



Committee Secretary  
Senate Legal and Constitutional Affairs Committee  
PO Box 6100  
Parliament House  
Canberra ACT 2600

26<sup>th</sup> August 2021

Members of Legal and Constitutional Affairs Committee

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

I would like to thank the Senate Legal and Constitutional Affairs References Committee for inviting me, as Initialism's Principal, to make a submission to the inquiry into the adequacy and efficacy of Australia's anti-money laundering and counter-terrorism financing (AML/CTF) regime.

My submission broadly addresses the following areas set out in the Inquiry's terms of reference:

- The extent to which Australia's AML/CTF regulatory arrangements could be strengthened to:
  - address governance and risk-management weaknesses within designated services, and
  - identify weaknesses before systemic or large-scale AML/CTF breaches occur;
- Australia's compliance with the Financial Action Task Force (FATF) recommendations and the Commonwealth Government's response to:
  - applicable recommendations in applicable FATF reports, and
  - the April 2016 Report on the statutory review of the Anti-Money Laundering and Counter-Terrorism Financing Act 2006 and associated rules and regulations; and
- The regulatory impact, costs and benefits of extending AML/CTF reporting obligations to designated non-financial businesses and professions (DNFBPs or 'gatekeeper professions'), often referred to as 'Tranche two' legislation.

My submission on the above elements of the Inquiry's terms of reference is spread across the following submission topics, which it is felt are fundamental to increasing the adequacy and efficacy of Australia's AML/CTF regime:

- The appropriateness of services designated in tables 1, 2, and 3 of Section 6 of the AML/CTF Act to determine whether a person is obligated to comply with the AML/CTF Act and AML/CTF Rules;
- Increasing Board and Senior Management accountability for AML/CTF compliance; and
- Bringing DNFBPs into Australia's AML/CTF regime.

The following is a summary of the key points my submission makes on each of the three topics:

The appropriateness of services designated in tables 1, 2 and 3 of Section 6 of the AML/CTF Act to determine whether a person is obligated to comply with the AML/CTF Act and AML/CTF Rules;

- The use of designated services to determine capture by the AML/CTF Act is unique to Australia with foreign jurisdictions with more mature AML/CTF regimes imposing AML/CTF regulation based on types of business rather than on the services being provided
- The use of designated services to determine the applicability of the AML/CTF Act to a business risks undermining the effectiveness of Australia's AML/CTF regime and its ability to adjust as the Australian business and AML/CTF landscape evolves.

- The use of designated services also risks the creation of arbitrage opportunities, the erosion of the concept of competitive neutrality, and ultimately will perpetuate an uneven AML/CTF compliance playing field across businesses providing similar products and services.
- The issues with using designated services to determine capture by the AML/CTF Act were highlighted by the FATF's 2015 Mutual Evaluation Report and the 2016 Statutory Review Report.

Increasing Board and Senior Management responsibility and accountability for AML/CTF compliance:

- Despite it being recognised that the Board Directors and Senior Management of businesses regulated for AML/CTF play a vital role in ensuring AML/CTF compliance, Australia has some of the least prescriptive AML/CTF responsibilities and accountabilities on Board Directors and Senior Management.
- Active engagement on AML/CTF compliance matters by Boards and Senior Management can only be assured when there are clear responsibilities and accountabilities for AML/CTF compliance and penalties for non-compliance.
- The 2015 FATF Mutual Evaluation Report criticised the Australian AML/CTF regime for not including sanctions on Directors and Senior Management if a reporting entity has breached the AML/CTF Act or AML/CTF Rules.
- More mature AML/CTF regimes globally have more defined AML/CTF compliance responsibilities, accountabilities and penalties placed on Boards, Senior Management, and the AML/CTF Compliance Officer.

Bringing DNFBPs into Australia's AML/CTF regime:

- The services DNFBPs legitimately provide to clients have been, and continue to be, exploited by criminals seeking to commit crimes and launder proceeds of criminal activity.
- Analysis of the FATF 4th Round Mutual Evaluation Reports published identifies Australia as one of only five countries that are non-compliant with all three FATF Recommendations related to DNFBPs.
- Australia has also been formally assessed as non-compliant with DNFBP recommendations for the most prolonged period as part of the 4th Round Mutual Evaluation process. However, little or no progress has been made by Australia to bring DNFBPs into its AML/CTF regime, and Australia is increasingly becoming an international outlier.
- It was anticipated that DNFBPs would be brought into Australia's AML/CTF regime as part of the second tranche of reforms, generally known as "Tranche II". However, since 2007, the debate about Australia's inclusion of DNFBPs in the AML/CTF regime has been bogged down by a lack of apparent political and federal government inaction, which has been justified in part by the hyperbole, scaremongering and catastrophic impacts predicted by the lobbyists for some DNFBP sectors.

Thank you once again for this opportunity to participate in this vitally important inquiry which, in my opinion, is long overdue and pivotal to ensuring Australia is brought into line with the FATF's recommendations and therefore creating a hostile environment towards money laundering and terrorism financing threats faced by Australia's financial system, economy, and the wider community.

Yours faithfully

Neil Jeans - Principal

## Introduction to Neil Jeans and Initialism

### Neil Jeans

I am the Principal of Initialism, a specialist AML/CTF consultancy based in Australia which advises reporting entities on AML/CTF matters, sanctions compliance, and risk management.

