ON POLITICALLY EXPOSED PERSONS, DE-RISKING AND THE FIGHT AGAINST CORRUPTION

Lawmakers in Brazil are worried about banks discriminating against politically exposed persons, but they are considering the wrong way to address the problem

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Earlier this month, the lower house of the Brazilian Congress rushed to approve a bill criminalising the discrimination of politically exposed persons – also known as "PEPs" – by financial institutions. The Senate still has to consider and vote on the proposal, but it has already caused an uproar in the country.

The bill proposes strong penalties, including jail time, for financial institutions that fail to provide "concrete" and "objective" reasons for refusing to open an account or provide other financial services to PEPs or their family members and close associates.

The author of the proposal is Congresswoman Dani Cunha. She is the daughter of Eduardo Cunha, former speaker of the Brazilian Chamber of Deputies – the lower house of the Congress – whose secret Swiss bank accounts previously cost him his job and landed in jail. The Supreme Court recently annulled his conviction on corruption and money laundering charges and ordered a retrial.

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What is the problem?

The legislative proposal takes the view that politically exposed persons and individuals closely connected to them – like direct family members and associates – should not be discriminated against based on their political exposure or connections when attempting to access the financial system. That is legitimate. The problem is how the bill proposes to deal with conduct considered "discriminatory".

PEPs are those who occupy certain positions of power and are therefore at a higher risk of abusing their entrusted role for personal gain.

As such, global anti-money laundering standards recommend financial institutions and others entering into a transaction with PEPs to exercise more caution. This means that when a client or the beneficial owner of a client entity is identified as a PEP, a family member or an associate, financial institutions should perform enhanced checks to assess the risk level of engaging with that individual. As a further preventative measure, they should also determine which mitigation measures would be necessary to address any identified risks.

The simple fact that someone is a politically exposed person, or linked to one, does not define the level of risk. But it gives rise to the need for further analysis, such as verifying the sources of wealth and funds of the PEP, requiring senior management approval and/or the ongoing monitoring of transactions. If the financial institution finds that a PEP poses high money-laundering risk, they should decide what mitigation measures need to be in place to address it. The measures can range from ongoing monitoring, reporting any suspicious transactions to the country's financial intelligence unit, to the closure of an account.

The problem, however, is that financial institutions often prefer not to have a relationship with certain categories of clients because they find the engagement to be time-consuming or resource-intensive. This is called "de-risking" and has indeed been affecting certain individuals and sectors' access to the financial system – particularly those operating in the non-for-profit sphere. And it can also affect politically exposed persons.

So how do we ensure that there are no abuses or that financial institutions diligently implement their anti-money laundering obligations?

The bill puts the burden on financial institutions to demonstrate and substantiate why an account cannot be opened or a why a service is denied, punishing those who fail to do so with a fine and prison sentence.

This provision casts serious doubts on the extent to which financial institutions would be able to do their jobs without undermining other important anti-money laundering principles, like ensuring confidentiality and safeguarding against the tipping-off of suspicious customers. If a financial institution carries out a detailed assessment of the risks related to a specific PEP and finds sufficient grounds to not enter or terminate a relationship, global rules dictate that this cannot be shared with the client.

So, if the proposed law passes, what are the bankers meant to do: abide by anti-money laundering principles and risk jail time or let a PEP know that they are flagged for high money-laundering risk?

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The right way to do it

It is the task of regulators and supervisors to ensure that financial institutions are implementing their anti-money laundering obligations correctly, without unintended consequences and without restricting the ability of certain sectors or individuals to access the financial system – unless there is strong reason for doing so.

Financial institutions should be required to document the steps they take when assessing a client and the motivation for their decisions in relation to that client, such as why they continue or terminate a relationship. This information should be reviewed by the supervisory authority – in Brazil's case, the Central Bank – as part of their regular inspections and ongoing supervision, but not shared with clients.

The supervisory authority should pay particular attention and punish financial institutions that engage in de-risking, excluding sectors or individuals without legitimate grounds.

Financial institutions are considered the gatekeepers of the financial sector. They need to have the space to undertake checks and, when necessary, prevent and stop possibly dirty money from moving through the financial system. They need to be able to do that without tipping off their clients that they could potentially become the subject of investigations. And it is the role of the authorities to make sure that financial institutions are doing their jobs adequately.

We at Transparency International have seen and analysed numerous cases of cross-border corruption in our 30 years of experience. What we see is that, more often than not, financial institutions are not pulling their weight: they are not asking enough questions, not monitoring high-risk PEPs, and not reporting relevant suspicious transactions in a timely manner. If we want less corruption and money laundering, our focus should be on ensuring that financial institutions are doing their job properly – identifying and reporting on high-risk customers and transactions – and not putting them in an impossible situation of choosing between a prison sentence and integrity.

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PRIORITIES Dirty money

COUNTRIES Brazil

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