

FATF



FATF GUIDANCE

# POLITICALLY EXPOSED PERSONS (RECOMMENDATIONS 12 AND 22)

June 2013



FINANCIAL ACTION TASK FORCE

The Financial Action Task Force (FATF) is an independent inter-governmental body that develops and promotes policies to protect the global financial system against money laundering, terrorist financing and the financing of proliferation of weapons of mass destruction. The FATF Recommendations are recognised as the global anti-money laundering (AML) and counter-terrorist financing (CFT) standard.

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**ACRONYMS**

<b>AML/CFT</b>	Anti-Money Laundering / Countering the Financing of Terrorism
<b>CDD</b>	Customer Due Diligence
<b>DNFBPs</b>	Designated Non-Financial Business or Professions
<b>FIU</b>	Financial Intelligence Unit
<b>ML</b>	Money Laundering
<b>PEP</b>	Politically Exposed Person
<b>STR</b>	Suspicious Transaction Report
<b>TF</b>	Terrorist Financing
<b>UNCAC</b>	United Nations Convention against Corruption

## I. INTRODUCTION

1. A politically exposed person (PEP) is defined by the Financial Action Task Force (FATF) as an individual who is or has been entrusted with a prominent public function. Due to their position and influence, it is recognised that many PEPs are in positions that potentially can be abused for the purpose of committing money laundering (ML) offences and related predicate offences, including corruption and bribery, as well as conducting activity related to terrorist financing (TF). This has been confirmed by analysis and case studies. The potential risks associated with PEPs justify the application of additional anti-money laundering / counter-terrorist financing (AML/CFT) preventive measures with respect to business relationships with PEPs. To address these risks, FATF Recommendations 12 and 22 require countries to ensure that financial institutions and designated non-financial businesses and professions (DNFBPs) implement measures to prevent the misuse of the financial system and non-financial businesses and professions by PEPs, and to detect such potential abuse if and when it occurs.

2. These requirements are preventive (not criminal) in nature, and should not be interpreted as stigmatising PEPs as such being involved in criminal activity. Refusing a business relationship with a PEP simply based on the determination that the client is a PEP is contrary to the letter and spirit of Recommendation 12.

3. The FATF first issued mandatory requirements covering foreign PEPs, their family members and close associates<sup>1</sup> in June 2003.<sup>2</sup> In February 2012, the FATF expanded the mandatory requirements to domestic PEPs and PEPs of international organisations, in line with Article 52 of the *United Nations Convention against Corruption* (UNCAC).<sup>3</sup> Article 52 of the UNCAC defines PEPs as “individuals who are, or have been, entrusted with prominent public functions and their family members and close associates”, and includes both domestic and foreign PEPs. The main aim of the obligations in Article 52 of UNCAC is to fight corruption, which the FATF endorses. However, it is important to note that the aim of the 2012 FATF requirements extends more broadly to the fight against ML and its predicate offences (designated categories of offences), including corruption, and TF.

4. Consistent with this objective, Recommendation 12 requires countries to implement measures requiring financial institutions to have appropriate risk management systems in place to determine whether customers or beneficial owners are foreign PEPs, or related or connected to a foreign PEP, and, if so, to take additional measures beyond performing normal customer due diligence (CDD) (as defined in Recommendation 10) to determine if and when they are doing business with them.

5. For domestic PEPs and international organisation PEPs, financial institutions must take reasonable measures to determine whether a customer or beneficial owner is a

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<sup>1</sup> See the *2003 FATF 40 Recommendations*: Recommendation 6 (for financial institutions) and Recommendation 12 (for DNFBPs).

<sup>2</sup> The 2003 FATF Recommendations encouraged countries to extend the requirements to domestic PEPs.

<sup>3</sup> The UNCAC is also referred to as the *Mérida Convention*, after the Mexican city where the high level signing Conference was held. The UNCAC was adopted by the United Nations General Assembly in October 2003, and subsequently entered into force in December 2005.

domestic/international organisation PEP, and then assess the risk of the business relationship. For higher risk business relationships with domestic PEPs and international organisation PEPs, financial institutions should take additional measures consistent with those applicable to foreign PEPs.

6. Recommendation 12 applies to financial institutions, and Recommendation 22 requires countries to apply these requirements to DNFBPs.

7. Effective implementation of the PEPs requirements has proven to be challenging for competent authorities, financial institutions and DNFBPs worldwide. This is evident from the results of the assessments of compliance with the *2003 FATF 40 Recommendations*, undertaken by the FATF, FATF-style regional bodies, International Monetary Fund and World Bank.<sup>4</sup> Implementation challenges have also been identified through publicly available supervisory reports and regulatory actions, and high profile cases of (former) government leaders and their relatives who appeared to have significant assets available abroad which were inconsistent with their official or licit income.

8. It is also important to note that the effective implementation of Recommendations 10, 12 and 22 have to be part of a full and effective implementation of the FATF Recommendations as a whole. See the *Reference Guide and Information Note on the Use of the FATF Recommendations to Support the Fight Against Corruption*.

9. This guidance paper is *non-binding* and should be read in conjunction with FATF Recommendations 12 and 22, and their Interpretive Notes. It is a guidance tool that is based on the experiences of countries, international organisations, the private sector and non-governmental organisations, and which may assist competent authorities and financial institutions and DNFBPs to effectively implement those Recommendations.

## II. DEFINITIONS

10. For the purpose of this guidance paper, the definitions set out in the Glossary to the FATF Recommendations apply.<sup>5</sup> The FATF Glossary definition of *politically exposed person* is meant to have the same meaning as the term *persons with prominent public functions* (as used in UNCAC Article 52).

11. In particular, the following definitions, which do not cover middle ranking or more junior individuals, apply to this guidance paper:

- *Foreign PEPs*: individuals who are or have been entrusted with prominent public functions by a foreign country, for example Heads of State or of government, senior politicians, senior government, judicial or military officials, senior executives of state owned corporations, important political party officials.

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<sup>4</sup> All FATF Mutual Evaluations are published on the website of the FATF, [www.fatf-gafi.org](http://www.fatf-gafi.org), which also holds links to the websites of the FATF-style regional bodies, the IMF and World Bank. See the assessment of Recommendations 6 and 12 of the *2003 FATF 40 Recommendations* in each of these reports.

<sup>5</sup> See in particular, the Glossary definitions of: *beneficial owner, competent authorities, country, criminal activity, financial institutions, designated non-financial businesses and professions, international organisations, politically exposed person, reasonable measures, risk, satisfied, should, and supervisors*.

- *Domestic PEPs*: individuals who are or have been entrusted domestically with prominent public functions, for example Heads of State or of government, senior politicians, senior government, judicial or military officials, senior executives of state owned corporations, important political party officials.
- *International organisation PEPs*: persons who are or have been entrusted with a prominent function by an international organisation, refers to members of senior management or individuals who have been entrusted with equivalent functions, *i.e.* directors, deputy directors and members of the board or equivalent functions.
- *Family members* are individuals who are related to a PEP either directly (consanguinity) or through marriage or similar (civil) forms of partnership.
- *Close associates* are individuals who are closely connected to a PEP, either socially or professionally.

12. The difference between a foreign PEP and a domestic PEP is the country which has entrusted the individual with the prominent public function. Pursuant to the definition of PEPs, other factors, such as country of domicile or nationality, are not relevant in determining the type of PEP, but may be relevant in determining the level of risk of a specific domestic PEP (as foreign PEPs are always high risk). It should also be noted that a domestic PEP is subject to the foreign PEPs requirements if that individual is also a foreign PEP through another prominent public function in another country.

13. Throughout the remainder of this guidance paper, references to *Recommendation 12* should be interpreted to mean both Recommendations 12 and 22, as the PEPs requirements are applicable to both financial institutions and DNFBPs.

### III. THE RELATIONSHIP BETWEEN RECOMMENDATIONS 10 (CUSTOMER DUE DILIGENCE) AND RECOMMENDATION 12, AND THE SPECIFIC REQUIREMENTS FOR PEPS.

14. Recommendations 10 and 12 are both part of the overall set of customer due diligence (CDD) requirements. The ability to determine if customers or beneficial owners are PEPs fully depends upon the effective implementation of CDD measures, including the identification, verification, and ongoing due diligence requirements as set out in Recommendation 10 (for financial institutions) and Recommendation 22 (for DNFBPs), as well as the effective application of a risk based approach (Recommendation 1). CDD measures are the indispensable starting point as they must be applied to any type of customer.

15. Recommendation 10 does not require CDD measures to be applied to customers who conduct “occasional” transactions below the applicable thresholds in the circumstances which are described in Recommendations 10 and 16 (wire transfers). Consequently, financial institutions and DNFBPs are not expected to determine whether such customers are PEPs, or to apply in such cases the enhanced measures required by Recommendation 12. However, if the financial institution or DNFBP

was provided with information which clearly indicates a PEP status of the occasional customer, it would obviously have to apply the requirements of Recommendation 12.

