

20 March 2015



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Dear Sir/Madam

**Draft Guidance Note 15/01; Key Terms Used in ‘Polititically Exposed Person’ Definition**

The Law Council of Australia (Law Council) appreciates the opportunity to contribute to the public consultation on draft Guidance Note 15/01 *Key terms used in ‘politically exposed person’ definition*<sup>1</sup> (the Guidance Note).

The Law Council strongly opposes financial criminality and is committed to raising awareness within Australian law practices of the risks of unwitting involvement in criminal acts. In this regard, the Law Council attaches profound importance to providing the Australian legal community with information, which enables law practices to fortify themselves against such risks through adherence of ethical and professional responsibilities.

The obligations for ‘enhanced Customer Due Diligence’ (CDD), including those in relation to *Politically Exposed Persons* (PEPs), were introduced into Australia’s AML Regime, upon the commencement of amendments to the AML Rules.<sup>2</sup> The amendments came into operation in June 2014.

The public consultation on the Guidance Note invites comment in two regards:

- whether the Guidance Note achieves its stated aim of assisting *reporting entities* in understanding key terms used in the PEP definition of Chapter 1 of the AML/CTF Rules; and
- to allow *savings that may result* from use of the Guidance Note to be estimated for the purpose of contributing to the Government’s red tape reduction target by providing businesses community organisations and individuals with a quantifiable regulatory cost reduction.

<sup>1</sup> Australian Transaction Reports Analysis Centre, Draft Guidance Note 15/01 *Key terms used in ‘politically exposed person’ definition*, released for consultation 19 January 2015 available at <http://www.austrac.gov.au/businesses/consultation-industry/austrac-consultation#peps>

<sup>2</sup> *Anti-Money Laundering and Counter-Terrorism Financing Rules Instrument 2007 (No. 1)*.

While legal practitioners are typically not subject to most of the obligations of *reporting entities* under the Australian AML/CTF regime, instituting appropriate AML/CTF risk management measures are an integrated aspect of satisfying ethical and professional obligations. However, lawyers in the United Kingdom and several European states are members of the regulated community of their jurisdiction and thus subject to PEP obligations. Thus for purposes of this consultation and because the topic of regulatory cost savings in respect of PEPs is a focus, the Law Council refers to the submissions of its counterparts at the International Bar Association and the Law Society of England and Wales, particularly where these submissions disclose measures that may be of assistance to the Australian Transaction Reports Analysis Centre (AUSTRAC) in achieving greater efficiencies.

### ***Assisting in interpretation of relevant terms***

The Law Council commends the AUSTRAC for developing the draft Guidance Note which does assist both the regulated community and others, by clarifying the terms relevant to the interpretation of the Rules on *Politically Exposed Persons*.

In particular the Law Council notes that the Guidance Note responds to some of the specific queries raised about terms, in submissions to the consultation on the (then) Draft Amendments to the AML/CTF Rules relating to Customer Due Diligence - including, for example, *Government Minister; Senior Politician; Senior Government Official; High Ranking Member Of The Armed Forces* and in relation to the required level of prominence of functions for the test of *Prominent Public Functions* (which includes *municipal levels*) time frame after which a PEP stops being politically exposed for purposes of the Rules.

The need for clarification on PEPs is a recurring theme in literature and was recently acknowledged by the findings of the KPMG Global Anti- Money Laundering Survey 2014 (KPMG Survey 2014) in which:

- 63 per cent of respondents believed regulators should provide additional guidance, emphasising the impact of accelerated regulatory change and the need for expectations to be clarified<sup>3</sup>; and
- 43 percent of respondents indicated a stronger relationship with regulators would also be a welcome change in approach.<sup>4</sup>

### ***Regulatory costs***

The introduction of enhanced CDD obligations for PEPs gives effect to the policy and Recommendations<sup>5</sup> of the Financial Action Task Force (FATF). The FATF has itself acknowledged that PEP requirements have proven challenging to effectively implement.<sup>6</sup>

