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Due diligence obligations of Swiss banks when handling assets of “politically exposed persons”

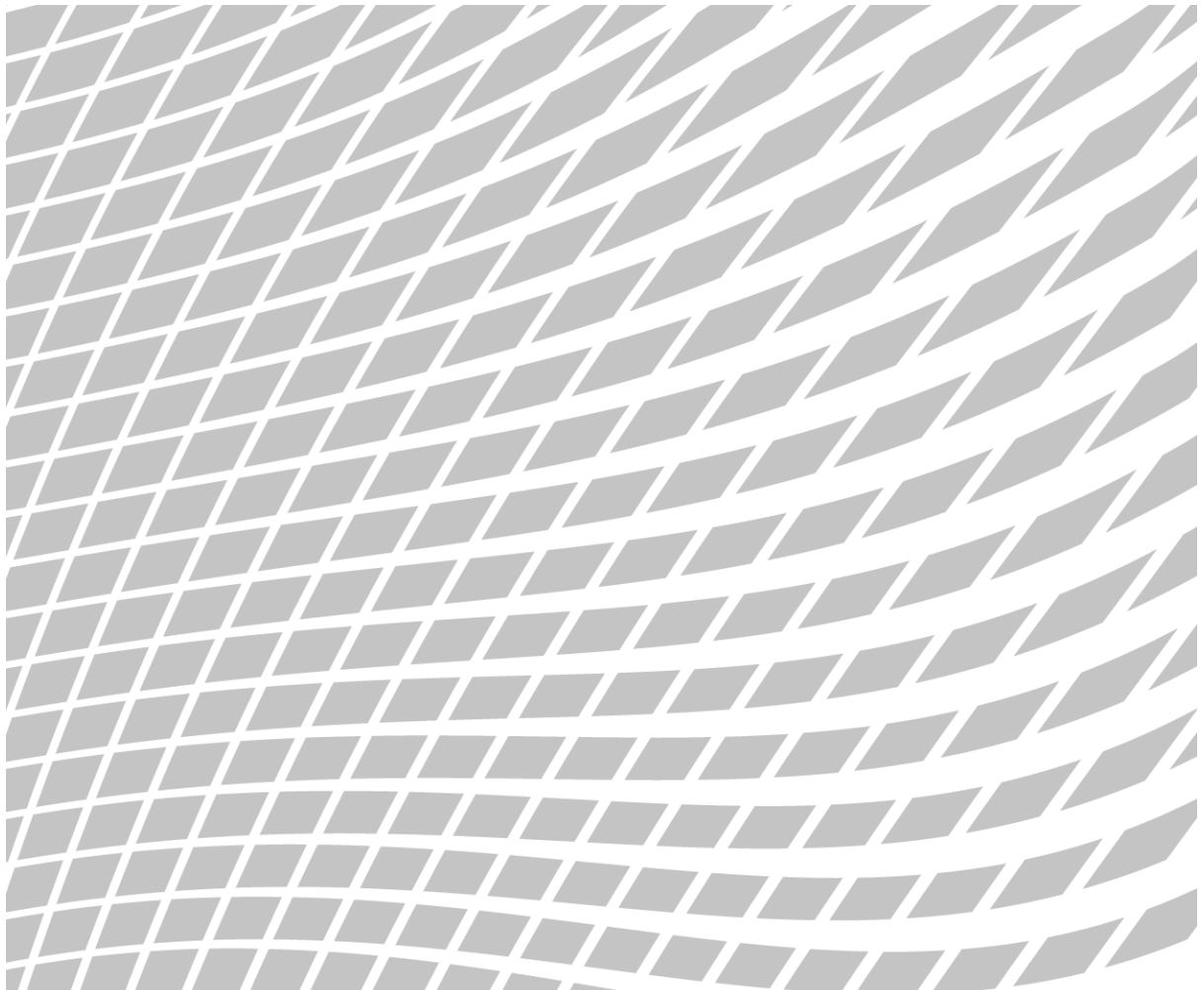


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Key points

- Since 1998, Switzerland has adopted concrete rules on how banks are to handle assets of politically exposed persons (PEPs). These due diligence regulations have been developed continuously and are now enshrined in FINMA's Anti-Money Laundering Ordinance. Business relationships with PEPs are not forbidden. The activities of financial intermediaries in such cases are, however, subject to strict due diligence obligations based on the Anti-Money Laundering Act (AMLA). Furthermore, financial intermediaries are obliged to report and freeze assets if they have reasonable suspicion of the assets coming from criminal sources.
- FINMA checks compliance with due diligence obligations for banks every year and is assisted in particular by audit firms. In case of non-compliance with due diligence obligations, FINMA intervenes and ensures that the institutions concerned make every effort to comply in future with the provisions. In serious cases, FINMA can impose sanctions.
- The Swiss ruling on handling business relationships with PEPs fulfils or exceeds the GAFI provisions which represent international standards. Switzerland's supervisory system is also considered as compliant at the international level.
- The ordering of sanctions issued in the cases of Tunisia, Egypt and Libya differ from the anti-money laundering provisions. The sanctions order aims to freeze the assets affected and to enforce compliance with international law, or to support a request for future legal assistance by the country in question. Under AMLA, on the other hand, the duty to report applies to financial intermediaries who have reasonable suspicion of money laundering or the financing of terrorism. Suspicions may, for instance, stem from indications that the Swiss or foreign criminal authorities are making investigations about the client.
- If, prior to the ordering of sanctions, no reporting has been made to the Money Laundering Reporting Office Switzerland (MROS), it does not automatically point to a breach of the anti-money laundering regulations. This issue is to be assessed on a case-to-case basis. Based on the ordering of sanctions concerning Tunisia, Egypt and Libya, FINMA is checking about a dozen banks in connection with the reporting of assets. No results are available as yet.

1 Purpose of this short report