16. The relationship between Recommendations 10 and 12, and the resulting requirements for determining if clients are foreign or domestic/international organisation PEPs can be summarised in three steps. Although these steps are sequenced, to determine if a new customer is a PEP (at the on-boarding or customer intake stage), it is understood that the three steps can take place at the same time. The three steps are further explained in the following table:

Step 1: Full and effective implementation of Recommendation 10	
<p>For foreign and domestic/international organisation PEPs</p> <ul style="list-style-type: none"> <li>• <i>Implement effective CDD measures in line with Recommendation 10.</i></li> <li>• <i>Recommendation 10 is the indispensable starting point for the effective implementation of Recommendation 12.</i></li> <li>• <i>Recommendation 12 imposes additional requirements for PEPs which are summarised in step 2 and 3.</i></li> </ul>	
Step 2: Determine if a customer is a PEP <sup>6</sup>	
<p>For foreign PEPs</p> <ul style="list-style-type: none"> <li>• <i>Recommendation 12 requires <b>appropriate risk management systems</b> to determine whether the customer or beneficial owner is a foreign PEP.</i></li> <li>• <i>This means that <b>proactive steps</b> must be taken, such as assessing customers on the basis of risk criteria, risk profiles, the business model, verification of CDD information, and the institution's own research, to determine whether a customer or a beneficial owner is a foreign PEP.</i></li> </ul>	<p>For domestic/international organisation PEPs</p> <ul style="list-style-type: none"> <li>• <i>Recommendation 12 requires <b>taking reasonable measures, based on the assessment of the level of risk</b>, to determine whether the customer or beneficial owner is a domestic PEP.</i></li> <li>• <i>This means <b>reviewing</b>, according to relevant risk factors, <b>CDD data</b> collected pursuant to Recommendation 10 in order <b>to determine</b> whether a customer or beneficial owner is a domestic PEP.</i></li> <li>• <i>Determine the risk of the business relationship and, in low risk cases, no further steps to determine if a customer is a PEP are required.</i></li> </ul>
Step 3: Take risk mitigation measures	
<p>For foreign PEPs</p> <ul style="list-style-type: none"> <li>• <i>Apply the <b>enhanced risk mitigation measures</b> of Recommendation 12 in all cases.</i></li> </ul>	<p>For domestic/international organisation PEPs</p> <ul style="list-style-type: none"> <li>• <i>In cases of a higher risk business relationship with the PEP, apply the <b>enhanced risk mitigation measures</b> of Recommendation 12.</i></li> </ul>

17. The different sets of requirements to detect PEPs (one for foreign PEPs, and one for domestic/international organisation PEPs) reflect that the level of risks are different. In practice financial institutions and DNFBPs will often use one customer on-boarding procedure for all customers.

<sup>6</sup> For the purposes of determining whether a customer or beneficial owner is a PEP, use of commercial databases is not required by the FATF Recommendations, and is not sufficient for the implementation of Recommendation 12.



18. When considering whether to establish or continue a business relationship with a PEP, the focus should be on the level of ML/TF risk associated with the particular PEP, and whether the financial institution or DNFBP has adequate controls in place to mitigate that ML/TF risk so as to avoid the institution from being abused for illicit purposes should the PEP be involved in criminal activity. This decision should be taken on the basis of the customer due diligence process and with an understanding of the particular characteristics of the public functions that the PEP has been entrusted with. The decision to establish or continue a customer relationship with a PEP should be guided primarily by an assessment of ML/TF risks, even if other considerations, such as regulatory risk, reputational risk or commercial interests, are taken into account.

19. Financial institutions and DNFBPs should consider whether they may be more vulnerable to domestic PEPs compared to foreign PEPs. For example, small financial institutions, with little or no exposure to foreign financial markets, who determine they are dealing with a foreign PEP, should consider in detail the reasons why such a relationship is being started. Financial institutions who operate in domestic markets where there are known issues relating to corruption should consider whether their exposure to domestic PEPs may be higher than to foreign PEPs.

20. In all cases, where a financial institution or DNFBP suspects or has reasonable grounds to suspect that funds are the proceeds of criminal activity, a STR (Suspicious Transaction Report) should be filed with the FIU (Financial Intelligence Unit).

#### A. FOREIGN PEPS

21. Pursuant to Recommendation 12, financial institutions and DNFBPs are required to have *appropriate risk management systems* as part of their internal rules to determine if a customer or beneficial owner is a foreign PEP. What risk management system is appropriate for a financial institution or DNFBP depends on the nature of the institution's business, the nature of its client profile, expected transactions and on other risk factors.

22. Financial institutions and DNFBPs doing business with a foreign PEP may not have much first-hand knowledge or direct access to information about variables such as what a reasonable income would be for a foreign public official at a particular level or in a particular position. This can make it more difficult to assess information, both at the account opening stage and during monitoring of the customer relationship. Consequently, appropriate risk management systems need to be implemented to address these particular risks both at the account opening/CDD stage, and when existing foreign customers become PEPs. If one of the tools used for the determination of foreign PEPs (see Section V below) indicate the presence of a PEP, but if doubts still exist, further investigation is necessary to be able to reach a sufficiently clear decision on the classification of the customer.

23. Foreign PEPs are always considered high risk and require the application of enhanced due diligence measures, as for all higher risk customers as described in Recommendation 10.<sup>7</sup> Recommendation 12 requires that the decision to engage or maintain the business relationship with the foreign PEP customer should not be taken at the ordinary level of the hierarchy, but at the level of the senior management. This should further lead to more proactive steps, in particular, to an

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<sup>7</sup> See paragraph 20 of the Interpretative Note to Recommendation 10.

increase in the monitoring of the business relationship, in order to determine whether those transactions or activities appear unusual or suspicious. Recommendation 12 also requires that financial institutions and DNFBPs take reasonable measures to establish the source of wealth and the source of funds.

24. Examples of such enhanced CDD measures include (but are not limited to): *i)* obtaining additional information on the customer; *ii)* obtaining additional information on the intended nature of the business relationship, and on the reasons for intended or performed transactions; *iii)* obtaining information on the source of funds or source of wealth of the customer; and *iv)* conducting enhanced monitoring of the business relationship, potentially by increasing the number and timing of controls applied, and identifying patterns of transactions that warrant additional scrutiny.

## B. DOMESTIC AND INTERNATIONAL ORGANISATION PEPS

25. A financial institution or DNFBP may perform the steps that are required for the implementation of the domestic/international organisation PEP requirements in concert as part of their procedures implementing Recommendation 10. Pursuant to Recommendation 12, financial institutions and DNFBPs are required to take reasonable measures as part of their internal controls to determine if a customer or beneficial owner is a domestic/international organisation PEP. To do this, financial institutions and DNFBPs should review, according to relevant risk factors, the CDD data collected pursuant to Recommendation 10.

26. In case the customer is determined to be a domestic/international organisation PEP, then financial institutions or DNFBPs should undertake a risk assessment of the PEPs business relationship. To this effect, they should notably gather sufficient information to understand the particular characteristics of the public functions that the PEP has been entrusted with and, in the case of an international organisation, the business model of that organization. Information on international organisations, for example, may be found on their respective website. The risk assessment should be a composite assessment of all the risk factors and needs to be done to determine if the business relationship with the PEP is of a higher risk. This assessment of the business relationship may take into account, among other factors *i)* customer risk factors, *ii)* country risk factors, and *iii)* product, service, transaction or delivery channel risks.<sup>8</sup> Additional factors to be taken into account should include the nature of the prominent public function that the PEP has, such as his or her level of seniority, access to or control over public funds and the nature of the position held.

27. If the risk assessment establishes that the business relationship with the domestic/international organisation PEP presents a normal or low risk, the financial institution and DNFBP is not required to apply enhanced due diligence measures. If, however, it suggests that the business relationship is of a higher risk, then the financial institution or DNFBP needs to take consistent measures that are required for foreign PEPs in as set in Recommendation 12 (b) to (d).

28. When implementing Recommendation 12, financial institutions and DNFBPs should ensure that they assess the risk of the customer and business relationship on the basis of the data collected

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<sup>8</sup> See paragraph 15 of the Interpretative Note to Recommendation 10.

pursuant to Recommendation 10.<sup>9</sup> If as a result of this assessment, a financial institutions or DNFBP has no reason to believe that a customer is a domestic/international organisation PEP, then based on this assessment it may not need to take additional measures at this stage to determine if a customer is a domestic/international organisation PEP. Financial institutions and DNFBs should be satisfied, based on reasonable measures<sup>10</sup>, that the domestic/international organisation PEP is not a higher risk customer, at the account opening stage or at a later stage. If the business relationship is high risk, then low risk factors become irrelevant and the measures the financial institutions and DNFBPs have in place in relation to such customers should be consistent with those applicable to foreign PEPs and other high risk customers.

29. It is possible that a financial institution or DNFBP rates a customer relationship with customer as high risk because of other factors, without determining at first that this customer is a domestic/international organisation PEP. If this is the case, then the enhanced due diligence measures that Recommendation 10 requires to be applied to this relationship because of these other factors, could lead to the determination that the customer is a domestic/international organisation PEP and, accordingly, lead to the application of the enhanced due diligence requirements stated in Recommendation 12.