I have a background in financial crime risk management, spanning almost 30 years. This includes working within Law Enforcement agencies investigating financial crime, including domestic and international fraud and money laundering in the 1990s, and as a Financial Services Regulator (UK FSA) developing AML regulation and supervision techniques in the late 1990s and early 2000s.

Between late 2001 and mid-2011, I worked at senior levels managing AML/CTF compliance across Europe, the US, Latin America, Asia, and Australia within three major European financial services institutions. Latterly, I headed the financial crime risk function at a major Australian bank during the period that the AML/CTF Act was being introduced in Australia and the assisted compliance period was in place.

Since August 2011, I have worked as a consultant advising financial institutions in Australia and globally on AML/CTF matters.

Since the early 2000s, in addition to working in and advising reporting entities I was:

- A member of the Board of the UK's Joint Money Laundering Steering Group (JMLSG) which sets the AML/CTF standards for all regulated businesses in the UK;
- The founding Joint-Chair of the Association of Certified Anti-Money Laundering Specialists (ACAMS) Australasian Chapter;
- A member of the faculty and have lectured as part of the International Compliance Association (ICA) Post Graduate Diploma of Applied Anti-Money Laundering and Counter-Terrorism Financing Management in Australia;
- A founding member of the SWIFT Sanctions Advisory Group, and regularly attended the Private Sector Expert forum of the Financial Action Task Force (FATF). I was also a founding participant in the FATFs FinTech and RegTech Forums;
- An Advisor to, and worked with, DNFBPs across New Zealand to support the sector in addressing their AML/CTF obligations from 2018 onwards;
- Appointed by AUSTRAC as their 'expert witness' in the civil claim against CBA for AML/CTF contraventions, which resulted in CBA paying a settlement of \$700 million in 2018;
- Authorised by AUSTRAC as an appropriately skilled AML/CTF External Auditor and appointed to conduct AfterPay Ltd's external audit under Section 162 of the AML/CTF Act in 2019;
- Appointed by AUSTRAC as their 'expert witness' in the civil claim against Westpac for AML/CTF contraventions, which resulted in Westpac paying a settlement of \$1.3 billion in 2020;

I have also recently given evidence in both the NSW Bergin Inquiry and the Victorian Royal Commission into Crown Resorts.

### Initialism

Initialism brings together over 75 years of combined experience of working across all aspects of AML/CTF. Our experience and knowledge has been developed across all aspects of the AML/CTF industry, including as AML/CTF Compliance Officers. Our consultants all have a proven track record of providing practical advice and delivering compliant, proportionate, and business sensitive AML/CTF compliance solutions.

This includes providing AML/CTF consultancy services to develop pragmatic responses to AML/CTF compliance and financial crime risk management challenges facing all sizes and types of businesses with AML/CTF obligations, both here in Australia and internationally.

These responses include the development and completion of ML/TF risk assessments, the design and delivery of AML/CTF Programs, Independent Reviews of AML/CTF Programs, and general AML/CTF Advisory services. Initialism also advises and supports businesses in responding to AML/CTF regulatory supervision and enforcement proceedings.

## **The appropriateness of designated services to determine whether a business is caught by the AML/CTF Act**

The use of designated services is a fundamental concept in the Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (AML/CTF Act), directly determining which 'persons' are obligated to comply with the AML/CTF Act and AML/CTF Rules. If a business does not provide one or more of the services designated by Tables 1, 2, or 3 of Section 6 of the AML/CTF Act, they are not a reporting entity and are therefore not required to comply with obligations set out in the AML/CTF Act.

The use of designated services to determine whether a 'person' is obligated to comply with the AML/CTF Act is a significant limiting factor to the effective and comprehensive application of AML/CTF compliance requirements and should be replaced with the business type model which has been adopted by the majority of mature AML/CTF regimes globally.

The continued use of designated services to determine the applicability of the AML/CTF Act to a 'person' risks undermining the effectiveness of Australia's AML/CTF regime, as well as the AML/CTF regime's ability over time to adjust as the AML/CTF landscape evolves and new businesses offering innovative products and services emerge which, due to their ML/TF vulnerability, should be covered by the AML/CTF regime.

The inappropriateness of the use of designated services to determine whether a 'person' is obligated under the AML/CTF Act is further reinforced by the innovation and fragmentation of the payments industry, which has increased the potential number of participants in a payment, some of which are not providing designated services but are nonetheless fundamental to the payment being made.

The Australian Payments industry has seen exponential growth in recent years in the complexity of emerging technology, the number of transactions (by value and volume), as well as the number of participants providing payment services<sup>1</sup>. However, the AML/CTF regime has failed to keep pace with innovation and changes to the way payments are originated and processed, simply because they do not provide, or they have been designed not to provide, one or more of the designated services under the AML/CTF Act.

The exclusions due to the designated services definition include digital wallets providers such as Apple Pay and Google Pay, digital currency wallet providers, certain types of FinTech 'money remitters', as well as many credit and debit card payment facilitators and merchant acquirers.

This stretching of the payment chain and insertion of non-AML/CTF regulated parties also results in the obfuscation of payment information and limits the ability of reporting entities to identify, mitigate, and ultimately manage their ML/TF risks.