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<sup>3</sup> KPMG Risk Consulting *Global Anti-Money Laundering Survey 2014* at page 37 available at <https://www.kpmg.com/KY/en/IssuesAndInsights/ArticlesPublications/PublishingImages/global-anti-money-laundering-survey-v3.pdf>

<sup>4</sup> KPMG Risk Consulting *Global Anti-Money Laundering Survey 2014* at page 37 available at <https://www.kpmg.com/KY/en/IssuesAndInsights/ArticlesPublications/PublishingImages/global-anti-money-laundering-survey-v3.pdf>

<sup>5</sup> The Financial Action Task Force has taken the view that PEPs present a greater risk of money laundering including the commission of predicate offences such as bribery and corruption, and financing of terrorism because they have more power and greater access to government funds that warrants greater scrutiny. While the FATF describes its guidance on PEPs as non-binding, it designates Recommendations 12 and 22

The findings of the KPMG Survey 2014 confirm that the reporting community is also ‘struggling when it comes to enhanced due diligence on PEP relationships..’<sup>7</sup> such that most organisations are compelled to turn to commercial search solutions to comply:

- 70 per cent of respondents use commercial lists;<sup>8</sup>
- Know Your Client requirements are reportedly the second costliest area of AML investment for the regulated community (after transaction monitoring systems).<sup>9</sup>

Given the consultation’s focus on regulatory costs savings, the Law Council notes the observations of its colleagues at the International Bar Association and the Law Society of England and Wales. Both organisations have commented extensively on the application of PEP obligations to the legal sector (lawyers are part of the AML/CTF regulated community in those jurisdictions) and on measures that would increase economic efficiencies, as follows.

In 2011, the Law Society of England Wales’s surveys of law practices indicated

- 60 per cent of respondents were using commercial e-verifiers to help them identify PEPs; and
- 33 per cent of respondents had turned down work because of the perceived risk posed by PEPs – rather than because they actually suspected money laundering...’<sup>10</sup>

‘...Commercial providers are very costly. Small firms can be spending a few hundred pounds a year simply to prove that they do not have a secret PEP in their client base. Larger firms can find themselves spending hundreds of thousands of pounds in licence fees and thousands of pounds in search fees each year...’<sup>11</sup>

In 2012, the Law Society of England and Wales quantified law practices compliance costs:

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as mandatory, requiring countries to ensure financial institutions and designated non-financial businesses and professions (DNFBPs) implement measures in relation to PEPs. The FATF *International Standards on Combatting Money Laundering and the Financing of Terrorism and Proliferation* 2012 available at <http://www.fatf-gafi.org/topics/fatfrecommendations/documents/fatf-recommendations.html>

<sup>6</sup> Financial Action Taskforce *Guidance on Politically Exposed Persons* June 2013 at paragraph 7, available at: <http://www.fatf-gafi.org/media/fatf/documents/recommendations/guidance-pep-rec12-22.pdf>

<sup>7</sup> Note: Respondents to KPMG’s Global Anti Money Laundering Survey 2014 comprise AML and compliance professionals in the top 1,000 global banks and AML financial services contacts in over 40 countries, including Australia. The KPMG Risk Consulting *Global Anti-Money Laundering Survey 2014* at page 31 available at <https://www.kpmg.com/KY/en/IssuesAndInsights/ArticlesPublications/PublishingImages/global-anti-money-laundering-survey-v3.pdf>

<sup>8</sup> KPMG Risk Consulting *Global Anti-Money Laundering Survey 2014* at page 29 available at <https://www.kpmg.com/KY/en/IssuesAndInsights/ArticlesPublications/PublishingImages/global-anti-money-laundering-survey-v3.pdf>

<sup>9</sup> KPMG Risk Consulting *Global Anti-Money Laundering Survey 2014* at page 14 available at <https://www.kpmg.com/KY/en/IssuesAndInsights/ArticlesPublications/PublishingImages/global-anti-money-laundering-survey-v3.pdf>