30. The risk based approach for domestic/international organisation PEPs (“reasonable measures”) implies that in some jurisdictions, some or all business relationships with domestic/international obligations PEPs may pose an equally high risk as those with foreign PEPs. Jurisdictions should not assume that the risk for all domestic/international organisation PEPs is the same, and that the risk is always lower for domestic/international organisation PEPs. Countries should base their assessment of risks in accordance with their obligations under Recommendation 1, and communicate the appropriate guidance to financial institutions and DNFBPs. Financial institutions and DNFBPs need to undertake their own assessment in this regard.

31. Even if a business relationship with a domestic/international obligation PEP is not initially deemed to be high risk, it may evolve into a higher risk business relationship at a later stage. Financial institutions and DNFBPs should conduct ongoing due diligence on their business relationship, consistent with Recommendation 10, to ensure they identify any changes to the risk of the customer relationship. If the risk changes and becomes high, the required measures of Recommendation 12 need to be applied.

### C. IDENTIFICATION OF BENEFICIAL OWNERS

32. Recommendation 12 requires the determination that a customer is a PEP. The PEP could be the customer or the beneficial owner of a legal entity that is the client. There is a risk that corrupt PEPs could circumvent AML/CFT and anti-corruption safeguards by opening accounts, establish business relationships or conducting transactions by using third parties, such as intermediaries,

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<sup>9</sup> In scenarios that qualify for simplified due diligence and which involve customer identification, financial institutions are not released from the obligation to determine domestic PEPs status of the customer. However, simplified due diligence may limit the extent of what are reasonable measures for PEP determination.

<sup>10</sup> The Glossary defines “reasonable measures” as meaning “appropriate measures which are commensurate with the ML/FT risks”. In this context, that would mean taking into account other relevant risk factors as described in the Interpretative Note to Recommendation 10.

legal entities or legal arrangements. Cases have demonstrated that corrupt PEPs often use legal entities to obscure their identity by being the beneficial owner of the client in order to distance themselves from transactions, and to access the financial system undetected. Intermediaries (*e.g.*, lawyers, real estate and escrow agents, lobbyists, bankers) have been known to access the financial system on behalf of PEPs to conceal the controller of the assets.

33. When conducting CDD, financial institutions and DNFBPs are required to identify the beneficial owner, and take reasonable measures to verify the identity of the beneficial owner, pursuant to Recommendations 10<sup>11</sup> and 22. If there are objective grounds to believe that a beneficial owner is a PEP, complete verification is mandatory in any case. Where a person is purporting to act on behalf of a beneficial owner (or is acting on behalf of a natural person), it is best practice to inquire the reason for doing so. This may lead to awareness that the beneficial owner of the client is a PEP.

34. If the person who is acting on behalf of a PEP, or if a customer or beneficial owner is identified as a family member or close associate of a PEP, then the requirements for PEPs should also apply accordingly.

### ***Beneficiaries of life insurance policies***

35. Additionally, the Interpretative Note to Recommendation 12 requires financial institutions to take reasonable measures to determine whether the beneficiaries of a life insurance policy and/or, where required, the beneficial owner or the beneficiary are PEPs. This should occur at the latest at the time of the pay out, and should be covered by the internal controls of the financial institution. The financial institution that processes payments purporting to be from life insurance policy pay-outs should apply risk-based monitoring of such payments to determine if the recipient of the funds is a PEP.

## **IV. SCOPE OF RECOMMENDATION 12**

### **A. PROMINENT PUBLIC FUNCTION**

36. The Glossary definition of *politically exposed person* provides some examples of the types of prominent public functions that an individual may be or may have been entrusted with by a foreign or domestic government (*e.g.*, Heads of State or of government, senior politicians, senior government, judicial or military officials, senior executives of state owned corporations, important political party officials) or by an international organisation (*e.g.*, directors, deputy directors and members of the board or equivalent function).

37. Middle ranking or more junior individuals in the foregoing categories are explicitly excluded from the Glossary definition of *politically exposed person*. However, there should be awareness that middle ranking and more junior officials could act on behalf of a PEP to circumvent AML/CFT controls. These less prominent public functions could be appropriately taken into account as customer risk factors in the framework of the overall assessment of risks associated with the

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<sup>11</sup> Recommendation 10 requires that the beneficial owner (the natural person) be identified and that the financial institution understand the purpose and intended nature of the business relationship.

business relationship in accordance with Recommendation 10 when they are acting on behalf of a PEP.

38. Although the Glossary definition includes some examples of what is meant by *prominent public function*, the precise level of seniority which triggers the PEPs requirements is not specified, and the list of examples provided is not exhaustive. This is because what constitutes a *prominent public function* domestically depends on the size (*e.g.* number of inhabitants, size of the budget), particular organisational framework of government or international organisation concerned, and the powers and responsibilities associated with particular public functions and other factors that are considered as part of the risk assessment under Recommendation 1. For example, prominent public functions may exist at the federal, state or provincial, and/or municipal levels. Jurisdictions may use the risk assessment in Recommendation 1 to identify the specific levels and types of PEPs which pose a higher risk.

39. It is a good practice for countries to provide guidance to financial institutions and DNFBPs concerning what constitutes a *prominent public function* for both domestic and foreign PEPs. The starting-point is the FATF Recommendations, with the specific guidance to be informed by the risk assessment. The absence of guidance can create or perpetuate unintended determinations by financial institutions and DNFBPs on who is (and is not) a PEP. Not only will this make monitoring compliance more difficult for supervisory agencies, but it may lead to case-by-case PEP decisions by reporting institutions that are influenced by the political preferences or business interests of senior management.

40. A number of approaches are possible. In some cases, it may be best practice for such guidance to specify a baseline list of particular positions within government which are sufficiently prominent so as to qualify as a PEP (*e.g.*, President, minister, deputy minister, etcetera), and to make the list publicly available (for example on the internet). Another possible method would be to use asset disclosures of public officials who are required to disclose their assets. In these instances, domestic and foreign financial institutions and DNFBPs could potentially access such information. This is particularly important for foreign financial institutions and DNFBPs, as corrupt officials will tend to hide proceeds of corruption abroad, yet it is extremely difficult for financial institutions and DNFBPs to determine which customers would be considered PEPs in a foreign country.

41. Another approach would be to describe generally the types of responsibilities that are sufficiently prominent (*e.g.*, final approval over government procurement processes, responsibility for budgetary spending over a certain amount, decision making powers over government subsidies and grants). It should be made clear that any list cannot be relied on as the sole source of information and does not override financial institutions' and DNFBPs' assessment of risk of the business relationship and the client in other ways.

42. For foreign PEPs, the financial institution or DNFBP may be less likely to have first-hand knowledge of the PEP's domestic situation readily at hand. Such information may be available from other institutions within the same financial group which are doing business in the foreign country or, alternatively, through the internet or other relevant sources.

43. International organisations could also provide information on their organisational structure and business model, as well as the type of functions that their senior management has been

entrusted with, and, where relevant, the type of institutional measures taken to prevent the misuse of these functions.

## B. TIME LIMITS OF PEP STATUS

44. Recommendation 12 also defines a PEP as being someone who has been (but may no longer be) entrusted with a prominent public function. The language of Recommendation 12 is consistent with a possible open ended approach (*i.e.*, “once a PEP – could always remain a PEP”). The handling of a client who is no longer entrusted with a prominent public function should be based on an assessment of risk and not on prescribed time limits.

45. The risk based approach requires that financial institutions and DNFBPs assess the ML/TF risk of a PEP who is no longer entrusted with a prominent public function, and take effective action to mitigate this risk. Possible risk factors are:

- the level of (informal) influence that the individual could still exercise; the seniority of the position that the individual held as a PEP; or
- whether the individual’s previous and current function are linked in any way (*e.g.*, formally by appointment of the PEPs successor, or informally by the fact that the PEP continues to deal with the same substantive matters).

## C. FAMILY MEMBERS AND CLOSE ASSOCIATES

46. Recommendation 12 applies also to family members and close associates of the PEP. The Recommendation does not define the scope of the terms *family members* and *close associates*, as this depends to some extent on the social-economic and cultural structure of the country of the PEP. Identifying such persons is also challenging, since the number of persons who qualify as family members and close associates is fluid, and may change significantly over time.

47. It is best practice for countries to provide financial institutions and DNFBPs with working definitions or examples of close associates and family members. When doing so, it should be kept in mind that such working definitions and examples should not be interpreted too narrowly or too widely.

48. For *family members*, this includes such relevant factors as the influence that particular types of family members generally have, and how broad the circle of close family members and dependents tends to be. For example, in some cultures, the number of family members who are considered to be close or who have influence may be quite small (*e.g.*, parents, siblings, spouses/partners, and children). In other cultures, grandparents and grandchildren might also be included, while in others, the circle of family members may be broader, and extend to cousins or even clans.

49. For *close associates*, examples include the following types of relationships: (known) (sexual) partners outside the family unit (*e.g.* girlfriends, boyfriends, mistresses); prominent members of the same political party, civil organisation, labour or employee union as the PEP; business partners or associates, especially those that share (beneficial) ownership of legal entities with the PEP, or who are otherwise connected (*e.g.*, through joint membership of a company board). In the case of

personal relationships, the social, economic and cultural context may also play a role in determining how close those relationships generally are.

50. For the assessment of risk, it is the links between the close associate and/or family member with the PEP that determine the level of risk. In some cultures, several different ethno-cultural-religious links (*e.g.* tribe, clan, caste, sect) may fit the description of both close associates and family members.

