

Aspects of identifying status of politically exposed person (1) (3/30/20)

Although the Anti Money Laundering and Counter Terrorism and Proliferation Financing (“AML/CTPF”) Act has been in force for more than ten years, some of the entities governed by the Act still find it difficult to identify the status of a “politically exposed person.”

Law and practice

To define the range of those persons, the AML/CTPF Act uses the terms “politically exposed person” (PEP), “family member of a PEP,” and “close associate of a PEP.”

Having identified a prospective customer as one of those persons, we should know that a due diligence review is necessary and we need to pay attention to any red flags that could indicate that the PEP, their family members or close associates may abuse the financial system.

Red flags are not defined by law and may vary according to inherent risks, for example:

- Using complex structures for masking the ultimate beneficial owner;
- Using complex structures without a good (business) reason;
- using middlemen where this is not consistent with normal business practice or is possibly aimed at hiding the identity of a PEP;
- family members or close relatives as ultimate beneficial owners;
- transactions involving high-risk industries, goods, services, business or supply channels, including –
 - a business that mainly takes care of high net worth foreign customers;
 - legal structuring and corporate service providers;
 - dealers in precious metals, precious stones or other luxury goods;
- transactions concluded in countries with increased risk have the following characteristics:
 - the foreign or domestic PEP comes from a higher risk country;
 - the PEP comes from a country considered one with a high risk of corruption according to credible sources;
 - the PEP comes from a country that has not ratified relevant anti-corruption treaties;
 - the PEP comes from a country in which a mono-economy prevails (i.e. economic reliance on one or a few export products);
 - the PEP comes from countries in which the political system is based on autocratic regimes.

Section 1(18) of the AML/CTPF Act defines a PEP as a person that holds or has held a significant public office in Latvia, another member state, or a third country.

When establishing a business relationship with a customer, the entity governed by the AML/CTPF Act should take risk assessment steps to determine whether the customer or its ultimate beneficial owner is a PEP, a family member of a PEP, or a close associate of a PEP. It is important to note that the list of offices given in the AML/CTPF Act is not an exhaustive one. For example, in certain cases, a Member of Parliament or a candidate for another similar position may also be considered a PEP. In providing services to foreign persons, the titles of positions and their influence in different countries may vary according to each

country's legal system, so we need to identify politically significant positions in the particular country, considering, for example, differences between politically significant positions in Latvia and abroad.

When it comes to drawing up a list of PEP offices, the entity governed by the AML/CTPF Act should consider risks associated with particular aspects, such as corruption. We note that corruption commonly occurs where the private sector is confronted with the public sector.

Corrupt officials and other PEPs may resort to secret methods for making personal profits, controlling funds, and keeping control over benefits gained through crime.

To achieve these aims, a PEP may use their family members or other closest associates who are secretly working for their benefit. Thus, a PEP's family members and close associates are subject to the same requirements for legitimacy checks and supervision applicable to the PEP.

Family members of a PEP are defined by section 1(18.1) of the AML/CTPF Act.¹

In a business relationship with a PEP, when it comes to identifying a close associate, we may look at political corruption, i.e. whether persons in a business relationship with the PEP face a high risk of corruption.

Persons outside the family (e.g. friends, colleagues, former fellow students) and persons who are in the same political party or public organisation with the PEP and persons who are prominent members of trade unions may be considered close associates of the PEP. However, a partner the PEP is actually living with is not considered a spouse and does not formally fit the definition of a family member under the AML/CTPF Act. Those cases are still considered to involve "close association."

(to be continued)

¹ a) The spouse or spouse equivalent of the PEP. A person is considered to be a spouse equivalent only if the national law confers this status on them;

b) Child of the PEP or of their spouse or spouse equivalent, or the spouse or spouse equivalent of that child;

c) Parent, grandparent, or grandchild;

d) Sibling.

A close associate of the PEP is an individual known (a) to have a business relationship or (b) some other close relationship with the PEP, or (c) to be a member or shareholder in the same company with the PEP, or (d) the sole owner of a legal arrangement known to have been actually formed for the PEP's benefit (section 1(18.2) of the AML/CTPF Act).