<sup>10</sup> The Law Society England and Wales, *Financial Action Task Force: Consultation Response*, January 2011 at pages 10-11 available at [http://www.americanbar.org/content/dam/aba/publishing/criminal\\_justice\\_section\\_newsletter/crimjust\\_taskforce\\_lawsocietyresponsetofatfconsultation.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/publishing/criminal_justice_section_newsletter/crimjust_taskforce_lawsocietyresponsetofatfconsultation.authcheckdam.pdf)

<sup>11</sup> The Law Society of England Wales, *Financial Action Task Force Consultation Response*, January 2011 at page 14 available at: [http://www.americanbar.org/content/dam/aba/publishing/criminal\\_justice\\_section\\_newsletter/crimjust\\_taskforce\\_lawsocietyresponsetofatfconsultation.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/publishing/criminal_justice_section_newsletter/crimjust_taskforce_lawsocietyresponsetofatfconsultation.authcheckdam.pdf)

‘...Access to a basic PEP list through an electronic verification service where there is a small client base will still cost a few hundred pound per year. Access to a more sophisticated PEP system, higher numbers of checks and/or increased number of access licences for more staff members will be more likely to cost around £2,000 to £20,000 a year per electronic verification service used. In addition there will be associated staff costs as the requirements are expanded, due to the need for further training and more extensive client inception processes...’<sup>12</sup>

‘...some of our members [advise] that the opening of a new international corporate client matter can cost in the region of £5,000 due to the chargeable time lost by fee earners and compliance staff in chasing documents and undertaking research, even in circumstances that generally would not be considered to give rise to a risk of money laundering. Even for smaller law firms, the opportunity cost of time spent on conducting due diligence checks on any client who is other than the absolute standard, is more than the fees they are able to charge for the work being undertaken. This either results in them taking on the client at a loss in the hope of future work or in simply turning away possible legitimate business...’<sup>13</sup>

‘...this non - risk based approach [to PEPs] is costing firms significant amounts of money, providing practical difficulties in terms of establishing source of funds, and at times limiting the provision of legal services to legitimate individuals...’<sup>14</sup>

The International Bar Association said:

‘...in jurisdictions where legal practitioners are subject to such requirements, they must apply enhanced due diligence to all PEPs (foreign and domestic) irrespective of the risk that the individual PEP or the specific transaction suggest. This non risk based approach is very costly...’<sup>15</sup>

### **Measures that could provide greater economic efficiencies**

In terms of further measures that might offer the opportunity to minimise compliance costs, the Law Council notes the following suggestions that have been made.

#### ***Cross border definitional issues***

PEP compliance costs are more pronounced for cross border businesses. The KPMG Survey 2014 opined this is because ‘*opinions on regulatory approach are marked by vast regional differences [that] further emphasise the challenge...in establishing a globally*

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<sup>12</sup> The Law Society England and Wales, *Development of a 4<sup>th</sup> Money Laundering Directive: Response to the European Commissions review of third money laundering directive*, June 2012 at pages 10-11 available at <http://www.lawsociety.org.uk/policy-campaigns/consultation-responses/documents/EU-consultation-response-2012/>

<sup>13</sup> The Law Society England and Wales, *Financial Action Task Force: Consultation Response*, June 2011 January 2011 at page 9 available at [http://www.americanbar.org/content/dam/aba/publishing/criminal\\_justice\\_section\\_newsletter/crimjust\\_taskforce\\_lawsocietyresponsetofatfconsultation.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/publishing/criminal_justice_section_newsletter/crimjust_taskforce_lawsocietyresponsetofatfconsultation.authcheckdam.pdf)