51. For foreign PEPs, the financial institution or DNFBP may not have first-hand knowledge of the PEP's cultural context readily at hand. Such information may be available from other institutions within the same financial group which are doing business in the foreign country or, alternatively, through the internet and other relevant sources.

52. The FATF Recommendations require that family members and close associates of PEPs should be determined to be PEPs because of the potential for abuse of the relationship for the purpose of moving the proceeds of crime, or facilitating their placement and disguise, as well as for terrorist financing purposes. Consistent with the risk based approach outlined above, the period for which family members and close associates of PEPs who are no longer entrusted with a prominent public function should be treated as PEPs is directly related to the assessment of risk for the PEP. For example, the infant son of a foreign PEP would not be a PEP (unless he holds a prominent public function, such as being the heir to the throne or Presidency). Although the infant son is not a PEP himself, he should be treated as a foreign PEP as long as his parent is considered to be a foreign PEP. Likewise, the close associate of a domestic PEP should be treated as a domestic PEP, even if that associate does not qualify as a PEP in his/her own right, for as long as the status of the domestic PEP remains.

53. If a financial institution or DNFBP finds that a PEP has known family members and close associates, it should search its records to determine whether it may be providing financial services to such members or associates, and if so classify them as PEPs and apply the required enhanced due diligence measures.

## **V. GUIDANCE ON THE USE OF SOURCES OF INFORMATION FOR THE DETERMINATION OF PEPs, THEIR FAMILY MEMBERS & CLOSE ASSOCIATES**

54. Determining whether customers or beneficial owners are PEPs and/or finding out who are their family members and close associates can be challenging, particularly when dealing with foreign PEPs for whom current information may not be readily available. Another implementation issue is determining whether existing clients of financial institutions and DNFBPs have become PEPs since the business relationship began. PEP-related corruption case typologies and supervisory reports (see Annex 2) show that, in many cases, the financial institutions and DNFBPs knew within at least a year after the relationship began that they were dealing with a PEP, yet failed to apply the appropriate risk classification and mitigation procedures. It is important that financial institutions and DNFBPs periodically monitor their existing client base against changes in the PEP universe and not just at the time of client on-boarding.

55. It is important to stress that customer due diligence is the key source of information for the purpose of determining that a customer is a PEP, as required by Recommendations 10 and 12. For

example, a key factor in this ongoing process is the customer's principle occupation, or employment. However, there are several other sources of information that can be used by financial institutions and DNFBPs to assist in determining if a client is a PEP. Financial institutions and DNFBPs should consider using additional sources of information, particularly when determining if a client is a foreign PEP, for the reasons noted above.

56. Unlike law enforcement and supervisors, financial institutions and DNFBPs have access to a valuable source of information: the customer. They should utilise this rather than relying on third party providers. However, financial institutions and DNFBPs will often need to use more than one of these sources of information to support CDD and/or to gather other information required by Recommendation 12 (such as on the source of funds and the source of wealth). As is indicated for some of the sources the disadvantages of using some sources to help determine that a customer is a PEP may outweigh potential advantages.

57. As a general starting point to enable an assessment of risk of specific customers, risk management systems or other internal control mechanisms should draw on a range of sources for establishing ML/TF risk and take this information effectively into account. This should not be limited to international instruments, Recommendations and guidelines, but should be extended to FATF, FATF-style regional bodies, IMF/World Bank and non-governmental organisation (NGO) reports and assessments, whether mutual evaluations, or assessments and analyses of AML/CFT compliance, governance, corruption, revenue management and transparency (including natural resource revenue management and transparency).

#### **A. ENSURING CLIENT CDD INFORMATION IS UP-TO-DATE**

58. Existing clients sometimes become PEPs after they enter a business relationship, so it is essential that financial institutions and DNFBPs monitor non-PEP accounts for a change in the PEP-status, customer profile or account activity and update customer information. Such ongoing monitoring should be based on risk, consistent with Recommendation 10.

#### **B. EMPLOYEES**

59. FATF Interpretative Note to Recommendation 18 requires internal control policies to include ongoing employee training programmes. These training programmes need to address effective ways of determining whether clients are PEP and to understand, assess and handle the potential risks associated with PEPs. Training should also use real life case studies and examples to ensure it is up to date. Human input and analysis from experienced and trained employees can be more valuable than automated software programmes for detecting and handling the risks associated with PEPs. This is especially the case for high net worth customers that are PEPs, which potentially carry the highest corruption and ML risks.

#### **C. INTERNET AND MEDIA SEARCHES**

60. Financial institutions and DNFBPs frequently use the internet and media as sources of information for the determination, monitoring, verification of information in relation to PEPs, although noting that information that is retrieved may not in all cases be comprehensive or reliable. While general searches on the larger search engines can prove difficult because of the number of



“hits” that would require reviewing, free search tools are offered through AML-specific websites that would be more targeted. In addition, searching focused sources that could be linked to the customer may assist in locating relevant information (for example, (social) media websites in the customer’s country of origin). Internet searches can also assist in retrieving general relevant (country) information. For example, for a financial institution or DNFBP it is relevant to know which countries prohibit certain PEPs (such as elected officials) from maintaining bank accounts abroad.

#### D. COMMERCIAL DATABASES

61. There are a variety of commercial databases available which may assist in the detection of PEPs. Use of these databases is not required by the FATF Recommendations, and is not sufficient for compliance with Recommendation 12. Financial institutions, DNFBPs and competent authorities can acquire access to such databases—although the subscription costs may be (too) high for many institutions. As well, the costs of such systems are necessarily passed on to the clients, which will ultimately increase the cost of accessing financial services. The fact that the cost of using commercial websites is too high for some institutions should be taken into account when assessing compliance with the PEP requirements.

62. The use of these databases should never replace traditional CDD processes. Using any lists or database software to assist in the determination that a client is a PEP may increase the risk that financial institutions or DNFBPs wrongly assume that if a name is (not) in such a database then the client is (not) a PEP. Such databases are simply additional sources of information about higher risk individuals in determining whether the person is a potential PEP or family members and close associates of PEPs. Commercial databases also have limitations of which competent authorities, financial institutions and DNFBPs should be aware:

- Commercial databases are not necessarily comprehensive or reliable as they generally draw solely from information that is publicly available and thus the subscribing financial institutions or DNFBPs have no way of verifying the accuracy, comprehensiveness and/or quality of the information contained in the databases. With elections, cabinet changes, and the general turnover of public officials taking place almost daily around the world, these lists cannot be relied upon as being up-to-date.
- The definition of PEPs used by providers of such databases may or may not align with the definition used in a particular country or accurately reflect the functions entrusted by a particular international organisation.
- The subscribing financial institutions and DNFBPs may not fully understand the parameters used to populate the database and the technical capabilities of the database. For example; the database may not catch certain names, or may exclude certain categories of PEPs.
- Inconsistent transliterations and spellings of names affect the ability of financial institutions and DNFBPs to match names in general. Scrubbing customer databases for matches against commercial databases may result in many false positives if such databases contain insufficient or inadequate

identifier information. This increases the risk of missing true matches and requires additional resources to separate false positives from true matches.

63. Financial institutions and DNFBPs using such databases as a support tool should ensure that they are fit for the purpose and are not simply outsourcing their risk assessment.

#### E. GOVERNMENT ISSUED PEP-LISTS

64. Countries sometimes publish lists of domestic PEPs or prominent public functions, although this is not required by the FATF standards and such lists have potential shortcomings and can pose potential challenges for effective implementation. There are two types of lists that countries may publish: a list of positions/functions that would be held by a PEP, or a list of actual names of PEPs. In general, while the inclusion on a list can confirm the fact that a person is a PEP, not being featured on a list does not exclude the possibility that a person is nevertheless a PEP.

65. With regard to the list of *actual names*, such lists of domestic PEPs can be problematic as they are quickly outdated, difficult to manage, costly to maintain, and do not contain family members or close associates, and therefore the FATF does not advocate this approach. In addition, such lists depend on the foreign country's interpretation of what constitutes a prominent public function and the criteria for listing an individual as a PEP may diverge from the interpretation and criteria which is applicable domestically. Finally, there is risk that financial institutions and DNFBPs would rely exclusively on the list, fail to consider other customers who may be PEPs, and therefore fail to have fully assessed the risk of the business relationship; significantly impacting the effectiveness of the measures.

66. On the other hand, compiling a list of domestic *positions/functions* that are considered to be *prominent public functions* (i.e., positions held by PEPs) is a practice that can provide financial institutions and DNFBPs with an important source of information to determine who is a PEP. Given that the definition of *prominent public function* depends on the particular organizational framework of a government and can vary from country-to-country, a list of functions also assists financial institutions and DNFBPs with the difficult task of interpreting the categories of public officials they should consider as a PEP in foreign countries.

67. Compiling and maintaining a list of domestic positions/functions would not be overly onerous for individual countries. In fact, many countries already have such a list (or at least a starting-point) of public functions that are required to file asset disclosures. Since it is a list of positions/functions which are likely to remain consistent for a period of time (as opposed to a list of names which can change from one day to the next) occasional updating would be sufficient. Again, the process for updating would be similar to that used for asset disclosure systems.

