribes each year.<sup>1</sup> The proceeds of corruption stolen from developing countries alone ranges from \$20 billion to \$40 billion per year—roughly equivalent to the annual GDP of the world’s 12 poorest countries where more than 240 million people live.<sup>2</sup>

Grand corruption, asset theft, and international flows of stolen and laundered money have an insidious and devastating impact on development. They degrade and undermine confidence in public institutions. They taint and destabilize financial systems, affecting trust. They damage the victim country’s investment climate and prospects for macroeconomic stability. This fuels capital flight, impedes growth and poverty reduction efforts, and heightens inequalities. These damages are long-lasting and become more severe the longer a corrupt regime is in place.<sup>3</sup> In all jurisdictions, political will at the highest levels is critical to fighting corruption and denying corrupt PEPs access to the financial system.

The ways in which corrupt PEPs launder their ill-gotten gains repeat and evolve. In the beginning, corrupt heads of state and prominent public officials banked in their

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1. World Bank, “The Costs of Corruption,” (April 8, 2004) quoting Daniel Kaufmann, Director for Governance, World Bank Institute. Link available at <http://go.worldbank.org/LJA29GHA80>.

2. UNODC and World Bank, “Stolen Asset Recovery (StAR) Initiative: Challenges, Opportunities, and Action Plan” (World Bank, Washington, DC, 2007), p. 9.

3. UNODC and World Bank, “Stolen Asset Recovery (StAR) Initiative: Challenges, Opportunities, and Action Plan” (World Bank, Washington, DC, 2007), p. 9.

own names in foreign jurisdictions or used relatives to open bank accounts. Current techniques continue to include abuse of bank facilities, but also the buying of real estate; the purchase and movement abroad of precious metals, jewels, and art work; and the physical cross-border movement of currency and negotiable instruments.<sup>4</sup> The use of close associates and corporate vehicles has been and remains a vexing problem. Ultimately most of the methods involve, at least in some way, the use of financial institutions, particularly banks, in the laundering of ill-gotten funds.

In addition to the early efforts of some governments, the international community made valuable commitments to address these pressing challenges. The United Nations Convention against Corruption was concluded in 2003. The same year, the Financial Action Task Force on Money Laundering (FATF) reviewed its Forty Recommendations to include standards that specifically target the laundering of the proceeds of corruption. We applaud those efforts and welcome the steps taken by several public agencies (including investigative and prosecutorial agencies), regulatory authorities, and banks to translate these commitments into practice. The reality, however, is that the distance between international commitment and visible effective action and impact remains wide. Steps taken have not been commensurate with the size and urgency of the challenge.

The Basel Committee on Banking Supervision, an international body of banking supervisors that formulates broad supervisory standards and guidance for implementation by its members, made plain the drawbacks of insufficient action for the international financial system as early as 2001:

[I]t is clearly undesirable, unethical and incompatible with the fit and proper conduct of banking operations to accept or maintain a business relationship if the bank knows or must assume that the funds derive from corruption or misuse of public assets. There is a compelling need for a bank considering a relationship with a person whom it suspects of being a PEP to identify that person fully, as well as people and companies that are clearly related to him/her.<sup>5</sup>

Accepting and managing funds from corrupt PEPs will severely damage the bank's own reputation and can undermine public confidence in the ethical standards of an entire financial centre, since such cases usually receive extensive media attention and strong political reaction.<sup>6</sup>

4. Money laundering is not confined to the financial services sector. The FATF 40+9 Recommendations apply to other sectors, referred to as designated nonfinancial businesses and professions (DNFBPs).

5. Basel Committee on Banking Supervision, "Customer Due Diligence for Banks," (Bank for International Settlements, October 2001), para. 43.

6. Basel Committee on Banking Supervision, "Customer Due Diligence for Banks," (Bank for International Settlements, October 2001), para. 42.

What is the reality? The picture today is of an overall failure of effective implementation of international PEP standards. There is surprisingly low compliance with FATF requirements on PEPs, especially among FATF members. Of the 124 countries assessed by FATF or by FATF-Style Regional Bodies, 61 percent were noncompliant and 23 percent were partially compliant. More than 80 percent of these jurisdictions are far behind.

This paper identifies three key actions necessary to make a genuine difference:

1. *Strong and sustained political will and mobilization.* Political will is needed to change laws and regulations, to create momentum for government authorities to make this a real priority, to ensure allocation of adequate resources, and to support more aggressive enforcement by regulators. Political will is also important on the implementation side: Absent such political commitment, some banks will not be motivated to make a meaningful commitment to improving customer due-diligence procedures with a view to detecting the proceeds of corruption.
2. *Clarification and harmonization of the international requirements on PEPs.* The current variations among approaches serve as both a good excuse not to act and are seen by some as a real impediment to the development and implementation of effective PEP controls. Harmonization would pave the way for useful guidance to be issued at the international or national level. Jurisdictions and banks would be provided with sounder and more consistent parameters.
3. *Stock-taking of the emerging typologies, with a focus on lifting what impedes the identification of beneficial owners who are PEPs.* PEP identification efforts are complicated by the increased use of close associates, legal entities, and other methods used to hide beneficial ownership or control by senior public officials.