<sup>14</sup> The Law Society England and Wales, *Financial Action Task Force: Consultation Response*, June 2011 January 2011 at pages 10-11 available at [http://www.americanbar.org/content/dam/aba/publishing/criminal\\_justice\\_section\\_newsletter/crimjust\\_taskforce\\_lawsocietyresponsetofatfconsultation.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/publishing/criminal_justice_section_newsletter/crimjust_taskforce_lawsocietyresponsetofatfconsultation.authcheckdam.pdf)

<sup>15</sup> International Bar Association *Comments on Review of Standards- 4<sup>th</sup> Round of Mutual Evaluations* 17 January 2011 available at [http://www.anti-moneylaundering.org/News\\_2011\\_17.aspx#170111](http://www.anti-moneylaundering.org/News_2011_17.aspx#170111)

*consistent approach.*<sup>16</sup> Attempts should be made to develop guidance material that has regard to the definition of terms relevant to PEPs across other jurisdictions and wherever possible build in consistency.

In this regard, the American Bar Association observed that:

‘...A domestic PEP may be defined in a certain manner in one jurisdiction and defined wholly differently in another jurisdiction. This type of variation will likely impose significant compliance burdens on the legal profession and will do little to advance clarity on compliance requirements. The apparent reluctance of the FATF to issue lists of PEPs—foreign or domestic—further exacerbates this concern...’<sup>17</sup>

### ***Central Registers of Government Appointed PEPs***

The case for Government appointed PEPs to be detailed in a central register is compelling, particularly in light of the cost relief, certainty and compliance incentive that such a measure could provide the regulated community.

The Law Society of England and Wales argued that:

‘...All of the persons who fall within the definition of a primary PEP are appointed by government. In making those appointments a government will generally undertake checks on the background of those persons, both in terms of their family members and business associates and their income and assets. ...governments should provide this information, which they are best placed to collect and retain, to the regulated sector to enable compliance with the PEP obligations...’ [A schedule of PEPs published by the regulatory authority would provide]. Certainty this will reduce costs for the regulated sector and ensure that all PEP’s are being adequately identified...’<sup>18</sup>

The International Bar Association agreed, indicating that:

‘...Governments are better placed to identify and retain details of PEPs than the regulated [community] and of course this would prevent inconsistency...’<sup>19</sup>  
‘...There will be significant cost for regulated entities if the Commission and/or Member States does not retain firstly a register of politically exposed individuals and secondly a register of their immediate family members. The due diligence to ascertain and monitor relationships with family members of PEPs will be extremely costly and can only result in disparity between the approaches taken...’<sup>20</sup>

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<sup>16</sup> KPMG Risk Consulting *Global Anti-Money Laundering Survey 2014* at page 36 available at <https://www.kpmg.com/KY/en/IssuesAndInsights/ArticlesPublications/PublishingImages/global-anti-money-laundering-survey-v3.pdf>

<sup>17</sup> American Bar Association *Comments to FATF* December 2011 available at [http://www.americanbar.org/content/dam/aba/uncategorized/2011/gao/2011dec13\\_gatekeeperregandtheprofession\\_l.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/uncategorized/2011/gao/2011dec13_gatekeeperregandtheprofession_l.authcheckdam.pdf)

<sup>18</sup> The Law Society England and Wales, *Development of a 4<sup>th</sup> Money Laundering Directive: Response to the European Commission's review of third money laundering directive*, June 2012 at page 9 available at <http://www.lawsociety.org.uk/policy-campaigns/consultation-responses/documents/EU-consultation-response-2012/>

<sup>19</sup> International Bar Association Working Document; *Directive of the European Parliament and of Council on the Prevention of the Use of the Financial System* October 2005 at page 8 available at <http://www.ibanet.org/Document/Default.aspx?DocumentUid=C8A1FDB5-352C-41B4-8620-A68A6CA13F2C>

<sup>20</sup> International Bar Association Working Document; *Directive of the European Parliament and of Council on the Prevention of the Use of the Financial System* October 2005 at page 9 available at <http://www.ibanet.org/Document/Default.aspx?DocumentUid=C8A1FDB5-352C-41B4-8620-A68A6CA13F2C>