68. Close associates and family members of PEPs might never be listed, but are still to be treated as PEPs, as required by Recommendation 12. Conducting CDD on a family member or close associate might also reveal information that can be cross-checked and used to verify information about the PEP which has been obtained from other sources.

## F. IN-HOUSE DATABASES AND INFORMATION SHARING WITHIN FINANCIAL GROUPS OR COUNTRIES

69. Some financial institutions and DNFBPs may choose to develop in-house databases as a tool to assist in the determination of who is a PEP. Similar to commercial databases, they may be very costly and resource intensive for financial institutions and DNFBPs to keep such database lists up-to-date. Recommendation 18 (internal controls and foreign branches and subsidiaries) requires financial groups to implement procedures for sharing information with the group for AML/CFT purposes. In relation to foreign PEPs, it is best practice for institutions within international financial groups to share information on PEPs for AML purposes. Additionally, financial institutions and DNFBPs within a country may be able to provide general information which is helpful to determine whether a PEP is trying to abuse the financial system (*e.g.*, the level of corruption in the country, the level of income for certain types of positions, etcetera).

70. However, data protection laws and/or privacy legislation may limit the ability of a financial institution or DNFBP to obtain information from a financial institution or DNFBP within the group in another jurisdiction for the purpose of verifying customer information, including on why the customer is opening an account in a foreign jurisdiction. Where this causes the financial institution or DNFBP to be unable to comply with the CDD requirements of Recommendation 10 in specific cases, the good practice is to refuse to open the account, commence business relations or process the transaction(s), or the business relationship should be terminated.

71. Where a financial institution or DNFBP frequently seeks information from financial institutions and DNFBPs in a particular country for the purposes of verifying CDD information, but is regularly denied on the grounds of data protection or privacy legislation, the institutions should consider notifying its supervisor and/or FIU. This offers the supervisor and/or FIU an opportunity to raise the issue with its foreign counterpart in an effort to find a solution which will meet the needs of both AML/CFT and privacy/data protection systems.

72. Some countries allow their financial institutions and DNFBPs to alert other financial institutions and DNFBPs in specific cases of action that they take regarding a customer, such as the termination of a customer relationship. Provided that a legal basis is created for such information exchange, this can prevent PEPs whose business was refused or terminated from shopping around.

## G. ASSET DISCLOSURE SYSTEMS

73. Countries have asset disclosure systems in place that apply to those individuals that hold prominent public functions. In implementing disclosure requirements, agencies managing asset disclosures usually need to build a list of the public officials required by law to file disclosures, so as to be able to monitor compliance. Financial institutions and DNFBPs could be aware of which countries require asset declarations from PEPs and require their customers to submit copies of such declarations. These could be used to help assess the PEP customer's risk level as part of ongoing monitoring to ensure account activity is consistent with assets and value disclosed. It should be noted that in many disclosure systems the accuracy of the disclosures form can be verified either on a routine basis, upon complaint, when corruption investigations are launched, etcetera. While many disclosure agencies are involved in conducting verification activities, their effectiveness varies due

to their overall capacity, resource endowment, availability of sources of information for cross-checking the content of disclosures, etcetera.

74. These names of filers and/or list of positions, where publicly available, can help financial institutions and DNFBPs to determine if a client is a PEP. Asset disclosure systems can also provide insight into the public functions that a country deems to be prominent. Some asset disclosure systems can provide guidance on the names of individuals filling these functions and their family members or close associates (where these are to file, or be named. In addition, asset disclosure systems may provide access to additional data, such as the date of birth and identification numbers, which can assist financial institutions and DNFBPs to determine the PEP status of clients.

75. Financial institutions and DNFBPs should be aware that the criteria used by a foreign country to determine which functions are covered by asset disclosure requirements may not correspond with the domestic criteria for a definition of a PEP. A further limitation is that an asset disclosure form is a self-declaration and, therefore, may not contain verified information or may contain (deliberately) contain false statements. Although there may be sanctions available for filing false or inaccurate information in an asset disclosure form, financial institutions and DNFBPs should take reasonable efforts to verify the information.

#### H. CUSTOMER SELF-DECLARATIONS

76. Self-declaration by a customer of their PEP status (*i.e.* by disclosing present or former employment or principal occupation clearly recognizable as a PEP) is known as a means of helping to determine whether that customer is a PEP. Some financial institutions and DNFBPs may also choose to obtain verbal or written declarations from customers to facilitate taking civil, administrative or criminal action against those PEPs who wrongly chose to not identify themselves as such.

77. However, financial institutions and DNFBPs who provide the customer with a PEP definition and ask the customer if they meet that definition should ensure that they do not rely solely on such self-declarations (which may in fact be false). Such a procedure would shift the financial institution's or DNFBP's obligation to their customer, which is not an acceptable practice. Moreover, many customers would not be able to determine if they are indeed a PEP, or not – for example because the customer is not aware of the definition of a PEP. Instead, businesses should actively engage with customers and elicit information pertinent to the different elements of the PEP definition. To do this effectively, well-trained staff and effective information gathering is required.

#### I. INFORMATION SHARING BY COMPETENT AUTHORITIES

78. The competent authorities may also have general information which is helpful in determining whether a PEP is trying to abuse the financial system (*e.g.*, the level of corruption in the country, the level of income for certain types of positions, etcetera) or specific information about particular persons which would facilitate the detection of foreign PEPs. Where such information may be made publicly available (*i.e.*, over the internet), it is best practice to do so. Alternatively, formal or informal networking or MOUs (Memorandum of Understanding) may be required so that information can be shared among domestic or foreign counterparts, also for purposes of disclosure to financial institutions and DNFBPs (provided there is a legal basis for doing so and provided that MOUs, where

applicable, allow such sharing). Both general information concerning the country from which a foreign PEP originates and more specific information (*e.g.*, about particular persons) are useful tools for verifying CDD information.

## VI. MEASURES APPLICABLE TO THE DIFFERENT TYPES OF PEPS

### A. FOREIGN PEPS AND HIGH RISK BUSINESS RELATIONSHIPS WITH DOMESTIC & INTERNATIONAL ORGANISATION PEPS

79. Foreign PEPS are always considered a high risk that warrants taking enhanced due diligence measures. In addition, business relationships with domestic PEPS and international organisation PEPS that are determined to be high risk should be subject to such measures. In both circumstances, the following enhanced due diligence measures apply: senior management approval, reasonable measures to establish the source of wealth and the source of funds, and enhanced ongoing monitoring of the business relationship.

80. For higher risk PEP relationships, it is a misconception to assume that detailed knowledge of a PEP may allow the relationship to be treated as other than high risk. For example, a foreign head of government remains a high risk PEP, no matter what the staff of the financial institution or DNFBP (*i.e.* account or client managers, senior executive staff) may know about this particular person, or the product provided. To appropriately manage the risks related to higher risk PEPS, financial institutions and DNFBPs may give greater weighting or emphasis in applying enhanced due diligence measures in specific situations.

#### ***Obtain senior management approval***

81. Pursuant to Recommendation 12, financial institutions and DNFBPs should be required to obtain senior management approval for establishing (or continuing, for existing customers) business relationships with foreign PEPS. Recommendation 12 does not define or specify the precise level of seniority within a financial institution or DNFBP that would be considered sufficient for being able to approve establishing or maintaining a customer relationship with a PEP because such a definition would not be meaningful in all countries and in all relevant contexts.

82. What will constitute *senior management* will depend on the size, structure, and nature of the financial institution or DNFBP involved. However, the objective is to ensure that more senior levels of management are aware of relationships with PEPS and that financial institutions and DNFBPs do not in any circumstance undertake business relationships with them in the absence of adequate controls. To make this assessment, the senior management person(s) involved will need to have a deep knowledge of the institution's AML/CFT programmes (*i.e.*, the internal control programmes), and a strong understanding of the potential or existing customer's ML/TF risk profile. Additionally, the senior management person(s) should have active involvement in the approval process of the institution's AML/CFT policies and procedures.

83. Appropriate arrangements for senior management approval can include having monitoring committees in place – or comparable decision making structures – that review high risk PEP customer and business relationships (both at the customer intake or acceptance stage as well as on an on-going basis). These structures should normally include the AML/CFT head, compliance

officers and customer service representatives. Larger or international financial institutions and DNFBPs may have a centralized monitoring/review process for higher risk PEPs. These structures can also help to ensure that all relevant internal information is carefully considered in specific cases. The responsibility regarding final decisions on customer relationships with PEPs should be clearly described. In all cases, it is best to document the approval or refusal by those involved in writing.

84. Although Recommendation 12 only requires senior management approval for establishing or continuing the customer relationship, it may be desirable, where financial institutions or DNFBPs lack the resources to implement internal controls and enhance ongoing monitoring mechanisms sufficiently to mitigate risk, for senior management to have a process to actively manage the termination of a the business relationship.

85. Senior management mechanisms to address the foregoing should be part of the internal control programs that financial institutions and DNFBPs are required to have in place pursuant to Recommendation 18. This should, *inter alia*, ensure that appropriate information regarding PEPs is available within institutions, when and where necessary, and include internal policies, procedures and controls relating to PEPs. The type and extent of internal control measures to be taken should be appropriate having regard to the risk of ML/TF and the size and nature of the business. Internal compliance manuals should not simply repeat regulatory requirements regarding PEPs - but should be tailored to the type of business and PEP customers that a firm does business with.