It is clear that the services designated by the AML/CTF Act have not kept pace with technological changes and developments in the financial services regulated sectors. Going forward, maintaining a set of designated services would perpetuate significant legislative burden and regulatory overhead that, as evidenced by the last 15 years, by definition will always be playing catch-up with industry evolution and innovation.

When introduced in 2007, the concept of designated services was an attempt to provide a degree of clarity and support businesses determining whether or not they have obligations under the AML/CTF Act and AML/CTF Rules. However, as the Australian AML/CTF regime matures, it is increasingly recognised that the use of designated services to determine AML/CTF Act applicability creates complexity and means that some businesses have experienced difficulty in determining whether a product or service they provide brings them into the AML/CTF regime or not.

The use of designated services also allows other 'persons' to avoid being obligated by the AML/CTF Act requirements by designing products and services that provide similar functionality to, but do not fully align with, the limited and rigid description of a designated service within the AML/CTF Act.

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<sup>1</sup> Payment Systems Board Annual Report 2020 – Trends in Payments, Clearing and Settlement Systems  
<https://www.rba.gov.au/publications/annual-reports/psb/2020/pdf/trends-in-payments-clearing-and-settlement-systems.pdf>

The continued use of designated services also risks the creation of arbitrage opportunities, the erosion of competitive neutrality, and ultimately an uneven AML/CTF compliance playing field across businesses providing similar products and services.

The services designated by the AML/CTF Act are grouped into services provided by the financial services sector, bullion dealers, and businesses providing gaming and gambling services. The AML/CTF Act, when introduced in 2007, initially designated 54 services provided by the financial services sector, 2 by bullion dealers, and 14 by businesses providing gaming and gambling services.

The financial services designated have increased by a very limited number since 2007 to now include 59 designated services to accommodate providing a designated remittance network, acting as a signatory to particular financial services, and exchanging digital (crypto) currencies.

The designated services within the AML/CTF Act specify the role that a 'person' plays in providing the designated service, the underpinning type of product or service provided, and who the customer is.

The use of designated services in determining whether a 'person' is obligated under the AML/CTF Act is unique to Australia. Foreign jurisdictions including New Zealand, Singapore, the United Kingdom, Ireland, and Canada create AML/CTF obligations on a type of business i.e., financial services or gambling, rather than on the products or services being provided i.e., providing a loan or betting).

The concept of designated services was established by the Australian Attorney-General's Department as part of the development of the AML/CTF Act and was intended to provide the industry with clarity and certainty over what types of products or services were intended to be subject to the AML/CTF Act obligations. This approach was partially welcomed by the industry, and at the time was felt to provide a sound basis to identify the extent to which a 'person' was caught by the AML/CTF Act in an immature AML/CTF compliance environment, with many existing businesses being newly captured by the AML/CTF requirements.

The Financial Action Task Force (FATF) 2015 Mutual Evaluation Report<sup>2</sup> identified a number of omissions in the list of designated services, which in their view created weaknesses in Australia's AML/CTF regime, thereby highlighting the limitations and inflexibility that the use of designated services to determine whether a 'person' was obligated by the AML/CTF Act creates.

The Statutory Review Report published in April 2016<sup>3</sup> also identified that the inclusion of designated services had added a significant layer of technical and legal complexity to the AML/CTF regime and was generating uncertainty, with stakeholders finding a number of the designated services unclear or confusing.

The Statutory Review Report, in recognising that the use of designated services to determine coverage by the AML/CTF Act was out of step with other countries, approached various industry participants and identified that the complexity of the designated service-based approach had also led to the inadvertent imposition of additional obligations on some businesses that have difficulty interpreting the scope of designated services and determining whether a product or service they provide creates an obligation or not.

The Statutory Review Report went on to comment that foreign jurisdictions' AML/CTF legislation and frameworks, based on the types of business undertaken rather than on the products or services being provided, is less complex and recommended a simplification of the designated services set out within the AML/CTF Act, presumably to align the designated services more closely to the business type model applied in other more mature AML/CTF regimes globally.

The Statutory Review Report, in recommending simplifying the designated services under Section 6 of the AML/CTF Act, in my opinion, recognised that the simplification of designated services would introduce greater clarity for businesses to determine whether or not the type of business they operate would be obligated under Australia's AML/CTF regime. However, it is also accepted that overseas AML/CTF regimes

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<sup>2</sup> FATF 4th Round Mutual Evaluation Report 2015 <https://www.fatf-gafi.org/media/fatf/documents/reports/mer4/Mutual-Evaluation-Report-Australia-2015.pdf>

<sup>3</sup> Report on the Statutory Review of the Anti-Money Laundering And Counter-Terrorism Financing Act 2006 and Associated Rules and Regulations <https://www.austrac.gov.au/sites/default/files/2019-07/report-on-the-statutory-review-of-the-anti-money-laundering.pdf>

that create AML/CTF obligations for types of businesses are not perfect and can also be circumvented by businesses creatively changing how they categorise their type of business.

In a February 2021 paper - Fintech regulation: how to achieve a level playing field<sup>4</sup>, the Bank for International Settlements (BIS) raised questions on the appropriateness of activity-based AML/CTF regulation in innovative and dynamic financial services sectors.

The BIS paper concluded that both activity-based and entity-based regulatory models have benefits and limitations, but for Fintech businesses across a broad range of regulations, including AML/CTF, an entity-based approach to regulation may be more appropriate.

