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GUIDANCE NOTE NO. 02 OF 2018

GUIDANCE NOTE ON THE TREATMENT OF POLITICALLY EXPOSED PERSONS

First issued: October 2018

1. Background

This Guidance Note is issued in terms of Section 9(1)(h) of the Financial Intelligence Act, 2012 (Act No. 13 of 2012) as amended (hereinafter referred to as the FIA). This document avails guidance on identification considerations of Politically Exposed Persons (PEPs) in terms of section 23 read with Regulations 6 and 15 of the FIA.

A 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) and Proliferation Financing (PF).

Section 23 of the FIA prescribes obligations with regards to the treatment of “Risk clients”. Where a client or beneficial owner has been identified through risk management mechanisms to be a high risk for ML, TF and PF employees of AIs must apply enhanced due diligence measures. Owing to their standing in society, it is internationally recognised and accepted that PEPs are inherently high risk clients.

To address these risks, the FIA, amongst others, requires Accountable and Reporting Institutions (AIs and RIs) to implement measures that prevent the misuse of the financial systems by PEPs. This includes detecting and reporting potential suspicious transactions to the FIC.

2. Defining a PEP

A PEP is meant to have the same meaning as the words “persons in prominent public positions or functions” including persons who have left prominent public positions or functions within twelve (12) months.

The above can be simplified in simple terms to include the following, amongst others:

- a) heads of state, heads of government, ministers and deputy, assistant ministers or senior politicians;
- b) members of parliament or of similar legislative bodies;
- c) members of the governing bodies of political parties;
- d) significant or important political party officials;
- e) senior executives of state owned corporations;
- f) members of supreme courts, of constitutional courts or of other high-level judicial bodies, the decisions of which are not subject to further appeal, except in exceptional circumstances;
- g) members of courts of auditors or of the boards of central banks;
- h) ambassadors and high-ranking officers in the armed forces;
- i) members of the administrative, management or supervisory bodies of state-owned enterprises; and
- j) directors, deputy directors and members of the board or equivalent function of an international organisation.

In particular, the following definitions, which do not cover middle ranking or junior staff in public functions, applies to this guidance paper:

- **Foreign PEPs:** individuals who are or have been entrusted with prominent public functions by a foreign country;
- **Domestic PEPs:** individuals who are or have been entrusted domestically with prominent public functions;
- **International organisation PEPs:** persons who are or have been entrusted with a prominent function by an international organisation;
- **Family members:** individuals who are related to a PEP either directly or through marriage or similar (civil) forms of partnership; and
- **Close associates:** individuals who are closely connected to a PEP, either socially or professionally.

The difference between a foreign PEP and a domestic PEP is the country which has entrusted the individual with a prominent public function.

Keep in mind that sections 3.5 and 3.6 of this document explains criteria of persons who are family members or close associates of PEPs.

3. This guidance is aimed at addressing the following:

3.1. What do AIs and RIs need to do?

AIs are obliged in terms of section 23 to 24 of the FIA and Regulation 15 to 16 to have appropriate risk-management systems and procedures to identify when their customer (or the beneficial owner of a customer) is a high risk or PEP and to manage the inherently high risks arising from having a business relationship with such customer.

Business relationships with the family and known close associates of a PEP should also be subjected to enhanced scrutiny. This guidance note discusses this further.

In meeting obligations of the FIA, it is expected that this is done on a Risk-Based Approach (RBA). This literally means, the level of enhanced due diligence measures a client should be subjected to should be as per the level of risk such client presents. Equally so, the nature of products should be considered on the level of risk exposure.

3.2. Why do PEPs, their close family members and associates pose a risk?

PEPs, by virtue of the positions they occupy are exposed to functions that may lead to abuse of office for personal gain or other interests. A PEP may use the financial system to launder the proceeds through abuse of office. It is by virtue of their roles that persons become PEPs and hence are required to be subjected to enhanced due diligence by AIs and RIs. Likewise, a PEP's family members and close associates may also benefit from, or be used to facilitate, abuse of public office by the PEP. It is as a result of this connection

that family and known close associates are required to be subject to scrutiny equivalent to such of a PEP.

Family and close associates are not themselves PEPs but solely as a result of their connection to a PEP.

International standards issued by the Financial Action Taskforce (FATF) recognise that PEPs may be in a position to abuse their public office for private gain. These requirements are preventative (not criminal) in nature and should not be interpreted as branding PEPs as such being involved in criminal activity.

3.3. Do all PEPs pose the same level of risk?

No. The risk differs between PEPs. This guidance note discusses how AIs and RIs may differentiate between PEPs that represent a lower risk and those that represent a higher risk. Various factors need to be considered to arrive at a reasonable risk rating for any type of client including PEPs.

Example 1:

Inherently high risk client, but risk reduced due to type of product and payment channel of such product

A Minister may inherently present a high ML risk to insurance service providers in general. But if such a Minister invests in funeral cover, with minimum premiums and such premiums are being paid directly from his or her state remuneration (salary), then such product and the manner in which payments are being made reduces the inherently high risk presented.