### ***Establish the source of wealth and source of funds***

86. Financial institutions and DNFBPs should be required to take reasonable measures to establish the source of wealth and the source of funds of foreign PEPs, pursuant to Recommendation 12. “Wealth” and “funds” are two different concepts.

87. The *source of wealth* refers to the origin of the PEP’s entire body of wealth (*i.e.*, total assets). This information will usually give an indication as to the volume of wealth the customer would be expected to have, and a picture of how the PEP acquired such wealth. Although financial institutions and DNFBPs may not have specific information about assets not deposited or processed by them, it may be possible to gather general information from commercial databases or other open sources.

88. The *source of funds* refers to the origin of the particular funds or other assets which are the subject of the business relationship between the PEP and the financial institution or DNFBP (*e.g.*, the amounts being invested, deposited, or wired as part of the business relationship). Normally it will be easier to obtain this information but it should not simply be limited to knowing from which financial institution it may have been transferred. The information obtained should be substantive and establish a provenance or reason for having been acquired.

89. Information about the source of wealth and source of funds is useful for ongoing due diligence purposes. When conducting ongoing due diligence of the business relationship, it is important for financial institutions and DNFBPs to ensure that the level and type of transactions are consistent with the institution’s knowledge of the PEP’s source of wealth and source of funds. The aim is to ensure that the reason for the business relationship is commensurate with what one could reasonably expect from the PEP, given his/her particular circumstances. When making this determination, the following factors should be taken into account: the current income of the PEP;

sources of wealth and funds which could be explained from previous positions, business undertakings, and family estates.

90. Where the level or type of activity in the business relationship diverges from what can be reasonably explained, given the knowledge of the PEP's source of wealth and source of funds, prompt further assessments of the situation should be undertaken. The outcomes of that assessment should determine if the business relationship is to be established or maintained, or whether further steps would be necessary, such as termination of the business relationship<sup>12</sup> and/or filing STRs to the financial intelligence unit (FIU), consistent with Recommendation 20 (reporting of suspicious transactions).

91. There is often an absence of information to help determine the source of wealth. Some institutions and DNFBPs will rely on (basic) information on publicly disclosed assets (going beyond the lists of persons that need to be disclosed). Many countries with asset disclosure systems have provisions in place on public access to the information in the disclosures, and make disclosures available on-line. While in many cases only a summary of the information filed by officials is made publicly available, the information that can be accessed sometimes includes categories such as values of income, real estate, stock holdings sources of income, positions on boards of companies, etcetera. Often, financial institutions and DNFBPs must primarily rely on a declaration by the (potential) customer. Where financial institutions and DNFBPs are relying on the customer's declaration of the source of funds/wealth, and inability to verify the information should be taken into account in establishing its value.

92. When inquiring into the source of wealth, it is also best practice to try to obtain a more specific overview of how much wealth the PEP has or controls, although it is understood that it may not always be fully possible to have an overview of the PEP's entire body of assets, especially when this information is not voluntarily disclosed. Failure to voluntarily disclose this information could also be considered a red flag.

93. The following sources of information are useful for verifying the accuracy of the customer's declaration about the source of wealth and source of funds: publicly available property registers, land registers, asset disclosure registers, company registers, past transactions (in the case of existing customers), and other sources of information about legal and beneficial ownership, where available. In the case of particularly high-profile PEPs, an internet search (including of social media) may also reveal useful information about the PEP's wealth and lifestyle and about their official income. Discrepancies between customer declarations and information from other sources could be indicators of ML suspicion and should never be disregarded.

94. When researching the source of wealth and source of funds, financial institutions and DNFBPs should focus on what can be reasonably explained, rather than on what might be expected. It seems that in some countries, in practice, PEPs are *expected* to have access to larger amounts of either licitly or illicitly obtained (cash) funds than non-PEPs, (*e.g.*, because there is an implicit expectation that individuals holding certain positions may have illicit income from corruption and other offences). This may lead to circumstances in which a higher risk PEP is assessed as having a lower customer risk and/or to cases where financial institutions and DNFBPs have incorrectly

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<sup>12</sup> In some cases, the competent authorities may request the financial institution or DNFBP not to terminate the business relationship, yet.

justified their (continued) business with a PEP based on the wealth and funds that could be *expected*, rather than on the wealth and funds that could reasonably be *explained*. Basing a risk assessment on such expectations is not compliant with Recommendation 12.

### ***Conduct enhanced ongoing monitoring of the business relationship***

95. Foreign PEPs are always considered high risk, which means that enhanced ongoing monitoring of the business relationship is always required, as is the case for higher risk domestic/international organisation PEPs. Some examples of enhanced due diligence measures are set out in paragraph 20 of the Interpretive Note to Recommendation 10. In practice, financial institutions and DNFBPs with the resources to implement electronic monitoring systems are able to conduct automated monitoring on a relatively constant basis. However, financial institutions and DNFBPs without the resources to fully computerise and fully link CDD information to an electronic monitoring system do not have this capacity. In such cases, more manual and resource-intensive methods of ongoing monitoring will be needed. This is an important implementation issue, especially for smaller financial institutions and DNFBPs.

96. When assessing the ML/TF risk level of a relationship with a domestic/international organisation PEP, financial institutions and DNFBPs should take into account such factors as whether the PEP:

- has business interests which are related to his/her public functions (conflict of interest);
- is involved in public procurement processes; whether the PEP holds several (related or unrelated) prominent public functions which may enable influence to be exerted at several key decision making points in a process, especially in spending departments;
- is from a country which has been identified by the FATF or others as having strategic AML/CFT regime deficiencies, or is known to have a high level of corruption;
- has a prominent public function in sectors known to be exposed to corruption levels, such as the oil and gas, mining, construction, natural resources, defence industries, sports, gaming, gambling sectors; or
- has a prominent public function that would allow him/her to exert a negative impact on the effective implementation of the FATF Recommendations in his/her country. The exact range of prominent public positions that this would apply to will likely differ from country to country, but could include the head of state, key ministers and other political or parliamentary leaders.

97. A broader selection of red flags and indicators of suspicion that are also useful for financial institutions and DNFBPs is provided in Annex 1.

98. When assessing whether adequate controls are in place to mitigate the risk of doing business with a particular PEP, consideration should be given to the level, frequency and extent of ongoing



monitoring and (enhanced) due diligence that will be required. It is important for the financial institutions and DNFBPs to use their understanding of the risks posed to ensure the systems they have in place are appropriate. The systems will therefore not be the same for all financial institutions and DNFBPs.

## **B. DOMESTIC & INTERNATIONAL ORGANISATION PEPs WHEN NOT HIGHER RISK**

99. When the risk assessment established that the business relationship with a domestic/international organisation PEP does not present a higher risk, the PEP in question can be treated like any other normal customer, *i.e.* the financial institution and DNFBP should apply normal customer due diligence measures and monitoring. When undertaking ongoing due diligence as required under Recommendation 10, it should be noted that a change in circumstances may change the level of risk applicable to a particular PEP, such that enhanced CDD and/or the measures set out in Recommendation 12 should be applied. This may necessitate a reconsideration of whether the financial institution or DNFBP has implemented internal controls which are sufficient to mitigate the higher level of risk. If the financial institution or DNFBP determines that it has not implemented internal controls which are sufficient to mitigate the higher level of risk, the business relationship should be terminated.

## **C. LIFE INSURANCE POLICIES WITH HIGHER RISKS**

100. The Interpretative Note to Recommendation 12 requires life insurance companies to determine whether individuals who are beneficiaries of the proceeds of life insurance policies are PEPs. This applies to foreign and domestic PEPs. Where a life insurance company has a client relationship with such an individual (for example, because the individual is him- or herself a holder of a life insurance policy) then the life insurance company should have already determined if the individual is a PEP. However, life insurance companies often do not have client relationships with beneficiaries. Where this is the case, the life insurance company should conduct CDD and make a PEP determination at the time that the company is gathering information and preparing the documentation to support the pay-out of the proceeds. The life insurance company should treat such beneficiary as a new customer for the purpose of applying this requirement.

## **VII. SUPERVISION**

101. As part of the assessment of risk conducted under Recommendation 1, competent authorities (which include supervisors) should identify and evaluate their National Risk Assessment (Recommendation 1), and ML/TF risks presented by PEPs and their activities in each jurisdiction and incorporate this knowledge and expertise into their risk-based approach to supervision, in line with Recommendation 26.

102. Supervisors should ensure that financial institutions and DNFBPs understand that assessing the reputational risk is not the same as assessing the risk that the institution will be abused for illicit purposes (*i.e.*, ML/TF risk) and should assess risk management controls and compliance with the PEPs requirements, and apply effective sanctions for non-compliance, in line with Recommendations 26 (regulation and supervision of financial institutions), 28 (and DNFBPs) and

35 (sanctions). Supervisory efforts should include a detailed review of systems used to determine and monitor PEPs, and not simply be a check of what source is used to detect PEPs. Countries may also consider publishing the sanctions which have been imposed for PEP violations to increase the awareness of risk involved in doing business with higher risk PEPs in the absence of adequate AML/CFT controls. At the same time, supervisors

103. Supervisors should also pay attention to PEPs, where appropriate, as a high-risk category in their role of taking necessary legal or regulatory measures to prevent criminals or their associates from holding, or being the beneficial owner of, a significant or controlling interest, or holding a management function in, a financial institution or DNFBP. In past cases, corrupt PEPs have captured domestic and foreign financial institutions and DNFBPs by gaining ownership, management control, or becoming a shareholder with a significant controlling interest in a financial institution or DNFBP – allowing them to exert control over the functioning of the institution or business and making use of it as a vehicle for corruption and ML.

