

How to handle the PEP due diligence, corruption challenge

Second of two parts.

IN THE MONTHS AFTER SEPTEMBER 11, dozens of companies entered the anti-money laundering technology business, promising their customers a solution to the troublesome problem of screening accounts for “politically exposed persons,” or PEPs.

All of a sudden, these firms are experts in creating these kinds of databases. But are they really? As I mentioned last time, PEPs are broadly defined. And who can produce this information? Even in a society as information-rich as the United States, how easy would it be to compile a list of First Lady Laura Bush’s first-cousins, nieces and nephews?

Policing the guardians

Some data providers do not even cover immediate family and close associates. Others argue over who lists the most relatives and close associates, or which database is the most comprehensive.

Although the industry extols due diligence, few institutions seem to conduct due diligence on the due-diligence providers. It is the institution’s responsibility to check the quality of the content and expertise of the database developers, and not just whether the salesman has financial industry experience.

Businesses shopping for a PEP database should determine:

Scope of the database: Does it contain just senior political figures, family members and close associates, or does it include lists of those in organized crime, drug trafficking, money laundering and terrorism? Most businesses want a one-stop shop, and will need to check on both high-risk individuals and PEPs to satisfy regulators.

Methodology: How does the vendor compile the database? What is the expertise of the developer? Is it just a static database

or is there additional research? What kinds of sources or research does the database use? Is it continually updated, and how?

Size and relevance: Financial institutions should look at the size of the database, how closely the names in it relate to your area of interest and where they are obtained. Are they compiled from sources specific to your subject area and considered reliable and reputable?

Spot-checking: Although anybody can find an omission if the name is relatively obscure, it’s a good idea to come up with a reasonable list of known, high-risk names that have been reported or listed and check them against the database.

Management’s options

Businesses in the market for PEP databases have three basic options: They can buy a high-end product, shop for a middle-of-the-road vendor, or do it themselves. Each avenue has its pros and cons:

High End: An ideal high product is likely only to be offered by a global services firm, perhaps in the news business. Having created PEP databases, I think that such an entity would be the only one capable of leveraging the resources and methodology necessary to compile a decent PEP database, or at least the closest we will come to one.

An international news organization could use its reporters and news bureaus worldwide to compile the database. Relevant information from news stories would be captured and forwarded to a central database. In addition, researchers in various news bureaus around the world would specifically develop information on PEPs.

Names and titles of PEPs could be conveniently listed, rather than requiring the user to search by name and read through news articles. The database could include PEPs, relatives and close associates, as well as names on U.S.,

European Union and U.N. lists.

The downside of such a high end product is probably a hefty subscription fee to cover the costs involved in putting together such a comprehensive database. This option is also likely to be too costly for most small and medium-sized institutions. And although it wouldn’t be as convenient, one could probably obtain much of this information independently by manually searching news archives.



Mid-range: A number of database vendors out there offer less expensive solutions. Naturally, the major drawback here is that the business conducting the due diligence will still have to hire staff to do the searches and, more importantly, deal with the inevitable follow-up investigation of false positives (different people with the same name.) The problem for many institutions is that the individuals doing the work should be qualified researchers, but are typically junior clerks. The quality of the search is severely handicapped if the researcher does not understand research protocol issues such as name derivations, character and symbol sequence order, different language spellings, etc.

Fees for most middle-of-the-road vendors start at around \$7,000 for an annual subscription to web access. Integration into your institution’s existing IT framework will bring higher costs, depending on the level of customization, the number of systems involved, etc.

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How to use databases and the Internet to screen for PEPs

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Do-it-yourself: Explaining how a business could screen for PEPs (and high-risk individuals) on its own would require a complete set of policies and procedures, probably in the form of a manual with directions on updating, maintaining and developing sources on an ongoing basis. The manual would probably list dozens if not hundreds of qualified Internet sites, databases and government lists pre-programmed as favorites into computer systems and customized with search spiders or intelligent agents. The method I describe below is merely intended as a brief overview.

So how to start? A do-it-yourself solution should employ a hybrid model: The use of manual “qualified” research on the Internet based on the specific subject name, in combination with automated checking of proprietary databases (e.g. in-house watch lists) and government lists (e.g. U.S., EU and U.N. sanctions lists).

I say “qualified” to emphasize that a simple Google search won’t do the job. Google searches less than 25% of the entire web – the remaining portion is often referred to as the “invisible” or “historical” web because it is not readily accessible using traditional search engines. In addition to using multiple meta-crawlers (such as Metacrawler) financial institutions should drill down into multiple news sites and news archives (such as www.highbeam.com), since most of the news reported on the Internet pertains to only the last 30 days.

An institution can develop its own hybrid model in-house, with the right expertise and training, or can outsource the program to an enhanced due-diligence vendor using a similar model (which can also be customized to their needs).

Although this is by far the most time-consuming method, it is probably the most accurate, and it has its place in smaller institutions dealing routinely with

enhanced due diligence (e.g. private or correspondent banking). I should say that at this level or size of institution, it may even be cost effective. I have seen institutions combine the hybrid model to screen certain high risk clients and a conventional database vendor for routine account acceptance.

Parting thought

Ultimately the question should be: Did your financial institution take all reasonable steps to ensure compliance with legislation, regulation and guidance? Did you perform to an adequate industry standard as defined by international best practice? I don’t think a regulator would look unkindly on such a risk-based approach, especially since there may not be a truly complete PEP database, and regulators have no alternatives to suggest.

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