The 5 Types of PEPs and the Risks They Pose

The term **politically exposed person** (PEP) is an important one in compliance. PEPs occupy prominent positions and can be a target for corruption — leaving your company vulnerable to money laundering and terrorist financing.

That's not to give PEPs a bad rap. Leaders of the world's most transparent governments and trusted institutions are technically PEPs; they're flagged as a risk because of their high profile.

Let's look at the five different types of PEPs your organization might encounter, and why it's so essential to identify them.

- FOREIGN PEPS
- DOMESTIC PEPS
- INTERNATIONAL ORGANIZATION PEPS
- FAMILY MEMBERS RELATED TO A PEP
- CLOSE ASSOCIATES OF A PEP

1. FOREIGN PEPS

Individuals given prominent public functions by a foreign country.

Foreign PEPs can include:

- Heads of state or government
- Senior government, judicial, or military officials
- Senior executives of state-owned corporations
- Important politicians or political party officials

According to the FATF, foreign PEPs should always be considered high-risk customers. It's always worth obtaining additional information on:

- The customers themselves
- The business and transactions they're conducting
- The source of their funds or wealth

When it comes to foreign PEPs, financial institutions have less first-hand, accessible information, like:

- What sort of domestic context are they operating in?
- What's a reasonable income for a foreign official at that particular level or position?

In most jurisdictions, there's no expiration date on foreign PEP status; to remain compliant with AML measures, this designation sticks with individuals for life.

2. DOMESTIC PEPS

Individuals entrusted domestically with prominent public functions.

An individual can still be a domestic PEP even if they come from abroad or live overseas.

- Their country of residence can raise a PEP's overall risk level, just as foreign PEPs are always treated as high risk.
- It's possible for an individual to be a domestic PEP and a foreign PEP if they have also been assigned prominent public functions by another country.

In some jurisdictions, individuals lose their domestic PEP status once they cease their public functions, but the FATF recommends that PEP status should be based on continuous risk assessment, not time limits.

While a domestic PEP is in office, pay attention to:

- The nature of their prominent public function
- Their level of seniority and the position
- Their access to or control over public funds

When a domestic PEP has left office, watch out for:

- The informal influence the individual still wields
- Anything that connects their previous public function with their new position, such as operating in a similar field or appointing their own successor

3. INTERNATIONAL ORGANIZATION PEPS

Persons who are or have been entrusted with a prominent function by an international organization.

What counts as an international organization?

It's any organization jointly created by the governments of more than one country through a formally signed agreement. These organizations are recognized by law in their member countries, but aren't considered resident in any of them.

International organization PEPs can include:

- Members of senior management
- Directors and deputy directors
- Other members of the board
- Anyone with equivalent functions

While some organizations clearly fit these criteria, others aren't so obvious. Do your research and due diligence to determine:

- If the customer is a PEP who works for an international organization
- The public functions they have been entrusted with
- The organization's structure and business model
- The types of functions senior management has been entrusted with
- Institutional measures taken to prevent the misuse of these functions

4. FAMILY MEMBERS RELATED TO A PEP

Individuals who are related to a PEP, whether through blood, marriage, or civil partnership.

A PEP has the potential to exploit their close relationships to move, disguise, place, or launder funds. Their family members might help them intentionally or unintentionally, and may also undertake transactions or apply for goods and services on their behalf.

- As a result, the FATF recommends that family members be treated as the same type of PEP as the individual they're affiliated with.

Trying to define who is and isn't a family member can be difficult:

- It's not a fixed category; it's fluid and changes over time
- It depends on the cultural and socioeconomic context

In some societies, the people considered "close" family are limited to parents, siblings, partners, and children, while in other cases, grandparents and grandchildren, aunts, uncles, cousins, and even entire clans could be part of an individual's close sphere.

That's why the FATF advises countries to provide financial institutions with definitions or examples, which should be interpreted flexibly when assessing risk.

5. CLOSE ASSOCIATES OF A PEP

Individuals who are closely connected to a PEP, either socially or professionally.

Close associates can include:

- Romantic partners outside the family unit
- Prominent members of the same political party, civil organization, labor, or employee union
- Business partners or associates sharing beneficial ownership of legal entities
- Colleagues who are otherwise connected, such as by joint membership on the same board

Like family members, close associates assume the same PEP status as the individual they're connected to. And like family members, they can be difficult to define.

- Social, cultural, and economic contexts need to be considered when determining what constitutes a close association.
- In some ethnic or religious situations, the descriptions pertaining to family members and close associates may overlap.

As with family members, the FATF recommends close associates be assessed based on their country's definitions of association and relationship.

So should my compliance program be on high alert for PEPs?

Yes! And no. Instead of throwing out red flags all over the place, your compliance program should be nuanced and rigorous depending on your business.

A SMART SCREENING PROGRAM:

- Starts with the regulatory minimum, and expands the net over time
- Ignores a PEP until they generate unusual financial activity
- Identifies patterns in large transactions that point to larger fraud
- Limits and monitors fuzzy matching technologies that can exponentially increase hits without boosting the quality of the results
- Weeds out the PEPs that aren't applicable to your business, your country's regulations, and your risk tolerance
- Gauges when a PEP is no longer a PEP depending on their original status and time away from the role
- Uses adaptive software to lighten the assessment load

Cognito was built for this. Our industry-leading search algorithms let you surface potential PEPs by referencing a range of regulated databases. From there, our platform is fully automated to provide constant re-scans and flag any changes in your customer accounts. If you're facing potential run-ins with PEPs, Cognito has the solutions you need. Let's have a conversation today.

Cognito