104. In addition to actual control, financial institutions and DNFBPs face potential political pressures associated with a PEP and possible retributions for not accepting a PEP or filing an STR on a PEP. These are potential issues that supervisors need to be aware of and monitor for compliance for, as required by Recommendation 26 (regulation and supervision of financial institutions) and Recommendation 28 (regulation and supervision of DNFBPs), as well as in their role of supervising financial institutions engaged in correspondent banking services (Recommendation 13, correspondent banking). Supervisors should be aware of these risks and take appropriate steps to mitigate them.

105. It is important for competent authorities, to understand that the detailed measures required for the implementation of Recommendation 12 and Recommendation 22 may differ from one sector to another, and even within a sector.<sup>13</sup> Regulatory requirements and day-to-day supervision should take into account the risk that businesses face, depending on their size, business products and other relevant factors. To this end, supervisors need to ensure that their staff is appropriately trained and resourced. This, in combination with a regulatory framework that is tailored to the needs of each sector / business line, should ensure that there is regulatory certainty. The publication of guidance, informed by supervision, should further clarify regulatory expectations for financial institutions and DNFBPs.

106. Supervisors (and other competent authorities) have an important role to play by providing guidance (pursuant to Recommendation 34, guidance and feedback) to financial institutions and DNFBPs on what constitutes a PEP (this could include definitions of *prominent public function, family members, and close associates*) and how to effectively apply the PEP requirements. It is equally important that supervisors articulate what the expectations are regarding higher risk customers that are PEPs. The detection and identification of PEPs should not be seen in practice as an aim in itself and lead to a ticking the box approach. However, the handling of the risks of higher risk PEPs is the key to the effective implementation of Recommendation 12. To this end supervisors could provide detailed guidance on good and poor practice to identify PEPs and about their regulatory expectations (*e.g.*, when to file an STR or to terminate a customer relationship). This

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<sup>13</sup> For example, the regulatory needs regarding PEPs may be different for global financial groups compared to small local not-for-profit cooperative credit unions.

should be an ongoing process which reflects changing in wider risk factors and involves dialogues with stakeholders. Supervisors may choose to undertake horizontal and thematic supervisory reviews of the implementation of Recommendation 12 by financial institutions and DNFBPs, and to publish the general results of these reviews as guidance that is relevant for both financial institutions and DNFBPs. Such guidance reports should not only focus on identified common shortcomings, but also identify best practices, including information on how to detect PEPs, as well as PEP's family members and close associates. Such reviews should be based on a representative sample of institutions.

### **Internal controls (Recommendation 18)**

107. In addition to the supervision of the general customer due diligence requirements, supervisors should also pay attention to internal controls of financial institutions and DNFBPs. Their supervisory methodology as it relates to PEPs should include: *i)* internal policies, procedures and controls, including appropriate compliance management arrangements, *ii)* a relevant ongoing employee training programme; and *iii)* an independent audit function to test the system. Competent authorities need to assess the relevance of the internal manuals for each supervised entity.

## **VIII. OTHER ISSUES**

### **A. IMMUNITY FROM PROSECUTION AND CONVICTION**

108. A common misconception is that PEPs who may enjoy immunity from prosecution and conviction (for example, Heads of State who, during their term of office, are immune from prosecution for actions committed prior to their taking office; or diplomats who are immune from prosecution and conviction in the countries where they are posted), are therefore exempt from the requirements of Recommendation 12. However, this is not the case. PEPs are not immune from the application of the requirements of Recommendation 12 or from being the subject of the obligation to report suspicious transactions pursuant to Recommendation 20. Although immunity may slow down or prevent the criminal prosecution and conviction of such PEPs, a STR may trigger an investigation which could identify other persons without immunity who are involved in criminal activity, and who could be prosecuted immediately (*e.g.*, co-conspirators or accomplices). In addition, the PEP may lose the immunity from domestic prosecution at a later stage, at which point a criminal investigation could be opened or continued.

109. In addition, in light of the expanding modern doctrine of immunity, under which criminal activities are not considered to fall within official acts of state and under which even high state officials have personal criminal responsibility for such criminal activities, criminal immunity should not simply be assumed to exist.

### **B. CONSISTENCY WITH ANTI-DISCRIMINATION LAWS**

110. Another common misconception is that the proper implementation of PEP requirements would breach anti-discriminatory laws which safeguard the equality of all citizens of a country. It is important to realise that the requirements of Recommendation 12 are one of many additional preventive CDD measures that the FATF requires for higher risk business relationships. Other

examples are correspondent banking (Recommendation 13), new technologies (Recommendation 15) and wire transfers (Recommendation 16). What these requirements have in common with Recommendation 12 is that they focus on higher risk business relationships – whether those relationships are with natural persons or legal persons. These requirements are specifically linked to prominent public functions, irrespective of the personal characteristics of the persons holding them. The definition of a PEP is not linked in any way to any of the personal characteristics that fall within the prohibited grounds for discrimination by international conventions.

### **C. SHARING OF BEST PRACTICES BETWEEN BUSINESS ASSOCIATIONS**

111. National and international business associations have developed sector specific guidance to assist their members to implement the requirements regarding PEPs. While such guidance is not FATF endorsed, it may nevertheless be a useful source of information for financial institutions and DNBPBs. Supervisors could assist business associations to exchange guidance and best practices.

## ANNEX 1: PEPS RED FLAGS / INDICATORS

### I. INTRODUCTION

1. The determination that a customer is a PEP is not an aim in itself but forms part of the process that enables financial institutions and DNFBPs to assess the different types of higher risks related to PEPs. Determining that a customer is a PEP does not absolve financial institutions and DNFBPs of further ongoing due diligence specifically tailored to the fact that the client is a PEP. Being a PEP does not prejudice a link to criminal activities, or equate to being a criminal and / or subsequent abuse of the financial system. Similarly, the fact that a person is a domestic/international organisation PEP does not automatically imply that he/she poses a higher risk. Financial institutions and DNFBPs need nevertheless to be aware of the risks that a PEP may abuse the financial system to launder illicit proceeds, and financial institutions and DNFBPs need to be aware of the red flags / indicators that can be used to detect such abuse.

2. The FATF has developed a collection of red flags / indicators that can be used to assist in the detection of misuse of the financial systems by PEPs during a customer relationship. This list of red flags / indicators is relevant to detect those PEPs that abuse the financial system, and does not intend to stigmatize all PEPs. Often, matching one or more of these red flags / indicators may only raise the risk of doing business with a customer (red flags, risk factors), and several red flags may need to be met to create a suspicion. However, in some cases and depending on the specific circumstances, matching just one or more of these red flags / indicators will directly lead to a ML suspicion<sup>14</sup> (indicators of suspicion).

3. These PEP red flags are not an exhaustive list and are complementary to the usual ML red flags that a reporting entity may be using. The methods of those PEPs that engage in illicit activity change and therefore indicators of their activity will do so as well. Also, there may be other red flags that should be considered as equally important in a particular country or region.

### II. DETECTING MISUSE OF THE FINANCIAL SYSTEM BY PEPS – RED FLAGS AND INDICATORS FOR SUSPICION

#### A. PEPS ATTEMPTING TO SHIELD THEIR IDENTITY:

4. PEPs are aware that their status as a PEP may facilitate the detection of their illicit behaviour. This means that PEPs may attempt to shield their identity, to prevent detection. Examples of ways in which this is done are:

- Use of corporate vehicles (legal entities and legal arrangements) to obscure the beneficial owner.

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<sup>14</sup> If, during the establishment or course of the customer relationship with a PEP, or when conducting occasional transactions for a PEP, a financial institution or DNFBP suspects ML, then the institution should file an STR to the financial intelligence unit (FIU), in accordance with FATF Recommendation 20. The FATF Recommendations do not require that a customer relationship with a PEP is terminated in case of suspicion or multiple suspicions; however, financial institutions and DNFBPs should be aware of the fact that continuing such a business relationship may create criminal liability, if appropriate.

- Use of corporate vehicles without valid business reason.
- Use of intermediaries when this does not match with normal business practices or when this seems to be used to shield identity of PEP.
- Use of family members or close associates as legal owner.