In recent weeks, Switzerland and other states have frozen assets of certain persons associated with the governments of Tunisia, Egypt and Libya.¹ Swiss financial intermediaries are called on to report these assets by orders issued by the Federal Council. Individual banks have made reports to that effect. This has prompted public debate on whether the reported assets should have been accepted in the first place or whether they should have been reported to the Money Laundering Reporting Office Switzerland (MROS) at an earlier stage. FINMA is currently reviewing these questions. It will announce its findings upon conclusion of the review. The purpose of this short report is for FINMA to explain in brief:

- the due diligence obligations for financial intermediaries handling assets of foreign politically exposed persons (PEPs) (Section 2);
- how compliance with these due diligence obligations is supervised (Section 3);
- how these rules and their supervision are perceived internationally (Section 4), and
- how supervision is being applied in the cases of Tunisia, Egypt and Libya (Section 5).

2 Due diligence obligations when handling assets of politically exposed persons (PEPs)

2.1 Origin and evolution of the due diligence regulations

Since 1986, new rules in dealing with assets of politically exposed persons have consistently been added in response to various cases which have arisen.² Switzerland was the first ever country, in 1998, to introduce concrete rules on how banks are to handle such assets.³ These due diligence regulations have been developed continuously in several stages and are now enshrined in FINMA's Anti-Money Laundering Ordinance of 8 December 2010 (AMLO-FINMA).⁴

On an international level, the *Wolfsberg AML Principles on Private Banking*⁵ were published in October 2000; in October 2001 came the *Customer Due Diligence Paper* from the Basel Committee⁶, and in November 2001 the *Supervisors' PEP Working Paper*⁷ was published.

¹ <http://www.admin.ch/dokumentation/gesetz/00068/index.html?lang=de&unterseite=yes> (in German).

² See paragraph 3.3 of this short report.

³ SFBC Circular 98/1 of 26 December 1998, no. 15

⁴ SR 955.033.0

⁵ <http://www.wolfsberg-principles.com/standards.html> (revised in May 2002)

⁶ <http://www.bis.org/publ/bcbs85.pdf>

⁷ Report published jointly by the German, Canadian, French, British and Swiss supervisory authorities: <http://www.finma.ch/archiv/ebk/d/archiv/2002/pdf/neu090702-03d.pdf>

2.2 Legal basis of due diligence regulations

The regulations on due diligence which a financial intermediary must observe to combat money laundering are enshrined in the Anti-Money Laundering Act (AMLA).⁸ The FINMA Anti-Money Laundering Ordinance (AMLO) specifies in more detail the due diligence regulations on handling the assets of politically exposed persons.

