Committee Secretary

Senate Legal and Constitutional Affairs Committee

By email: legcon.sen@aph.gov.au

1st December 2021

Dear Committee Secretary

Inquiry into the adequacy and efficacy of Australia's anti-money laundering and counter-terrorism financing (AML/CTF) regime - Replies to Questions on Notice.

I make the following replies to the Questions on Notice contained in the email message of 16th November 2021.

Question 1 - Mr Oliver, as a lawyer, did you participate in the Queensland Law Society study referenced in the Law Council of Australia submission to this Inquiry. If you did, what conclusions did you draw from the questions posed by the QLS?

Yes.

Below is the link to the survey. It is my belief that the survey questions have not changed from 2016 / 17 to date.

https://www.surveymonkey.com/r/GDLWQR8

It is my opinion that the survey, and the way in which the questions were framed, was designed to influence the results towards a high overall cost for initial AML-CTF Program implementation and ongoing annual compliance.

The following are several survey questions, potential responses, and my comments.

Question 7 asks "For the transaction types listed in question 5 [business areas likely to be subject to AML Act obligations], how much would it cost on average, per transaction, to identify the beneficial owner such that the legal practice is satisfied that it knows who the beneficial owner is (to holdings of 25% or more), or in the case of legal person arrangements, the legal practice has taken reasonable measures to understand the ownership and control structure."

The response radio buttons allow for the following costs:

"$1-50 per transaction

$51-75 per transaction

$76-100 per transaction

$101-125 per transaction

$125+ per transaction"

Comment - The AML Act requires beneficial ownership to be established at the beginning of the customer relationship, not per transaction as stated in the question.

Question 8 asks: "For the transaction types listed in question 5, how much would it cost on average, per transaction to obtain information on the purpose and intended nature of the client matters?"

The response radio buttons allow for the following costs:

"$1-50 per transaction

$51-75 per transaction

$76-100 per transaction

$101-125 per transaction

$125+ per transaction"

Comment - If a respondent law firm in 2017 met its legal, ethical, and risk management obligations there should be little or no additional cost. It is a fundamental obligation and the underlying basis for a legal retainer with a client for a law firm to "to obtain information on the purpose and intended nature of the client matters".

Question 2 - Are there differences between legal professional privilege and client confidentially that are relevant to AML/CTF?

Yes.

Sect. 242 of Anti-Money Laundering & Counter-Terrorism Financing Act, 2006 (the Act) states "This Act does not affect the law relating to legal professional privilege." The Act is silent on the broader concept of confidentiality.

It must be assumed that the drafting of Sect. 242 does not contemplate that a law firm reporting entity would be required to make a Suspicious Matter Report if legal professional privilege applied or attached to the communication between the lawyer and the client that gave rise to a reportable suspicion. On the other side, as Sect. 242 is silent on client confidentiality it must be assumed that the Act does contemplate

situations where a Suspicious Matter Report must be made when the lawyer has confidential information which is not subject to legal professional privilege that gives rise to a reportable suspicion.

Exceptions to client confidentiality exist. These are outlined in the Australian Solicitors Conduct (ASC) Rules, Rule 9.2. The relevant ASC Rule in the context of the AML regime is Rule 9.2.2:

"A solicitor may disclose information which is confidential to a client if: the solicitor is permitted or is compelled by law to disclose".

Making a Suspicious Matter Report under the Act would meet this exception.

If Sect. 242 is not considered a strong enough protection of legal professional privilege, the Act should be amended to introduce the concept of privileged communication. Sect. 42 of the New Zealand Anti-Money Laundering & Terrorist Financing Act, 2009 Act is a relevant precedent.

Experience in the United Kingdom, New Zealand, and other similar common law jurisdictions shows that the AML/CTF regime and regulated lawyers and law firms can adapt to the complexity of both legal professional privilege and client confidentiality. In practice, those regulated lawyer and law firms will need to revise their knowledge of the concepts of client confidentiality and legal professional privilege.

Question 3 - What business processes are currently in place in the average law firm that would comply with AML/CTF requirements?

It is best to put the answer to this question in table format. The table below outlines the current key Act & AML/CTF Rules (Rules) obligations against the business processes that a competently run law firm following legal ethics and risk management practices should have in place.

Act / Rule Obligation	Current Law Firm Procedure / Process
Enrolment with AUSTRAC	Law firm registration with, and ongoing notifications to, local legal regulator. Lawyer registration and practising certificate with local legal regulator. Membership of professional standards scheme. Australian Tax Office.

	ASIC / Workcover authority (if incorporated).
ML/TF Risk Assessment	Firm wide business and financial risk assessments. Legal operational risk management - (complaints and claims avoidance) and requirements of legal insurer. Client segment risk assessments. Client matter risk assessment when opening a new client matter or a new matter for existing client.
AML-CTF Program	Office policies and procedures manuals, including: • Core duties and professional obligations; • Client intake and conflicts of interest; • Client / matter / retainer management; • Practice management; • Claims and complaints; • Cyber security; • Data protection; • Finance; • Anti-fraud; • Employment / personnel / recruitment.
AML/CTF risk awareness training	Firm training for lawyers, support staff, and accounts / finance staff. Compulsory CPD / CLE training.
Employee Due Diligence	Recruitment policies & procedures. Obligation not to employ certain categories of persons (disqualified persons, and lawyers with certain prohibitions).
Oversight by boards and management	Firm governance and reporting structures.