## B. RED FLAGS AND INDICATORS RELATING TO THE PEP AND HIS BEHAVIOUR:

5. Specific behaviour and individual characteristics of PEPs may raise red flags / risk levels or cause a suspicion:

- Use of corporate vehicles (legal entities and legal arrangements) to obscure *i)* ownership, *ii)* involved industries or *iii)* countries.
- The PEP makes inquiries about the institution's AML policy or PEP policy.
- The PEP seems generally uncomfortable to provide information about source of wealth or source of funds.
- The information that is provided by the PEP is inconsistent with other (publicly available) information, such as asset declarations and published official salaries.
- The PEP is unable or reluctant to explain the reason for doing business in the country of the financial institution or DNFBP.
- The PEP provides inaccurate or incomplete information.
- The PEPs seeks to make use of the services of a financial institution or DNFBP that would normally not cater to foreign or high value clients.
- Funds are repeatedly moved to and from countries to which the PEPs does not seem to have ties with.
- The PEP is or has been denied entry to the country (visa denial).
- The PEP is from a country that prohibits or restricts its/certain citizens to hold accounts or own certain property in a foreign country.

## C. THE PEP'S POSITION OR INVOLVEMENT IN BUSINESSES:

6. The position that a PEP holds and the manner in which the PEP presents his/her position are important factors to be taken into account. Possible red flags are:

- The PEP has a substantial authority over or access to state assets and funds, policies and operations.
- The PEP has control over regulatory approvals, including awarding licences and concessions.
- The PEP has the formal or informal ability to control mechanisms established to prevent and detected ML/TF.

- The PEP (actively) downplays importance of his/her public function, or the public function s/he is related to associated with.
- The PEP does not reveal all positions (including those that are *ex officio*).
- The PEP has access to, control or influence over, government or corporate accounts.
- The PEP (partially) owns or controls financial institutions or DNFBPs, either privately, or *ex officio*.
- The PEP (partially) owns or controls the financial institution or DNFBP (either privately or *ex officio*) that is a counter part or a correspondent in a transaction.
- The PEP is a director or beneficial owner of a legal entity that is a client of a financial institution or a DNFBP.

#### **D. RED FLAGS AND INDICATORS RELATING TO THE INDUSTRY/SECTOR WITH WHICH THE PEP IS INVOLVED:**

7. A connection with a high risk industry may raise the risk of doing business with a PEP. Under Recommendation 1, competent authorities, financial institutions and DNFBPs are required for determining which types of clients may be higher risk. For this, financial institutions and DNFBPs will also be guided by national guidance or risk assessments. Which industries may be at risk depends on the risk assessments and varies from country to country, and on other industry safeguards that may be in place. Examples of higher risk industries are:

- Arms trade and defence industry.
- Banking and finance.
- Businesses active in government procurement, *i.e.*, those whose business is selling to government or state agencies.
- Construction and (large) infrastructure.
- Development and other types of assistance.
- Human health activities.
- Mining and extraction.
- Privatisation.
- Provision of public goods, utilities.

#### **E. BUSINESS RELATIONSHIP / TRANSACTION, PURPOSE OF BUSINESS RELATIONSHIP:**

8. Red flag and indicators can also relate to the specific business relationship or transaction:
- Multiple STRs have been submitted on a PEP.

- (Consistent) use of rounded amounts, where this cannot be explained by the expected business.
- Deposit or withdrawal of large amounts of cash from an account, use of bank cheques or other bearer instruments to make large payments. Use of large amounts of cash in the business relationship.
- Other financial institutions and DNFBPs have terminated the business relationship with the PEP.
- Other financial institutions and DNFBPs have been subject to regulatory actions over doing business with the PEP.
- Personal and business related money flows are difficult to distinguish from each other.
- Financial activity is inconsistent with legitimate or expected activity, funds are moved to or from an account or between financial institutions without a business rationale.
- The account shows substantial activity after a dormant period; or over a relatively short time; or shortly after commencing the business relationship.
- The account shows substantial flow of cash or wire transfers into or out of the account.
- Transactions between non-client corporate vehicles and the PEP's accounts.
- A PEP is unable or reluctant to provide details or credible explanations for establishing a business relationship, opening an account or conducting transactions.
- A PEP receives large international funds transfers to a gaming account. The PEP withdraws a small amount for gaming purposes and withdraws the balance by way of cheque.
- A PEP uses third parties to exchange gaming chips for cash and vice versa with little or minimal gaming activity.
- A PEP uses multiple bank accounts for no apparent commercial or other reason.

#### **F. PRODUCTS, SERVICE, TRANSACTION OR DELIVERY CHANNELS:**

9. The FATF Recommendations (Interpretative Note to Recommendation 10) contain examples of products, industries, service, transaction or delivery channels, which are of a higher risk, irrespective of the type of customer. These examples are:

- Private banking.
- Anonymous transactions (including cash).



- Non-face-to-face business relationships or transactions.
- Payments received from unknown or un-associated third parties.

10. If these industries, products, service, transaction or delivery channels are used by PEPs, then this adds an additional risk factor (depending on the nature of the PEP). In addition to the examples already listed in the FATF Recommendations, there are other products, industries, service, transaction or delivery channels that can become additionally vulnerable when used by PEPs. Examples of these are:

- Businesses that cater mainly to (high value) foreign clients.
- Trust and company service providers.
- Wire transfers, to and from a PEP account that cannot be economically explained, or that lack relevant originator or beneficiary information.
- Correspondent and concentration accounts.
- Dealers in precious metals and precious stones, or other luxurious goods.
- Dealers in luxurious transport vehicles (such as cars, sports cars, ships, helicopters and planes).
- High end real estate dealers.

## G. COUNTRY SPECIFIC RED FLAGS AND INDICATORS

11. The FATF Recommendations (Interpretative Note to Recommendation 10) contain examples of higher risk country or geographic risk factors, irrespective of the type of customer. Additionally, the following red flags and indicators relating to countries can be taken into account when doing business with a PEP:

- The foreign or domestic PEP is from a higher risk country (as defined by the FATF in Recommendation 19, or the Interpretative Note to Recommendation 10).
- Additional risks occur if a foreign or domestic PEP from a higher risk country would in his/her position have control or influence over decisions that would effectively address identified shortcomings in the AML/CFT system.
- Foreign or domestic PEPs from countries identified by credible sources as having a high risk of corruption.
- Foreign or domestic PEPs from countries that have not signed or ratified or have not or insufficiently implemented relevant anti-corruption conventions, such as the UNCAC, and the OECD Anti-Bribery Convention.
- Foreign or domestic PEPs from countries with a mono economies (economic dependency on one or a few export products), especially if export control or licensing measures have been put in place.

- Foreign or domestic PEPs from countries that are dependent on the export of illicit goods, such as drugs.
- Foreign or domestic PEPs from countries (including political subdivisions) with political systems that are based on personal rule, autocratic regimes, or countries where a major objective is to enrich those in power, and countries with high level of patronage appointments.
- Foreign or domestic PEPs from countries with poor and/or opaque governance and accountability.
- Foreign or domestic PEPs from countries identified by credible sources as having high levels of (organised) crime.

## ANNEX 2: SOURCES OF CASE INFORMATION

There is an abundance of sources with information on cases related to PEPs. This list below highlights those sources that were used as input to the drafting of this guidance paper.<sup>15</sup>

- *Banks' management of high ML risk situations, How banks deal with high risk customers (including PEPs), correspondent banking relationships and wire transfers*, Financial Services Authority (FSA), United Kingdom, 2011.
- *Barriers to Asset Recovery, An Analysis of the Key Barriers and Recommendations for Action* (Stephenson, Gray, Power, Brun, Dunker and Panjer), StAR (World Bank / UNODC) 2011.
- *Corruption – ML Nexus: an Analysis of Risks and Control Measures in West Africa*, GIABA.
- *Corruption Cases Search Center, Stolen Asset Recovery Initiative (StAR) at <http://star.worldbank.org/corruption-cases>* (World Bank / UNODC).
- *Due diligence obligations of Swiss banks when handling assets of “politically exposed persons”*, Swiss Financial Market Supervisory Authority (FINMA), 2011.
- *Laundering the Proceeds of Corruption*, Financial Action Task Force, July 2011.
- *PEPs, Preventive Measures for the Banking Sector* (Greenberg, Gray, Schantz, Latham, Gardner), StAR (World Bank / UNODC) 2010.
- *Preventing ML and TF, a Practical Guide for Bank Supervisors* (Chatain, McDowell, Mousset, Schott, Van der Does de Willebois), World Bank, 2009.
- *Specific Risk Factors in the Laundering of Proceeds of Corruption - Assistance to reporting institutions*, Financial Action Task Force, June 2012.
- *The Puppet Masters, How the Corrupt Use Legal Structures to Hide Stolen Assets and What to Do About It* (Van der Does de Willebois, Halter, Harrison, Won Park, Sharman), StAR(World Bank / UNODC) 2011.
- *The Secret Life of a Shopaholic, How an African Dictator’s Playboy son went on a multi-million dollar shopping spree in the U.S.*, Global Witness, 2009.
- *Third round Mutual Evaluation Reports*, Financial Action Task Force 2005 – 2012 (at [www.fatf-gafi.org](http://www.fatf-gafi.org)).
- *Undue Diligence, How Banks do Business with Corrupt Regimes*, Global Witness, 2009.

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<sup>15</sup> The FATF does not necessarily partially or fully endorse all of the views expressed in all of these publications.

- *Using Asset Disclosure for Identifying PEPs* (Rossi, Pop, Clementucci, Sawaqed) World Bank, 2012.
- *Wolfsberg Anti-Corruption Guidance*, the Wolfsberg Group, 2011.