2.3 The term “politically exposed person”

The term “politically exposed person” (PEP) is defined in the FINMA Anti-Money Laundering Ordinance as follows:

- persons holding prominent public positions abroad (such as “Heads of State or Government, senior politicians at national level, senior government, judicial, military or party officials at national level, senior executives of state-owned companies of national importance”), and
- “Companies and people identified as having close family ties or personal or business connections to the aforementioned persons”.⁹

2.4 Target group for the due diligence regulations

The due diligence regulations must be obeyed by all financial intermediaries according to the Anti-Money Laundering Act. That includes banks, certain fund management and investment companies, life insurers, securities dealers and other natural and legal persons in the financial sector, such as asset managers.¹⁰

2.5 Content of the due diligence regulations

The anti-money laundering regulations require all financial intermediaries to observe due diligence obligations and organisational measures to prevent money laundering and the financing of terrorism. The AMLA defines general due diligence obligations regarding clients, including identifying the contracting party and beneficial owner, knowing the nature and purpose of the business relationship, documenting and preserving records and the duty to report suspicion of money laundering or financing of terrorism. Financial intermediaries are also obliged to conduct more far-reaching clarifications if the business relationship or transaction is classified as higher risk.¹¹

2.6 Duty of financial intermediaries to clarify a business relationship with a PEP

Swiss legislation does not forbid a financial intermediary from having a business relationship with po-

⁸ SR 955.0

⁹ Art. 2 para. 1 let. a AMLO-FINMA

¹⁰ Art. 2 AMLA

¹¹ Chapter 2, sec. 1 AMLA

litically exposed persons or receiving assets from them – provided, naturally, that the assets are not the proceeds of a crime. The FINMA Anti-Money Laundering Ordinance, however, imposes strict conditions on handling money from PEPs. It obliges financial intermediaries to treat any business dealings with PEPs as a higher-risk business relationship and to label them as such for internal use.¹² As a result, these business dealings entail greater due diligence obligations.

Therefore banks, according to anti-money laundering regulations, must clarify their business relationship with PEPs and always classify any such business relationship as higher risk. They must perform additional clarifications, including identifying the origin of the assets deposited, the origin of a PEP's wealth, the background of larger incoming payments and other details. The financial intermediaries must ensure there is a plausible outcome of their clarifications and document them.¹³

2.7 The responsibilities involved in having a business relationship with a PEP

The most senior executive body of the financial intermediary or one of its members must decide on whether to conduct business with a PEP. Furthermore, the most senior executive body must review such relationships annually and decide whether to maintain them.¹⁴

2.8 Organisational precautions for financial intermediaries

In addition to the increased due diligence obligations, the AMLO-FINMA stipulates that the financial intermediary must designate one or more qualified persons as an anti-money laundering body. This body prepares internal directives for combating money laundering and the financing of terrorism, which must be approved by the board of directors or the senior executive body and communicated to the persons concerned in a suitable way. These internal directives regulate the business policy concerning PEPs.¹⁵

Financial intermediaries must also have effective procedures for monitoring the business relationship and the transactions. In practice, banks regularly monitor their business dealings with clients with the aid of an IT-based name-matching tool.¹⁶ When monitoring transactions, for example, banks are obliged to use an IT-based system, which enables the banks to identify those transactions that need to be looked into further.¹⁷

2.9 Duty to report business relationships with a PEP

According to the Anti-Money Laundering Act, if the financial intermediary knows or has reasonable

¹² Art. 12 paras. 3 and 4 AMLO-FINMA

¹³ Section 1 para. 5 AMLO-FINMA

¹⁴ Art. 18 para. 1 AMLO-FINMA

¹⁵ Art. 22 AMLO-FINMA

¹⁶ Report on implementing the SFBC Ordinance on Money Laundering of October 2005: http://www.finma.ch/archiv/ebk/d/archiv/2005/20051012/051012_02_d.pdf (in German).

¹⁷ Art. 19 AMLO-FINMA

grounds to suspect that:

- the assets involved in the business relationship are connected to an offence in terms of Art. 305^{bis} of the Swiss Criminal Code (money laundering) or Art. 260^{ter} no. 1 of the Swiss Criminal Code (criminal organisation);
- the assets are the proceeds of a felony or are controlled by a criminal organisation, or
- the assets serve the financing of terrorism (Art. 260^{quinquies} para. 1 Swiss Criminal Code),

it must immediately file a report with the MROS. There is also a duty to report if the financial intermediary terminates negotiations aimed at establishing a business relationship for these reasons.¹⁸

The mere fact that a PEP is a client of a financial intermediary does not entail a duty to report. As in all other cases which must be reported, the financial intermediary has reasonable suspicion of the criminal origin of the assets or of the assets being used to finance terrorism.