## Examples of high and low risk situations

The Law Society of England and Wales (as the supervisory authority for solicitors in listed in the regulations) has submitted as follows:

‘...At present, all PEPs are assumed to be a risk simply because they have access to government or state funds. While it is accepted that there is a risk that a PEP will have accepted a bribe or misappropriated government funds because s/he has greater access to these funds than the average citizen, that does not mean that all PEPs are corrupt. Where a PEP is purchasing a modest family home with the proceeds of the sale of their former home and a mortgage, there is very little money laundering risk. The risk is even less so when it is the sibling of a primary PEP undertaking the same transaction. Yet because PEPs have been singled out in the standards as a specific high risk indicator, regulated entities are required to conduct enhanced due diligence and monitoring irrespective of the real risk of the individual client and the individual transaction. This is leading to firms undertaking significant due diligence to protect themselves from sanctions for regulatory breach rather than from a real risk of money laundering. By contrast, it is not generally accepted that simply because accounts clerks have increased opportunity to steal from their employer or pharmacists have increased access to prescription medication which they could be selling illegally, they should all be treated high risk. That would not generally be considered risk based or proportionate, and the key focus should be on situations where there are other warning signs of money laundering, such as attempted use of unexplained private funds. Arguably, therefore the same should be said for the approach to PEPs...’<sup>21</sup>

Accordingly the Law Society England Wales has proposed that examples of high and low risk situations would assist the regulated community to better understand the desired approach:

- In particular more targeted information could be provided about situations which may pose a higher risk to different sectors in methodologies and sector specific guidance;<sup>22</sup>
- there is no regulation of the fees charged by commercial providers and unless reliable evidence of the risks actually faced and the criminal sanctions for non-compliance can be understood, the market is unlikely to be a rational or efficient regulator of such costs’<sup>23</sup>

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<sup>21</sup> The Law Society England and Wales, *Financial Action Task Force: Consultation Response*, June 2011 January 2011 at page 6 available at [http://www.americanbar.org/content/dam/aba/publishing/criminal\\_justice\\_section\\_newsletter/crimjust\\_taskforce\\_lawsocietyresponsetofatfconsultation.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/publishing/criminal_justice_section_newsletter/crimjust_taskforce_lawsocietyresponsetofatfconsultation.authcheckdam.pdf)

<sup>22</sup> The Law Society England and Wales, *Financial Action Task Force: Consultation Response*, June 2011 January 2011 at page 6 available at [http://www.americanbar.org/content/dam/aba/publishing/criminal\\_justice\\_section\\_newsletter/crimjust\\_taskforce\\_lawsocietyresponsetofatfconsultation.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/publishing/criminal_justice_section_newsletter/crimjust_taskforce_lawsocietyresponsetofatfconsultation.authcheckdam.pdf)

<sup>23</sup> The Law Society of England Wales *Financial Action Task Force Consultation Response* January 2011 at page 14 available at:

The Law Council hopes that these few comments may be of assistance to the consultation.

Thank you again for the opportunity to provide the views of the legal profession. Should any further information be required, please contact Ms Carole Caple, Senior Lawyer on 02 6246 3737 or [carole.caple@lawcouncil.asn.au](mailto:carole.caple@lawcouncil.asn.au).

Yours faithfully

A handwritten signature in black ink, appearing to read 'Martyn Hagan', written in a cursive style.

MARTYN HAGAN  
SECRETARY GENERAL

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[http://www.americanbar.org/content/dam/aba/publishing/criminal\\_justice\\_section\\_newsletter/crimjust\\_taskforce\\_lawsocietyresponsetofatfconsultation.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/publishing/criminal_justice_section_newsletter/crimjust_taskforce_lawsocietyresponsetofatfconsultation.authcheckdam.pdf)