Example 2:

Inherently high risk client investing in products that are vulnerable for ML

Unit Trust products are investments which earn an investor interest. One can thus place funds in a unit trust and such investment would grow with interest earnings. Unit Trust products differ in nature.

A minister chooses to invest in Unit Trust products with a local insurance service provider. The Unit Trust product invested operates by clients making payments, not only from salaries but from any other source, into such investments.

The minister, who, for arguments sake earns a net income of NAD 40,000.00 monthly suddenly makes an additional investment of NAD 700,000.00. In terms of the FIA, the AI would be expected to satisfy itself that such funds are not from illicit activities. This is easier determined by understanding the sources of such funds. It may be that such funds are from legitimate sources but the service provider has to conduct the necessary due diligence to understand such.

Another example could be a high risk client investing in a Unit Trusts or similar long term investment product. That is, investing NAD 1,000,000.00 in a product that only matures (or pays out) after five years. Within a short period after investing, such client cancels the investment and the proceeds are transferred to his or her bank account. To those laundering, the penalty fees for cancellation are negligible as the bulk of the funds are released/layered. The banks receiving such funds would not readily find same suspicious as such could be interpreted as proceeds from an investment product.

3.4. Should AIs/RIs apply the same measures to all relationships with PEPs?

No. When conducting transactions or business with PEPs AIs/RIs should take a proportionate, risk-based and differentiated approach based on the individual risks presented by PEPs. This means that PEPs, their family members and close associates that pose a lower risk should be subjected to minimum due diligence or less scrutiny than those who present a higher risk.

3.5. Who are the “family” of a PEP?

Family members of a PEP include the following:

- a spouse or partner of the PEP;
- children of the PEP and their spouses or partners; and
- parents of the PEP.

3.6. Who are people regarded as “close associates” of a PEP?

Known close associates of a PEP include the following:

- an individual known to have joint beneficial ownership of a legal entity or a legal arrangement or any other close business relationship with a PEP. For example, a PEP’s business partners; and
- an individual who has sole beneficial ownership of a legal entity or a legal arrangement which is known to have been set up for the benefit of a PEP.

A known close associate of a PEP is not a PEP themselves purely as a consequence of being associated with a PEP.

Als and RIs need to understand the nature of relationships of high risk clients and determine the extent of potential risk exposure. There is no “one size fits all” approach to determining which circumstance presents a high risk.

3.7. Does the FIC provide a PEPs list?

No. The FIC opines that Als/RIs should be in a position to make the reasonable call to be able to identify persons who would be considered PEPs. For example, by perusing section 2 of this document (and any other public reliable sources), one would be able to apply the criteria for such persons who would be considered as PEPs.

3.8. What are some indicators that a PEP poses a lower risk?

Lower risk indicators - geographical

A PEP may pose a lower risk if he/she solely operates in a country that has the following characteristics:

- a) associated with low levels of corruption;
- b) political stability and free and fair elections;

- c) strong state institutions;
- d) credible anti-money laundering framework;
- e) a free press with a track record for probing official misconduct;
- f) an independent judiciary and a criminal justice system free from political interference;
- g) a track record for investigating political corruption and taking action against wrongdoers;
- h) strong traditions of audit within the public sector;
- i) legal protection for whistle-blowers; and
- j) well-developed registries for ownership of land, companies and equities.

Lower risk indicators – personal and professional

A PEP may pose a lower risk if he/she has some of the following characteristics:

- is subject to rigorous disclosure requirements;
- does not have executive decision-making responsibilities;
- his or her financial transactions are in line with the established financial profile; and
- has ceased to be a PEP for at least 12 months.

3.9. What are some indicators that a PEP poses a higher risk?

Higher risk indicators - geographical

A PEP may pose a greater risk if she/he is from, or closely connected to a country with some of the following characteristics:

- a) associated with high levels of corruption;
- b) political instability;
- c) ineffective state institutions;
- d) ineffective anti-money laundering framework;
- e) armed conflict;
- f) non-democratic forms of government;
- g) widespread organised criminality;

- h) a political economy dominated by persons with close links to the state;
- i) lacking a free press on legal or other means of investigation;
- j) a criminal justice system vulnerable to political interference;
- k) lacking expertise and skills related to bookkeeping, accountancy and audit, particularly in the public sector;
- l) law and culture unfriendly to the interests of whistle-blowers; and
- m) weaknesses in the transparency of registries of ownership for companies, land and equities.

Higher risk indicators – personal and professional

A politically exposed person may pose a higher risk if she/he has any of the following characteristics:

- a) personal wealth or lifestyle inconsistent with known legitimate sources of income or wealth;
- b) subject to credible allegations of financial misconduct;
- c) there is evidence they have sought to disguise the nature of their financial circumstances;
- d) is responsible for, or able to influence, large public procurement exercises, particularly where procurement is not subject to competitive tender, or otherwise lacks transparency; and
- e) is responsible for, or able to influence allocation of scarce government licenses/permits such as mineral extraction concessions or permission for significant construction projects.