If there is a simple suspicion, the financial intermediary is entitled to report it. If it does not do so, the financial intermediary is obliged to document the reasons why.¹⁹

2.10 Obligations to freeze a PEP's assets

Simultaneously to reporting its suspicions, the financial intermediary must freeze the PEP's entrusted assets for five working days.²⁰ Within this period, the financial intermediary may receive a ruling from the criminal prosecution authorities upholding the freeze.

3 Supervision of compliance with the due diligence obligations

3.1 Monitoring by FINMA of compliance with the due diligence obligations

FINMA annually monitors compliance with the due diligence obligations regarding money laundering – also with respect to PEPs – with the assistance of audit firms. They conduct on-site audits of financial intermediaries' due diligence practice and they must mention any and all substantial deficiencies in the audit reports to FINMA. In addition, according to its new supervisory approach, FINMA will itself conduct more on-site checks, which may include reviewing compliance with the due diligence obligations under the AMLA.

¹⁸ Art. 9 AMLA

¹⁹ Art. 29 AMLO-FINMA

²⁰ Art. 10 AMLA

3.2 Consequences of a financial intermediary infringing their due diligence obligations

If non-compliance with the anti-money laundering provisions becomes apparent either during an audit or otherwise, FINMA will ensure that the institutions in question take measures to meet these provisions in the future. FINMA reviews the measures taken. In serious cases, FINMA may order further measures including issuing sanctions.²¹ A serious infringement can, notably, call into question the financial intermediary's requirement to provide assurance of proper business conduct. Major breaches may lead to a prohibition from practising the profession and a confiscation of the profit.²²

In addition, the CDB Supervisory Committee may impose fines of up to CHF 10 million for failure to comply with identification obligations pursuant to the "Agreement on the Swiss Banks' Code of Conduct With Regard to the Exercise of Due Diligence" of 7 April 2008 (CDB 2008).²³

3.3 Sanctions imposed by the supervisory authority for failure to observe due diligence obligations

In response to cases that have arisen in the past, the supervisory authority has been consistently adding new principles to its rules governing PEPs and has intervened with certain banks on some occasions:

- Following the Marcos case (former President of the Philippines) in 1986, it became obligatory for the initiation of a PEP business relationship to be decided at executive board level within the bank.
- Following operation "Mani pulite", initiated in 1993 in Italy in response to mafia corruption, the Swiss Federal Banking Commission (SFBC) stipulated that persons who accept corrupt funds do not fulfil the requirement to provide assurance of proper business conduct.
- Following the Mobutu case (the former President of Zaire) in 1998, the CDB was amended to explicitly state that it is prohibited to accept assets of illegal origin and that the business policy regarding PEPs is to be defined in internal guidelines.
- Also in 1998, following the Abacha case (the former President of Nigeria), there were 19 investigations and three extraordinary bank audits. The SFBC published the outcome of its investigations. From that point on, such business relationships had to be rated as higher risk. Furthermore, banks were obliged to require more evidence than the statements of the contracting parties when conducting further clarifications. An SFBC circular introduced concrete rules for banks in dealing with assets from PEPs. The issue was also discussed internationally in response to prompting from the SFBC.
- Following the criminal proceedings against Montesinos (Peruvian PEP) in 2000, the SFBC investigated five banks. Infringements of due diligence obligations were found at one bank, the ruling was published and it was stated that the bank director did not fulfil the requirement to provide as-

²¹ Art. 29 ff. FINMASA (Financial Market Supervision Act, SR 956.1) http://www.admin.ch/ch/e/rs/c956_1.html

²² Art. 9 AMLO-FINMA

²³ Art. 11 CDB 08

urance of proper business conduct. Audit firms were mandated to perform an extraordinary audit of all banks involved for 2002. It was also established that personal contact must be established with the contracting party when initiating a business relationship.²⁴

- Following the SFBC's Anti-Money Laundering Ordinance, which came into force in July 2003, the SFBC undertook an audit of the implementation of the due diligence obligations defined in the Ordinance. This systematic, detailed and comprehensive audit was conducted by audit firms at over 900 banks, securities dealers and fund management companies and covered 26.5 million business relationships. The audits related to the 2004 financial year. The results were published in a report in October 2005.²⁵

Between 2001 and 2008, the SFBC intervened 30 times in response to infringements of anti-money laundering legislation. The Anti-Money Laundering Control Authority (AMLCA) issued 22 sanctions between 2004 and 2008. The CDB Supervisory Commission issued 168 sanctions between 2001 and 2010.