In my professional experience of supporting many reporting entities and businesses seeking to understand whether they are or should be a Reporting Entity, many struggle with the concept of designated services and, on occasion, specifically design out the criteria set out in the designated services classification to avoid coverage by the AML/CTF regime.

An AML/CTF regime that specifies the types of business to be obligated and defines it on the basis of what products and services a 'person' provides that have been deemed vulnerable to ML/TF, as is the case with New Zealand's, the UK's, and Canada's AML/CTF regimes, whilst not perfect, in my opinion allows for greater flexibility and regulatory certainty.

The adoption of a more entity-based AML/CTF regime would also address the situation that Australia finds itself in as the AML/CTF regime matures in an innovative and dynamic business environment, which has led to the designated services concept undermining the efficacy of Australia's AML/CTF regime and creating confusion for a business trying to understand whether it is caught by the AML/CTF Act, as well as creating opportunities for businesses to avoid AML/CTF regulation.

#### **Increasing Board and Senior Management accountability for AML/CTF compliance**

Australia has some of the least prescriptive AML/CTF accountabilities on Board Directors and Senior Management of a Reporting Entity to ensure AML/CTF compliance, despite it being recognised both in Australia and internationally that the Board of Directors and Senior Management of a business regulated under an AML/CTF regime play a vital role in the efficacy of managing ML/TF risks and achieving sustainable compliance.

Board and Senior Management governance and oversight are at the heart of the AML/CTF risk-based approach espoused by the FATF, requiring reporting entities to take responsibility for the identification, management, and mitigation of the ML/TF risks reasonably faced and to take adequate steps to ensure effective compliance with AML/CTF obligations.

Regulators globally agree that Boards and Senior Management are responsible for setting risk appetites and for putting controls in place to ensure that ongoing risks are managed within that appetite. This cannot be done without active engagement by Boards and Senior Management, and active engagement can only be achieved when there are clear accountabilities for AML/CTF compliance. However, the AML/CTF Act and AML/CTF Rules currently do not place unequivocal obligations on the Board and Senior Management roles with respect to ensuring AML/CTF compliance nor do they set the expectations to which those accountabilities are to be carried out.

The Board of Directors and Senior Management accountabilities are contained in a single paragraph in the AML/CTF Rules, which requires them to simply approve the Part A AML/CTF Program and also ensure the Part A AML/CTF Program is subject to Board and Senior Management's ongoing oversight. Neither the AML/CTF Act nor the AML/CTF Rules define what steps should be taken to appropriately approve the AML/CTF Program nor what type and extent of ongoing oversight is required.

It is broadly accepted that Boards and Senior Management of Reporting Entities need to satisfy themselves that current ML/TF risks are understood so that AML/CTF related controls are capable of managing those ML/TF risks within an accepted appetite setting and that appropriate reporting mechanisms are in place to

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<sup>4</sup> <https://www.bis.org/fsi/fsipapers17.pdf>

give them assurance that those AML/CTF related controls are operating as intended. However, the requirements within the AML/CTF Rules do not cover specific accountabilities placed on the Boards and Senior Management of Reporting Entities nor does the AML/CTF Act include penalties for failure to discharge those accountabilities.

This issue was raised in the FATF 2015 Mutual Evaluation Report<sup>5</sup>, which recorded only "Partial Compliance" with FATF Recommendation 35, in part because the Australian AML/CTF regime does not extend sanctions to Directors and Senior Management if a reporting entity has contravened the AML/CTF Act or AML/CTF Rules.

In the 2015 Mutual Evaluation Report, the FATF identified that it is not specified in the AML/CTF Act or AML/CTF Rules that, in addition to the sanctions applicable to the natural person who contravenes a provision of the AML/CTF Act or an obligation in the AML/CTF Rules, Directors and Senior Management of Reporting Entities or DNFBPs are also liable for the contravention of the AML/CTF Act and therefore may be sanctioned.

The FATF 2015 Mutual Evaluation Report also noted that AUSTRAC could refer breaches to APRA. However, APRA does not have the direct ability to remove managers and directors of a reporting entity for contraventions of the AML/CTF Act.

This issue was also recognised by the Statutory Review Report in 2016<sup>6</sup>, which stated that the FATF raised concerns that these sanctions do not extend to directors and senior managers of a reporting entity where it is the reporting entity that has contravened the AML/CTF Act, recommending that to address this, the AML/CTF Act should be amended to provide that sanctions for contraventions of the AML/CTF Act can also apply to senior managers and directors in appropriate circumstances.

The Statutory Review Report also sighted the approach adopted by Singapore under Section 28 of the Monetary Authority of Singapore Act which gives the Monetary Authority of Singapore (MAS) the power to apply sanctions and financial penalties for, amongst other things, AML/CTF non-compliance against regulated businesses and their management.

This issue has also been addressed as part of the 6<sup>th</sup> EU Anti-Money Laundering Directive, which came into force in December 2020. The introduction of these changes has created a mechanism through which companies can now be held liable for failing to prevent an individual in their organisation from breaching AML/CTF requirements. Management teams across organisations now have an increased responsibility to ensure their business is AML/CTF compliant, as well as to implement and manage adequate AML/CTF policies, procedures, and internal controls.