This is not an exhaustive list. AIs and RIs should consider the profile or information relating to PEPs, and who they are doing business with.

3.10. What are some indicators that a PEP's family or known close associates pose a lower risk?

A family member or close associate of a politically exposed person may pose a lower risk if they have the following characteristics:

- He or she is a family member or close associate with a PEP who themselves poses a lower risk;
- He or she is a family member or close associate with a PEP who is no longer in office; and
- He or she is under 18 years of age.

3.11. What are some indicators that a PEP's family or known close associates pose a higher risk?

The family and close associates of a PEP may pose a higher risk if they have any of the following characteristics:

- a) Wealth derived from the granting of government licences;
- b) Wealth derived from preferential granting of government tenders and access to the privatisation of former state assets;
- c) Wealth derived from commerce in industry or sectors associated with high-barriers to entry or a lack of competition, particularly where these barriers stem from law, regulation or other government policy;
- d) Wealth or lifestyle inconsistent with known legitimate sources of income or wealth;
- e) Subject to credible allegations of financial misconduct; and
- f) Appointment to a public office that appears inconsistent with personal merit.

3.12. What measures should AI/RI take when they identify a customer is a PEP, or a family member or known close associate of a PEP?

The FIA and its Regulations require that enhanced customer due diligence measures are taken to manage and mitigate the risks posed by PEPs and their families and known close associates. This includes appropriate risk management systems/mechanisms to determine whether the customer, or the beneficial owner of the customer, is a PEP, or a family or known close associate of a PEP.

Section 23 of the FIA requires that AIs/RIs:

- have approval from senior management for establishing or continuing business relationships with such persons;
- take adequate measures to establish the source of wealth and source of funds that are involved in business relationships or transactions with such persons; and
- conduct enhanced, ongoing monitoring of those business relationships. Such could entail keeping an eye on the transacting behaviour of all high risk clients/PEPs. If any transacting behaviour is not in line with the expected norm, such should be reviewed in order to determine if it is suspicious.

3.13. To what extent may public information be taken into account?

When deciding whether a person is a known close associate of a PEP, AIs and RIs only need to have regard for information that is already in their possession or credible information that is publicly known. AIs and RIs should may make use of credible public information when establishing source of wealth and source of funds. This could include information from public registers, such as beneficial ownership registers and other credible databases. AIs and RIs should take account of the information on these types of registers or databases to minimise the burden on customers and avoid duplication with other regimes where appropriate.

If any, the extent to which media reports and other information in the public domain are to be relied on is dependent on the AI or RIs' evaluation of such information.

3.14. What measures may AIs/RIs take in lower-risk situations?

The following measures can be appropriate in lower-risk situations:

- Undertaking customer due diligence to establish whether the customer is a family member or has a close relationship with a PEP;
- Taking less intrusive and less exhaustive (Minimum Customer Due Diligence) steps to establish the source of wealth and source of funds of family members or

known close associates of a PEP; for example, only use information already available to the institution (such as transaction records or publicly available information) and do not make further inquiries of the individual unless anomalies arise.

- Oversight and approval of the relationship takes place at a less senior level of management; and
- A business relationship with a PEP or a PEP's family and close associates is subject to less frequent formal review.

3.15. What measures may AIs/RIs take in higher-risk situations?

Each circumstance or customer presents a unique set of facts which may have a bearing on risk exposure. For example, a PEP who is involved in certain types of business ventures may present a different risk to a PEP whose only source of income is a monthly salary, but he is in a position to influence awarding of tenders etc. Such unique circumstances of each PEP thus call for unique or tailored approach in due diligence, depending on the control framework of an AI or RI. It is thus quite challenging to prescribe a "one size fits all approach". What is helpful is to categorize customers who share commonalities in terms of their risk profiles. Each category is then accorded certain control measures relevant to its risk exposure. When customers are engaged, they are simply subjected to due diligence measures as per such risk categorization.

The following measures can be amongst key considerations appropriate in higher-risk situations:

- Take more intrusive and exhaustive steps to establish the source of wealth and source of funds (per identified transaction) of family members or known close associates of a PEP;
- Oversight and approval of the relationship takes place at a more senior level of management. Before providing services to a PEP, such are first approved by senior management; and
- A business relationship with a PEP or a PEP's family and close associates is subjected to more frequent and thorough formal reviews to determine potential suspicious transactions which should be reported to the FIC.

4. Commencement

This Guidance Note shall come into effect on the date of issue.

5. General

This Guidance Note:

- a) uses plain language to explain the obligations under the Act, as well as related Regulations;
- b) is intended to explain, but not replace the language of the Act and Regulations;
- c) is issued without prejudice to other existing guidance or work in the identified area; and
- d) shall be reviewed as and when the FIC deems fit.

6. FIC contact details:

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