4 Swiss regulations and the international environment

4.1 International standards on handling assets of politically exposed persons

The Financial Action Task Force (FATF)²⁶ sets the international standards in combating money laundering and, therefore, in dealing with politically exposed persons. The FATF is the leading international body in the fight against money laundering. Its main purpose is to develop and promote principles for combating money laundering and the financing of terrorism. The FATF has passed 40 recommendations as minimum standards and nine special recommendations to combat the financing of terrorism. The FATF's Recommendation 6 is the current international standard regarding due diligence obligations when handling assets from PEPs.²⁷

4.2 International view of Swiss due diligence regulations

The regulations set forth in the Anti-Money Laundering Act and its implementing provisions for politically exposed persons are compliant with international requirements. In 2005, the FATF considered the Swiss Anti Money Laundering regulations as largely compliant with its own standards. This compatibility has grown stronger in the interim as the Swiss authorities have incorporated further measures into their regulations. This was confirmed by the FATF follow-up report in October 2009.²⁸

²⁴ Urs Zulauf, Marc Siegel: *Expérience et pratique de l'autorité de surveillance suisse face à l'abus du système financier par des personnes politiquement exposées* (Experience and practice of the Swiss supervisory authorities in the fight against financial system abuse by politically exposed persons); Stämpfli Editions SA, Berne, 2002, p.144 ff.

²⁵ Report on implementing the SFBC Ordinance on Money Laundering of October 2005:
http://www.finma.ch/archiv/ebk/d/archiv/2005/20051012/051012_02_d.pdf (in German).

²⁶ The footnote numbering corresponds to the German text. Therefore, this footnote is redundant.

²⁷ http://www.fatf-gafi.org/document/5/0,3746,en_32250379_32236920_43678853_1_1_1_1,00.html

²⁸ http://www.fatf-gafi.org/infobycountry/0,3380,en_32250379_32236963_1_70327_1_1_1,00.html

4.3 Due diligence regulations in other states

FATF minimum standards claim validity for all states. The report published by the World Bank in 2009, “Stolen Asset Recovery – Politically Exposed Persons – A Policy Paper on Strengthening Preventive Measures”, mentions that the procedures for dealing with the PEP issue were reviewed in 124 jurisdictions.²⁹ The report points out that FATF Recommendation 6 was either not at all or only partially implemented in 104 jurisdictions. Switzerland belongs to 16% of the countries reviewed that were rated as compliant or largely compliant with the FATF minimum standards for PEPs.

5 Supervision in the cases of Tunisia, Egypt and Libya

5.1 Sanction orders

A distinction must be made between sanction orders and anti-money laundering provisions. The State Secretariat for Economic Affairs (SECO) is responsible for the implementation of rulings based on the Embargo Act. Rulings based on Art. 184 of the Federal Constitution of the Swiss Constitution, applicable in the instances addressed here, normally come under the remit of the Federal Department of Foreign Affairs (FDFA). These sanctions are rather politically motivated: joining in international embargos or sanctions, enforcing international law or – as in this case – freezing assets in Switzerland in support of a future request for legal assistance by the country in question.

The asset freeze decreed by the Federal Council directly – based on the constitution – is a preventive measure. The aim in such cases is usually to prevent the withdrawal of any illegally acquired assets or stolen public funds from Switzerland, and to allow the judicial authorities of those states concerned to file requests for legal assistance to Switzerland. The question of the legality of the origin of the frozen assets is then clarified via these judicial assistance procedures or national criminal proceedings on which the said requests are based.