The failure of Board Directors and Senior Management to discharge even the high-level responsibilities and accountabilities within the AML/CTF Rules has been a consistent feature and significant contributory factor in AML/CTF compliance failures highlighted by recent AUSTRAC enforcement action.

It is also notable that ASIC has investigated whether the actions of Board Directors and Senior Management that resulted in recent AUSTRAC civil claims constituted breaches under the Corporations Act. However, based on the outcome of ASIC's investigations into the Directors and Officers of both CBA and Westpac, it appears that, despite the clear failure of Directors and Senior Management to ensure appropriate and effective AML/CTF compliance responses were in place, it is legislatively challenging to reach the burden of proof required to mount a successful prosecution under the Corporations Act for failures in AML/CTF oversight and governance.

Against this background, the responsibilities and accountabilities of Board Directors and Senior Managers of a regulated business should be strengthened to ensure the AML/CTF Act and AML/CTF Rules provide adequate mechanisms to ensure Boards and Senior Management are actively engaged in ensuring AML/CTF compliance, and to ensure there is appropriate recourse for failure to identify, manage, and mitigate the ML/TF risks their businesses reasonably face and to effectively comply with AML/CTF obligations.

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<sup>5</sup> FATF 4<sup>th</sup> Round Mutual Evaluation Report 2015 <https://www.fatf-gafi.org/media/fatf/documents/reports/mer4/Mutual-Evaluation-Report-Australia-2015.pdf>

<sup>6</sup> Report on the Statutory Review of the Anti-Money Laundering And Counter-Terrorism Financing Act 2006 and Associated Rules and Regulations <https://www.austrac.gov.au/sites/default/files/2019-07/report-on-the-statutory-review-of-the-anti-money-laundering.pdf>

As the Australian AML/CTF regime matures, consideration should also be given to placing legislative or regulatory obligations on the person designated as the AML/CTF Compliance Officer, as a key role in ensuring AML/CTF compliance.

Once again, the AML/CTF Rules set out high-level requirements to designate an employee role as the AML/CTF Compliance Officer at the management level. However, the Rules do not require the post holder to be appropriately qualified, skilled, or experienced, nor do they place specific responsibilities on the AML/CTF Compliance Officer or impose sanctions for failing to adequately discharge the role.

This issue was also identified by the FATF's 2015 Mutual Evaluation Report<sup>7</sup>, which rated Australia partially compliant with FATF Recommendation 18 covering the internal AML/CTF controls an entity must have in place to reduce its ML/TF risks, identifying that apart from the obligation to nominate a compliance officer at management level, reporting entities are not required to have any other compliance management arrangements.

The issue was also identified in the Statutory Review Report, which documented industry recommendations to amend the AML/CTF Act and AML/CTF Rules to describe the role and function of AML/CTF Compliance Officers, requiring them to attain and maintain competency standards and qualifications to hold the role.

The Statutory Review Report also identified that an alternative model to the Annual Compliance Report was to adopt a senior management compliance reporting model under which the AML/CTF Compliance Officer submits an annual report to senior management detailing the business' state of AML/CTF compliance, with reports to be made available to AUSTRAC upon request and to be admissible in court. Whilst this is the approach in some other countries, there is a move internationally to adopt the direct reporting model currently in place under the Annual Compliance Report obligations.

This raises an interesting point regarding the responsibility and accountability of the AML/CTF Compliance Officer to formally report the level of compliance to the Board and Senior Management as part of their oversight and governance obligations.

In other more mature AML/CTF regimes, for example in the UK, the AML/CTF Compliance Officer (referred to as the Money Laundering Reporting Officer or 'MLRO') is required to report periodically to the Board and Senior Management on the appropriateness and effectiveness of the reporting entity's AML/CTF compliance, with the AML/CTF Compliance Officer being granted "Safe Harbour" from any exposure to sanctions or other penalties through regulation by reporting AML/CTF non-compliance concerns to the Board and Senior Management and requesting support to address those concerns.

This is also extended to require the AML/CTF Compliance Officer to report to the regulator where Board and Senior Management, in their opinion, are not taking AML/CTF compliance obligations seriously and are failing to provide adequate funding and resources to ensure AML/CTF compliance.

As the Australian AML/CTF regime matures and is extended to DNFBDPs to comply with Australia's international commitments, it will be important to increase, or at the very least further clarify, the accountabilities placed on the Board and Senior Management to ensure compliance with AML/CTF obligations, as well as to provide appropriate sanctions where Board and Senior Management fail to ensure compliance without reasonable excuse.

This should also be extended to the AML/CTF Compliance Officer, who plays a vital role in ensuring AML/CTF compliance, as this would create healthy tension and ensure that AML/CTF compliance receives the appropriate attention.

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<sup>7</sup> FATF 4<sup>th</sup> Round Mutual Evaluation Report 2015 <https://www.fatf-gafi.org/media/fatf/documents/reports/mer4/Mutual-Evaluation-Report-Australia-2015.pdf>



## Bringing DNFBPs into Australia's AML/CTF regime

DNFBPs are important business sectors that significantly contribute to the Australian economy and the business community. However, like other business sectors recognised as vulnerable to ML/TF and already covered by the AML/CTF Act, some of the services DNFBPs legitimately provide to clients have been, and continue to be, exploited by criminals seeking to commit crimes and launder proceeds of criminal activity.