Against this background, this StAR paper offers a series of recommendations and good practices designed to help increase the quality and effectiveness of those PEP measures adopted by regulatory authorities and banks. In addition, the paper provides recommendations that we hope the standard setters will consider.

Outlined below are the principal recommendations.

## **Principal Recommendation 1**

### **Apply Enhanced Due Diligence to all PEPs, Foreign and Domestic**

**Laws and regulations should make no distinction between domestic and foreign PEPs. The standards adopted by FATF and regional and national standard setters should require similar enhanced due diligence for both foreign and domestic PEPs.** The distinction between foreign and domestic PEPs in existing standards lets prominent domestic public officials and their families and close associates “off the hook.” There is no justifiable basis for the distinction. All PEPs are exposed to the opportunity

to misuse their position for personal gain; therefore, this distinction omits an important risk area. Most international banks already apply enhanced due diligence to both domestic and foreign PEPs, even though they are not required by law or regulation, and small banks generally are well aware of the identity of domestic PEPs. Thus little, if any, additional burden would be placed on banks applying this standard.

## **Principal Recommendation 2**

### **Require a Declaration of Beneficial Ownership**

**At account opening and as needed thereafter, banks should require customers to complete a written declaration of the identity and details of the natural person(s) who are the ultimate beneficial owner(s) of the business relationship or transaction as a first step in meeting their beneficial ownership customer due diligence requirements (see the sample form in box 2.2).** A critical problem identified by banks, regulators, and law enforcement alike is the recurring and intractable problem of untying the knot of legal entities formed for the purpose of hiding the identity of the natural persons who are the beneficial owners. Requiring a written declaration of beneficial ownership by the contracting customer should be an important first step in the bank's effort to identify and verify the identity of the beneficial owner. It is not the only step, nor is it sufficient on its own—banks must take additional measures to verify the declaration and conduct complementary customer due diligence, and regulatory authorities must ensure that additional actions are taken. The declaration is to be executed in a manner that provides for a criminal penalty for intentionally making a material false statement. While some criminals are unlikely to be deterred, officials and their family members and close associates will be less inclined to lie to banks if they face individual criminal liability for the false statement. In addition, the signed declaration could be used as evidence of criminal intent in a money laundering or fraud prosecution; the basis for a civil suit by the financial institution; a reason for closing the account; and an important piece of evidence in a nonconviction, based on a freezing or forfeiture proceeding initiated by the government.

## **Principal Recommendation 3**

### **Request Asset and Income Disclosure Forms**

**A public official should be asked to provide a copy of any asset and income declaration forms filed with their authorities, as well as subsequent updates. If a customer refuses, the bank should assess the reasons and determine, using a risk-based approach, whether to proceed with the business relationship.** More than 110 countries require that their public officials file asset and income disclosure forms. In the course

of our research, we found only one bank that asks customers for a copy of the form, although all banks agreed that it was an additional tool and noted that they ask for the same information and more during account opening. The form provides an important “snapshot in time” that the bank can use to compare to information provided by the customer or with account activity. Because there may be legitimate reasons for the customer to decline to provide a copy or for not having filed the forms, the bank should ask about the reason for refusal and determine, using a risk-based approach, whether to open the account or continue the relationship. Verification by local authorities of the information on such forms is uneven across jurisdictions, so banks should remain cautious about the information provided, but it can help in customer profiling.

## **Principal Recommendation 4**

### **Periodic Review of PEP Customers**

**PEP customers should be reviewed by senior management or a committee including at least one senior manager using a risk-based approach, at least yearly, and the results of the review should be documented.** Over the course of a business relationship with a PEP, ongoing monitoring procedures may reveal changes to the profile and activity. The PEP may have been promoted or elected to a more senior position, engaged in litigation, or perhaps transactions have deviated from the norm. Considered separately, the activities, transactions, or profile changes may not be sufficient to raise “red flags.” Once the information is assembled however, the “big picture” may reveal increases in overall risk or suspicions of corrupt activity. Implementing a periodic review of PEP customers using a risk-based approach, at least yearly, helps to create an overall view of a customer and overcome a narrow approach in which decisions are made transaction by transaction. This review is a common practice among the banks visited, and it ensures that the banks assemble a comprehensive picture of each PEP customer, which is analyzed and considered by senior management or a committee comprised of at least one senior manager on a regular basis. This enhances the oversight of the PEP by the bank’s management. The individual or committee subsequently makes decisions on termination or continuation of the business relationship.

## **Principal Recommendation 5**

### **Avoid Setting Limits on the Time a PEP Remains a PEP**

**Where a person has ceased to be entrusted with a prominent public function, countries should not introduce time limits on the length of time the person, family member, or close associate needs to be treated as a PEP.** Many geographic, cultural, and political factors determine the duration of the power and influence held by public



officials, relatives, and close associates. In many cases, the influence held by prominent public officials and close associates outlasts the term in office by years, even decades, and corrupt monies do not become legitimate after a certain time period. Rather than setting time limits, banks should be encouraged to consider the ongoing PEP status of their customers on a case-by-case basis using a risk-based approach, and regulatory authorities should provide guidance about what this entails. If the risk is low, banks can consider declassifying the relationship, but only after carefully evaluating the continuation of anti-money laundering risks and with the approval of senior management.

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