AML/CTF Compliance Officer	Managing partner / director. Risk partner / director.
Independent Review	Trust account audit. Financial audit. Potential compliance audit by local regulator. Internal file / matter audits.
Permanent Establishment in a foreign country	N/A to majority of Australian law firms.
Reporting	See below.
Ongoing Customer Due Diligence	Ongoing monitoring of matter risk. Client to update firm of change of details.
Enhanced Customer Due Diligence	Ongoing monitoring of matter risk. Taking of further instructions during the matter.
Transaction Monitoring	Ongoing contact with the client during the duration of the matter. Ongoing monitoring of matter risk. Ongoing monitoring of trust account. File / matter audit.
Customer Due Diligence	Client intake / on-boarding processes, including: • Collection of client name or names (individual); • Collection of client name (non-individual) and who is instructing on behalf (agent); • Understanding of instructions / transaction; • Client matter risk assessment; • Conflict of Interest checks; • Verification of Identity checks (property matters);

	• Is the client giving unethical / unreasonable instructions?; • Obligation to open trust account ledger in correct client name (not false or anonymous); • Taking detailed instructions from the client with respect the matter and the outcome; • Overarching ethical obligation - Who is the client and what are their instructions; • Engagement / retainer management.
Reporting – SMR	None – SMR Financial Transactions Reports Act, 1988 - solicitor significant cash transaction report (SCTR) to AUSTRAC.
Reporting – Threshold Transactions	Financial Transactions Reports Act, 1988 - solicitor significant cash transaction report (SCTR) to AUSTRAC.
Reporting – International Funds Transfer Instructions	None. Current AML Act Exemption.
Reporting – Annual Compliance Report	Annual requirement with respect to practising certificates. Trust accounting rules.
AUSTRAC Oversight	Subject to State Supreme Court and Legal Regulator oversight.
Record keeping	General legal, insurance, and ethical obligations to keep client and firm records for 7 years.

The key Act & Rules obligations do not reflect any changes or simplifications that may be contained in the potential AML regulatory framework as it would apply to law firms in the future.

It must be remembered that not all law firms will be subject to potential AML Act obligations. Also, it may be that only certain practice areas in firms would be subject to those obligations.

Question 4 - How could the AML/CTF Act and AML/CTF Rules be simplified to support reporting entity compliance?

These are my major suggested simplifications, there are many more. These suggestions are based upon my knowledge of Act and Rules, advising on those obligations, and assisting reporting entities designed and implement workable but compliant AML-CTF Programs.

The Act

Designated Services

Move from a designated services regime to a regulation by entity business type.

Definition of Designated Remittance Arrangement and Items 31 & 32

The definition of designated remittance arrangement, coupled with designated services Items 31 & 32 is so broad as to capture many business models, and therefore businesses, that were not intended to be caught by the Act.

The intention of these definitions is to ensure that remittance providers / money service bureaux sending funds offshore / receiving funds onshore were caught by the Act, and by extension to make International Funds Transfer Instructions reports. It was not intended to capture businesses that are not remittance providers / money service bureaux, which it currently does. These business that are not intended to be caught face the prospect of either registering as remittance providers and complying with the Act, or seeking legal advice to make an exemption application (with no guarantee of success).

The definitions of designated remittance arrangement and Items 31 & 32 should be narrowed to only capture the intended businesses - remittance providers / money service bureaux who send funds offshore / receive funds onshore.

It is common case that these definitions are problematic for potential reporting entities, reporting entities, and AUSTRAC.

Customer Due Diligence Reliance Provisions - Sects. 37A, 37B, and 38

The Act was amended in December 2020 to allow for a wider use of reliance by one reporting entity on the Customer Due Diligence carried out by another reporting entity onshore or a similarly regulated entity offshore. While the intent of the amendments is positive, the practical implementation of reliance will be difficult due to the complexity of the associated Rule 7.

Revise Rule 7 to lessen the upfront and ongoing requirements for Customer Due Diligence reliance.

Division 3—Identification Procedures for Certain Low-risk Services

To date no low-risk designated services have been designated in the Rules.

There are many designated services which could be considered low-risk services therefore allowing reporting entities to avail of a simplified verification standard.

Designated Business Group

A designated business group is currently defined in Rule 2. Who can join a designated business group is narrow, for example entities related to each other within the meaning of Sect. 50 of the Corporations Act, 2001. The relationship requirements to join a designated business group as stated in Rule 2.1.2 do not cater for modern business structures including franchising or partnerships of trading trusts or other legitimate business structures. Reporting entities in these types of business structures are forced to have multiple AML-CTF Programs with all the additional costs instead of a Joint AML-CTF Program. The reason being that they do not meet Rule 2.1.2 so are precluded from forming a designated business group. The only avenue to form a designated business is by making an application to AUSTRAC for an exemption.