Money laundering cases I investigated as a law enforcement officer specialising in money laundering and proceeds of crime investigations highlighted the extensive use of DNFBP services to launder the proceeds of crime. These money laundering schemes are detailed in Jeffrey Robinson's books *The Laundrymen*<sup>8</sup> and *The Sink*<sup>9</sup>, and were the subject of criminal cases in the mid-1990s brought jointly by UK law enforcement agencies and the Manhattan District Attorney's Office into securities fraud and the international laundering of the proceeds of criminal activity including drug trafficking through the exploitation of the services of lawyers and accountants in the US and the UK.

There is a significant body of research that highlights the vulnerability of key DNFBP sectors, dating as far back as 1997 when the FATF first identified the vulnerability of designated non-financial businesses and professions to money laundering<sup>10</sup>.

The FATF Typologies Report in 1998 identified lawyers, notaries, accountants, company formation agents, real estate agents, and sellers of high-value items as being vulnerable to being used and abused to launder money<sup>11</sup>, identifying the use of DNFBPs both unbeknown to the DNFBP and with knowledge of the business as to the criminal purpose of the activity. This was followed up by the FATF's 2001 and 2004<sup>12</sup> Typologies, which further detail the use and abuse of DNFBP sectors.

In 2007, the FATF also published a report entitled "*Money Laundering and Terrorist Financing Through the Real Estate Sector*"<sup>13</sup>. This was followed up by a FATF Report<sup>14</sup> in 2010, which provided further typologies on how corporate vehicles can be used by criminals and money launderers. This Report identified the use of multiple DNFBP sectors (lawyers, accountants) as being involved in the Trust and Company Service Provider sector and identified that the vehicles created and managed are used as part of money laundering schemes, including the sale and purchase of real estate.

In 2013, the FATF also published a Report<sup>15</sup> on the "*ML/TF vulnerabilities of legal professionals*" providing an analysis of over 100 case studies and concluding that criminals seek out the involvement of legal professionals in their ML/TF activities to conceal and obfuscate illicit activity and to add a veil of legitimacy.

In 2018, the FATF also published a Report on Professional Money Laundering<sup>16</sup>. The Report detailed many case studies where DNFBPs have been involved in laundering the proceeds of criminal activity or financing terrorist activity.

In June 2019, the FATF also published specific guidance on the risk-based approach for three key DNFBP sectors, the legal profession<sup>17</sup>, accountants<sup>18</sup> and trust and company service providers (TCSPs)<sup>19</sup> on how to

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<sup>8</sup> *The Laundrymen* (ISBN 0-671-71384-1) <http://www.jeffreyrobinson.com/laundrymen>

<sup>9</sup> *The Sink* (ISBN 1-84119-682-7) <http://www.jeffreyrobinson.com/the-sink>

<sup>10</sup> FATF -VIII Money laundering typologies exercise (February 1997) <https://www.fincen.gov/sites/default/files/shared/fatf.pdf>

<sup>11</sup> FATF-IX Annual Report <https://www.fatf-gafi.org/media/fatf/documents/reports/1997%201998%20ENG.pdf>

<sup>12</sup> FATF-XV Typologies Report 2003-2004 [https://www.fatf-gafi.org/media/fatf/documents/reports/2003\\_2004\\_ML\\_Typologies\\_ENG.pdf](https://www.fatf-gafi.org/media/fatf/documents/reports/2003_2004_ML_Typologies_ENG.pdf)

<sup>13</sup> FATF Report – ML & TF through the Real Estate Sector <http://www.fatf-gafi.org/media/fatf/documents/reports/ML%20and%20TF%20through%20the%20Real%20Estate%20Sector.pdf>

<sup>14</sup> FATF Report – Money Laundering using TCSPs - <http://www.fatf-gafi.org/media/fatf/documents/reports/Money%20Laundering%20Using%20Trust%20and%20Company%20Service%20Providers.pdf>

<sup>15</sup> FATF Report – ML&TF Vulnerabilities of Legal Professionals <http://www.fatf-gafi.org/media/fatf/documents/reports/ML%20and%20TF%20vulnerabilities%20legal%20professionals.pdf>

<sup>16</sup> FATF Report on Professional Money Laundering <http://www.fatf-gafi.org/media/fatf/documents/Professional-Money-Laundering.pdf>

<sup>17</sup> FATF Guidance on RBA for lawyers - <https://www.fatf-gafi.org/media/fatf/documents/reports/Risk-Based-Approach-Legal-Professionals.pdf>

<sup>18</sup> FATF Guidance on RBA for accountants - <https://www.fatf-gafi.org/media/fatf/documents/reports/RBA-Accounting-Profession.pdf>

<sup>19</sup> FATF Guidance on RBA for TCSPs - <https://www.fatf-gafi.org/media/fatf/documents/reports/RBA-Trust-Company-Service-Providers.pdf>

address ML/TF risks. This reinforces the ML/TF vulnerabilities of DNFBPs, which is one of the key reasons why the regulation of DNFBPs for AML/CTF has been a key pillar of the FATF Recommendations and why their inclusion is a vital element of any effective AML/CTF regime.