5.2 The relationship between reporting and freezing according to the Anti-Money Laundering Act and Federal Council freezing orders

The financial intermediary must freeze the assets of those people, companies and/or organisations listed in the annex to the freezing orders pertaining to measures taken against certain individuals/entities from Tunisia, the Arab Republic of Egypt and Libya, and report them to the Directorate of International Law at the FDFA.³⁰

These freezing orders from the Federal Council are different from the provisions of the money laundering regulations. Reporting and freezing assets under the Anti-Money Laundering Act and under the

²⁹ Report compiled by the Stolen Asset Recovery Initiative (StAR Initiative), a World Bank initiative in cooperation with the United Nations Office on Drugs and Crime (UNODC); <http://siteresources.worldbank.org/EXTSARI/Resources/5570284-1257172052492/PEPs-ful.pdf?resourceurlname=PEPs-ful.pdf>

³⁰ <http://www.admin.ch/dokumentation/gesetz/00068/index.html?lang=de&unterseite=yes> (in German).

orders issued by the Federal Council are two different instruments with differing objectives. The purpose of orders by the Federal Council to freeze such assets in Switzerland is to allow the country in question to request future legal assistance. A freeze by way of sanctions automatically applies, regardless of any suspicion of money laundering. The duty to report enshrined in the AMLA, on the other hand, requires that the financial intermediary has a reasonable suspicion of money laundering or financing of terrorism. This implies concrete indications of a crime.

If a financial intermediary issues a report to the Directorate for International Law, it must conduct special investigations of the reported business relationships according to Art. 6 para. 2 let. b AMLA. If there are no additional grounds for suspicion apart from the fact that a given person, company or organisation are listed in the annex to the order, there are no reasonable grounds for suspicion, only the simple suspicion itself. The financial intermediary may exercise its right to report according to Art. 305^{ter} para. 2 of the Swiss Criminal Code. If the financial intermediary does not exercise this right, it must document the reasons why and monitor the relationship closely.³¹

Should additional clarifications reveal indications giving grounds for the suspicion of money laundering or financing of terrorism, the financial intermediary must report such findings to the MROS pursuant to Art. 9 AMLA. Findings giving grounds for suspicion are, for example, indications that the natural or legal persons in question are subject to criminal investigations either in or outside Switzerland.³²

5.3 Cooperation between the offices concerned

FINMA supports those offices mandated by the Federal Council sanction orders to implement the sanctions. In most cases, SECO is the competent authority. The special cases of Tunisia, Egypt and Libya, however, fall under the remit of the Directorate of International Law (FDFA). FINMA also publishes the sanctions and requests all financial intermediaries to strictly adhere to them.³³

FINMA, the MROS and the criminal authorities can exchange information with each other.³⁴ The SECO and FDFA can also forward information to FINMA.³⁵ Information is being exchanged between FINMA and the FDFA regarding the cases of Tunisia, Egypt and Libya.

5.4 Procedure for FINMA

There is only a duty to report under Art. 9 AMLA in the case of reasonable suspicion. If no report is filed to the MROS prior to the sanctions, it does not automatically suggest wrong conduct on the part

³¹ Art. 29 AMLO-FINMA

³² See for example the EU Decree of 4 February 2011 concerning restrictive measures directed against certain persons, entities and bodies in view of the situation in Tunisia: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:031:0001:0012:EN:PDF>

³³ <http://www.finma.ch/d/aktuell/Seiten/aktuell-verordnung-personen-tunesien.aspx>; <http://www.finma.ch/d/aktuell/Seiten/aktuell-verordnung-massnahmen-personen-aegypten-20110211.aspx>, and <http://www.finma.ch/d/aktuell/Seiten/aktuell-verordnung-massnahmen-personen-libyen-20110224.aspx>

³⁴ Art. 29 and Art. 29a AMLA

³⁵ Art. 14 Regierungs- und Verwaltungsorganisationsverordnung (Ordinance on the Organisation of Government and Administration) (SR 172.010.1) (in German) / Art. 7 Embargo Act (SR 946.231) (in German)

of the bank. Business relationships with politically exposed persons are not forbidden. Banks must, however, meet strict due diligence obligations. This is to be assessed on a case-by-case basis.

As regards the sanctions relating to Tunisia, Egypt and Libya, FINMA is currently reviewing whether the banks fulfilled their due diligence and reporting obligations. Since February 2011, FINMA has checked in detail extensive papers and documentation requested from about a dozen banks which will be analysed during the coming weeks. FINMA will then take further steps if there is reason to do so.