The types of entity allowed to join / form a designated business group should be broadened.

Suspicious Matter Reporting Obligation

Sect. 41 the suspicious matter reporting obligation is extremely broad, and is frequently underestimated, or misunderstood, by reporting entities. For example, AUSTRAC considers that a Sect. 41 Suspicious Matter Report must be made by a reporting entity which detects fraud or potentially fraudulent activity. The reporting of potentially fraudulent activity is a considerable burden to a wide cohort of reporting entities as these entities must either make a report or breach Sect. 41. Reporting entities consider reporting potentially fraudulent activity as low value to law enforcement but with high internal costs. Of note, New Zealand does not require potentially fraudulent activity to be reported.

Either amend Sect. 41 to narrow its scope or AUSTRAC produces guidance / public legal interpretation that relieves reporting entities of the obligation to report potentially fraudulent activity.

The Rules

Rule 4 - Applicable Customer Identification Procedure / Know Your Customer

The Rules for Applicable Customer Identification Procedure / Know Your Customer are overly complex to achieve the goal for a reporting entity to be reasonably satisfied that the customer is who he or she claims to be (in the case of an individual) or that the entity exists (in the case of a non-individual).

For example, Rule 4.2.3 requires the collection a customer's full name. Then the obligation on a reporting is to either:

- verify full name under Rule 4.2.6; or
- verify name (under safe harbour procedures where ML/TF risk is medium or lower) under Rules 4.2.10 to 4.2.13.

Full name has been determined by AUSTRAC to mean a person's first name, middle name or names (if any), and surname. Full name is not defined in the Rules. Name has been determined to mean a person's first name and surname (not middle name). This subtle difference in terminology causes reporting entities confusion in understanding the requirements of the Rules, and causes technical problems in attempting to capture a middle name from a customer who may not be inclined to provide it.

Rules 4.2.3 and 4.2.6 should be reworded from "full name" to "name". Also, remove all Rules relating to safe harbour. The change from "full name" to "name" to allow a more flexible approach to verification and give clarity over the highly complex Rules 4.2.10 to 4.2.13. Such a change would not heighten any real or perceived ML/TF risk.

There are numerous other examples of complexity in Rule 4.

Determination of Politically Exposed Persons

The requirement under Rule 4.13 to make a determination of PEP status on a customer or beneficial owner of a customer is onerous given the low to negligible probability of a customer / beneficial owner of the average reporting entity actually being a PEP. This PEP determination causes additional complexity in customer on-boarding and additional expense.

The Rule could be simplified by designating certain low-risk services or reporting entities to be exempt from PEP determination unless the customer is considered higher ML/TF risk or Enhanced Customer Due Diligence has to be undertaken.

Ongoing Customer Due Diligence - Rules 15.2[1] & 15.3[2]

The wording of these Rules is overly complex and difficult to interpret.

They could be simplified by revision into plain English. Alternatively, AUSTRAC should provide more guidance as to the meaning and intend of these Rules.

The Rules Overall

The wording of Rules is complex making them not easily understood by reporting entities.

Exemptions & Modifications Under the Act

Due to the complexity of the Act many reporting entities, or potential reporting entities, are forced to apply to AUSTRAC for exemptions to the Act. The exemption application process is currently lengthy with not statutory response time placed upon AUSTRAC.

Exemptions could be simplified by: introducing a class order type exemptions, akin to the system operated by ASIC; a fast tracked exemption process for low-risk exemptions; and a statutory response time to be place upon AUSTRAC to respond to exemption applications.

Law Council of Australia's Submission on the Act and the Rules.

I endorse the recommendations proposed in Part Two: Financial Services of the Law Council of Australia's submission dated 15th September 2021.

Proposed Changes for Tranche 2

The Proposed Regulated Population / Proposed Designated Services

Confine the regulated population to those designated non-financial businesses and professions which provide services aligned to Financial Action Task Force

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[1] Rule 15.2 "A reporting entity must include in Part A of its AML/CTF program appropriate risk-based systems and controls to enable a reporting entity to determine in what circumstances further KYC information or beneficial owner information should be collected or verified in respect of customers or beneficial owners of customers to enable the review and update of KYC information and beneficial owner information for ongoing customer due diligence purposes."

[2] Rule 15.3 "A reporting entity must undertake reasonable measures to keep, update and review the documents, data or information collected under the applicable customer identification procedure (particularly in relation to high risk customers) and the beneficial owner identification requirements specified in Chapter 4 of these Rules."

Recommendation 22. Do no use the proposed designated services as outlined in Second Tranche discussion paper circa 2008.

Legal Professional Privilege

Sect. 242 - legal professional privilege should be amended to include a definition of privileged communication. Sect. 42 of the New Zealand Anti-Money Laundering & Terrorist Financing Act, 2009 Act is a good precedent.

Identification Procedures

Due to the nature of the work of lawyers and accountants the Sect. 33 special circumstances "that justify the carrying out of the applicable customer identification procedure .... after the commence of the provision of the designated service" should be broadly defined in the Rules.

Yours sincerely,

Paddy Oliver
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