Additionally, as far back as 2007, the Australian Transaction Reports and Analysis Centre's (AUSTRAC) own typologies have also identified multiple cases where DNFBPs were used as part of criminal enterprises or to launder the proceeds of criminal activity, including drug trafficking and fraud, in Australia.

In 2008, AUSTRAC's typologies<sup>20</sup> detailed further cases of the use of real estate and accountants by criminals, and in 2010 AUSTRAC's typologies<sup>21</sup> assessed the industries involved in its case studies between 2007 and 2010 and identified that 13% of all case studies over the period involved DNFBPs.

AUSTRAC has not produced typology reports since 2014. However, in 2015 AUSTRAC published "*a Strategic Analysis Brief – Money Laundering Through Real Estate*"<sup>22</sup>. The 2015 Report identifies multiple typologies where lawyers and real estate agents are vulnerable to being used to launder money.

There is also a significant and growing body of work that identifies the vulnerabilities of all DNFBP sectors both internationally and domestically in Australia, supported by specific cases both in Australia and overseas, including a Transparency International Canada Report<sup>23</sup> in March 2019, which identified CAN\$28.4 billion invested in Greater Toronto Area housing since 2008, through corporations. This also includes over CAN\$1 billion in 2016 invested in Vancouver real estate, identified by Police as the proceeds of illicit Fentanyl (opiate) importation by Chinese organised crime groups<sup>24</sup>. This criminal activity touches a number of DNFBP sectors, which was echoed in the ABC Four Corners documentary "Project Dragon"<sup>25</sup> in early 2019, in which I participated, and which identified significant money flows into the Australian real estate market.

From as far back as 2003, in response to the increased acceptance of the vulnerability of DNFBPs to facilitating money laundering and other criminal activities, the FATF introduced international requirements to include DNFBPs in a country's AML/CTF regime, calling upon "all countries to take the necessary steps to bring their national systems for combating money laundering and terrorist financing into compliance with the FATF Recommendations, and to effectively implement the measures." Over the years, the FATF has maintained a focus on bringing DNFBPs into AML/CTF regimes.

As a founding member of the FATF, Australia has participated in the development and ratification of the DNFBP international standards by the FATF since 2003.

From the outset, the FATF Recommendations have provided a sound basis for countries to introduce AML/CTF regulation to key DNFBP sectors, with the FATF seeking to limit the type of DNFBP activity covered by AML/CTF requirements to those activities particularly vulnerable to money laundering and financing terrorism, and predominately focusing on the financial transactions, the management of assets, and the creation and management of legal entities undertaken by DNFBPs on behalf of clients.

Analysis of the FATF 4th Round Mutual Evaluation Reports published identifies Australia as one of only five countries that are non-compliant with all three FATF Recommendations related to DNFBPs. In 2014, the FATF commenced its 4th Round of Mutual Evaluations and, to date, has published Mutual Evaluation Reports (MERS) on 112 countries<sup>26</sup>. The mutual evaluation includes an assessment of compliance with the Recommendations that relate to DNFBPs.

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<sup>20</sup> AUSTRAC Case Studies 2008 <http://www.austrac.gov.au/typologies-2008-case-studies>

<sup>21</sup> AUSTRAC Typologies and case studies report 2010 <https://www.austrac.gov.au/business/how-comply-guidance-and-resources/guidance-resources/typologies-and-case-studies-report-2010>

<sup>22</sup> AUSTRAC Report ML through Real Estate <http://www.austrac.gov.au/sites/default/files/sa-brief-real-estate.pdf>

<sup>23</sup> Transparency International Canada Report <http://www.transparencycanada.ca/wp-content/uploads/2019/03/BOT-GTA-Report-WEB-copy.pdf>

<sup>24</sup> Global News – Fentanyl Making a Killing <https://globalnews.ca/news/4658157/fentanyl-vancouver-real-estate-billion-money-laundering-police-study/>

<sup>25</sup> Project Dragon <https://www.abc.net.au/4corners/project-dragon/10837468>

<sup>26</sup> FATF Consolidated Ratings <https://www.fatf-gafi.org/media/fatf/documents/4th-Round-Ratings.pdf>

As of late August 2021, of the 112 countries assessed by the FATF's 4<sup>th</sup> Round Mutual Evaluation process to assess compliance with AML/CTF international standards by the FATF that commenced in 2014, it has been established that:

- Eleven countries<sup>27</sup> have not implemented FATF Recommendation 22 to require DNFBPs to undertake customer due diligence, which is a key AML/CTF compliance measure;
- Eight countries<sup>28</sup> have not implemented FATF Recommendation 23 to require DNFBPs to undertake other AML/CTF compliance measures; and
- Thirteen countries<sup>29</sup> have yet to implement FATF Recommendation 28 and establish AML/CTF regulation and supervision for DNFBPs.

Australia is one of only five countries that are non-compliant with all three FATF recommendations related to DNFBPs. The other countries that are non-compliant are China, Haiti, Madagascar, and the United States of America.

Australia has also been formally assessed as non-compliant with DNFBP recommendations for the longest period as part of the 4<sup>th</sup> Round Mutual Evaluation process. However, little or no progress has been made by Australia to bring DNFBPs into its AML/CTF regime.

Australia's non-compliance with the DNFBP AML/CTF compliance standards was also identified in the FATF's 2005 Mutual Evaluation Report. Australia's longstanding and continued non-compliance with AML/CTF international standards for the AML/CTF regulation of DNFBPs means it is increasingly becoming an international outlier.

At the time of the introduction of the AML/CTF Act in 2007, it was anticipated that DNFBPs would be brought into Australia's AML/CTF regime as part of the second tranche of reforms, generally known as "Tranche II".

Since 2007, the debate about Australia's inclusion of DNFBPs in the AML/CTF regime can be characterised as continuing to be bogged down by a lack of apparent political will resulting in federal government inaction, which has been justified in part by the hyperbole, scaremongering and catastrophic impacts predicted by the lobbyists for some DNFBP sectors.

These predications are espoused without evidence or a rational basis and fly in the face of contradictory experiences by the same DNFB sectors in other jurisdictions, as can be seen from the experience of New Zealand that included DNFBPs in their AML/CTF regime in 2018.

In 2017, post the FATF 2015 Mutual Evaluation and the Statutory Review Report in 2016, the Australian Government also commissioned its own cost-benefit analysis of bringing DNFBPs into the AML/CTF regime, which it is understood was reviewed at a federal cabinet level. However, neither this cost-benefit analysis report nor any of the findings have yet to be published.

Bringing DNFBPs into Australia's AML/CTF regime will be a significant and important wave of AML/CTF regulatory reform that will level the playing field and enhance Australia's ability to detect and prevent money laundering, terrorist financing, and other predicate crimes.

The inclusion of DNFBPs will also go some way to addressing long-established distortions and the potentially disproportionate focus on other business sectors currently covered by the AML/CTF Act. It will also increase the level of reporting to AUSTRAC and the information and intelligence dividend that should help and support authorities to identify and tackle money laundering, terrorism financing and other predicate offences.

Whilst the AML/CTF obligations for DNFBPs will most likely be the same as those for current reporting entities, in reality, the operational approach to AML/CTF compliance by DNFBPs, in a number of areas, may

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<sup>27</sup> Australia, Canada, China, Democratic Republic of Congo, Haiti, Jordan, Madagascar, Palau, Solomon Islands, Thailand, and United States.

<sup>28</sup> Australia, Canada, China, Haiti, Jordan, Madagascar, Mexico, and United States.

<sup>29</sup> Australia, Burkina Faso, China, Democratic Republic of Congo, Haiti, Madagascar, Mali, Mauritania, Palau, Senegal, Tanzania, Uganda, and United States.

be different. The challenges facing the DNFBP sectors to address AML/CTF compliance will take careful consideration and therefore time to address. However, the challenges are not insurmountable.

The exemption process available under Section 229 of the AML/CTF Act allows for the refinement of obligations under the AML/CTF Rules and provides relief from parts of the AML/CTF Rules that are irrelevant and/or inappropriate for each DNFBP sector, based on the type of activity undertaken by the DNFBP sector and the nature of the ML/TF risks faced.

Addressing the challenges to ensure effective AML/CTF compliance by DNFBPs will take cooperation from both within DNFBP sectors, as well as wider industry and regulatory stakeholders. This includes industry associations, major players in each DNFBP sector, vendors, and service providers, as well as other reporting entities that provide financial services to DNFBPs.

The willingness of stakeholders to engage with these challenges will, in reality, only occur once there is regulatory certainty, as it is only at this point that most stakeholders will be prepared to actively engage and devote appropriate levels of time and resources to address the challenges.

Since the beginning of 2018, Initialism has worked with all DNFBP sectors across New Zealand. Our extensive engagement with DNFBPs the length and breadth of New Zealand provided Initialism with unique insights into the effort, and therefore the impact and cost, potentially faced by DNFBPs in Australia when getting to grips with compliance with AML/CTF requirements.

Our experience in New Zealand indicates that DNFBPs in New Zealand were not quick to move, and in many cases, they left it very late to start thinking about what AML/CTF compliance meant for their business and putting in place appropriate responses. This was due to the way that the businesses are resourced, and they usually tend to address changes only when they really need to.

In New Zealand, this also resulted in many businesses being set up to take advantage of the revenue opportunity that AML/CTF for DNFBPs created. However, many of these businesses had very little or no experience in AML/CTF compliance, which meant that DNFBPs have, in some cases, been poorly advised, and despite spending time, effort, and money, they struggled to achieve an appropriate level of AML/CTF compliance.

The way that each DNFBP sector reacted to achieving AML/CTF compliance was in part due to the poor communication from industry associations and the delayed timing of regulatory engagement, which meant that some businesses did not fully appreciate the challenges they faced, how much effort was required and therefore how much time and attention needed to be devoted to achieving compliance.

One of the key challenges raised by the legal profession is the issue of legal privilege and how to balance apparently competing requirements. Whilst this is an issue that needs to be carefully worked through, experience from other jurisdictions indicates that this issue and its impact tends to be over-emphasised by lawyers.

In reality, the services likely to be covered by AML/CTF do not extend to legal advice that may attract privilege and the focus of AML/CTF regulation, in line with FATF standards, is on the financial transaction aspect of legal work and not the advice element..

More information about bringing DNFBPs into Australia's regime can be found in a paper published by Initialism in July 2019 entitled "A Tranche Too Hard", which is available on Initialism's website at <https://initialism.com.au/initialism-white-paper-a-tranche-too-hard/>