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Supplementary Submission to the Senate Legal and Constitutional Affairs Legislation Committee

Anti-Money Laundering and Counter-Terrorism Financing Amendment Bill 2024 [Provisions]

Attorney-General's Department Supplementary Submission

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Introduction

The Attorney-General's Department (the department) thanks the Senate Legal and Constitutional Affairs Legislation Committee (the Committee) for the opportunity to make a supplementary submission to the inquiry on the provisions of the Anti-Money Laundering and Counter-Terrorism Financing Amendment Bill 2024 (the Bill).

This supplementary submission provides further detail to respond to issues raised in submissions to the Committee on aspects of the Bill. It should be read alongside the department's submission to the Committee, the Bill and its explanatory materials.

AML/CTF programs – Foreign branches and subsidiaries

Preventing regulatory duplication

Some stakeholders have provided feedback that the obligations proposed to be applied to foreign branches or subsidiaries of reporting entities would be overly burdensome and result in a duplication of effort for reporting entities. Specifically, stakeholders have raised concerns that reporting entities would be required to assess the laws of the host country and compare them to the Australian requirements, and be required to create bespoke anti-money laundering and counter-terrorism financing (AML/CTF) programs for the foreign entity. Stakeholders are also concerned that the host country may have different legal expectations for the same obligation under the Australian legislation, leading to regulatory duplication, delays in customer service and reduced competitiveness.

The Bill would set out high-level principles for all reporting entities that are aligned with the international FATF standards. Most FATF members' AML/CTF legal frameworks meet the FATF standards for customer due diligence.[1] It will not be necessary for reporting entities to assess foreign laws—the provisions have been drafted specifically to remove this need by avoiding concepts of 'equivalence' or 'strictness' of foreign laws. The Bill removes the current concept of 'comparable' laws which reporting entities are currently required to assess under Rule 8.8.3 of the Anti-Money Laundering and Counter-Terrorism Financing Rules Instrument 2007 (No.1) (AML/CTF Rules).

The Bill focuses instead on what occurs in practice, i.e. reporting entities simply need to ensure that their own customer due diligence (CDD) measures as set out in their own AML/CTF policies meet an objective standard of establishing the identity of the customer etc. This is both a basic and universal requirement of AML/CTF regulation, and good business practice.

More specific obligations are required of domestic reporting entities providing services in Australia. Through this deliberate drafting, foreign branches and subsidiaries of reporting entities will be provided flexibility in how they meet these high-level obligations, with the ability to leverage the policies, procedures, systems and controls that are already in place to provide designated services in the host country.

[1] As at 10 October, only 31 jurisdictions out of more than 200 jurisdictions in the FATF Global Network were rated 'non-compliant' or 'partially compliant' with FATF Recommendation 10 regarding customer due diligence. The majority of these jurisdictions are in Africa.

Further, the AML/CTF Rules that will be developed to clarify CDD obligations will not be apply to foreign branches and subsidiaries, except in circumstances such as recognising CDD undertaken in another country for the purposes of providing designated services in Australia (known as 'passporting'). The matters in section 28(2) set out the requirements for FATF Recommendations 10 and 12, and should already be the basis for the host country's regulatory guidance. This will prevent any duplication of existing policies, procedures, systems and controls and would provide maximum flexibility for these reporting entities.

The department understands that in practice, reporting entities will generally be able to extend their domestic, Australian-based AML/CTF programs to their foreign branches and subsidiaries, and already do so.

Conflict of laws

Some stakeholders are concerned reporting entities with foreign branches and subsidiaries would require additional administrative effort to actively assess and compare the laws of Australia with those of the host country to identify where there may be a conflict of laws.

The obligations contained in the Bill are deliberately high-level, and principles-based, to reflect FATF requirements. This will minimise the possibility that an Australian requirement will conflict with any FATF-compliant laws of a foreign jurisdiction.

The Bill has been deliberately drafted to remove the current concept of 'comparable' laws, which would require reporting entities to assess other jurisdictions' AML/CTF laws.

In the event that a conflict occurs, and prevents a reporting entity from complying with the high-level obligations, the reporting entities will be able to rely on the defence in new section 236A. To access the defence, the reporting entity will be required to notify AUSTRAC of the conflict, and then take action to implement policies that reasonably mitigate and manage the risk arising from the conflict. This aligns with FATF Recommendation 18.

Customer due diligence (CDD) framework

Providing flexibility appropriate to risk

Some stakeholders have made submissions to the Committee providing that the CDD framework in Schedule 2 of the Bill introduces greater prescription and more onerous tests than the existing regime.

The AML/CTF regime currently has a procedural focus on *how* a reporting entity should fulfil its CDD obligations, rather than describing the outcome to be achieved. For example, reporting entities are required to carry out the applicable customer identification procedure in respect of a customer, rather than being required to actually know their customer or understand the risks presented by their customers.

The CDD framework in the Bill has been deliberately reframed to more appropriately focus reporting entities' obligations on outcomes (businesses knowing their customer), rather than prescribed processes (the steps or procedures businesses take to know their customer).

This is in line with the expectations of the FATF, and meets the overall purpose of the reforms to harden Australia against criminal exploitation. The Bill achieves this by ensuring businesses know who they are dealing with, and have processes in place to mitigate and manage the money laundering and terrorism financing risks associated with providing designated services to their customers.

In moving to an outcomes-based CDD framework, the Bill necessarily sets out clear outcomes that industry must achieve to meet their obligations. Currently CDD obligations are overly detailed, complex and substantively contained in the AML/CTF Rules, despite being a core obligation of the AML/CTF regime.

Further, some existing obligations are implied, which the department has heard makes it difficult for reporting entities to understand and comply with their obligations, and for AUSTRAC to issue clear but legally accurate guidance. The outcomes are not substantially different from existing obligations, but are more clearly stated in the primary legislation.

Under the Bill, reporting entities are empowered to flexibly undertake CDD in a way that is commensurate to the customer's money laundering and terrorism financing risk. For example, reporting entities would be given flexibility about:

- the type of 'Know Your Customer' (KYC) information they collect about a customer
- which of the KYC information collected the reporting entity will verify, and
- flexibility about how they verify that KYC information,

so long as it is appropriately based on the customer's money laundering and terrorism financing risk.

For example, at present, prescriptive AML/CTF Rules are required to relieve reporting entities of the obligation to verify beneficial owners of certain low-risk domestic and foreign companies (e.g. listed public companies), and certain low-risk domestic trusts (e.g. those subject to the oversight of a Commonwealth statutory regulator). The prescriptive approach has led to a discrepancy due to the lack of recognition of low-risk foreign trusts (i.e. those subject to regulatory oversight overseas). Under new section 28, reporting entities would be able to undertake collection and verification appropriate to the illicit financing risk of the customer without prescriptive requirements.

Timing for initial CDD

During consultation on the reforms, some stakeholders provided feedback that the timing requirements for conducting initial CDD in section 28 of the Bill are difficult and inconsistent with existing business practices. However, the requirement to undertake customer due diligence before providing a designated service is not prescriptive, but a fundamental principle of AML/CTF regulation in Australia and around the world. In certain circumstances there is, however, a recognised need to delay elements of customer due diligence as an exception to this general principle. One circumstance that is already recognised in AML/CTF Rules is the opening of bank accounts. Delayed verification for this service will continue to be permitted in line with the existing delayed verification Rule.

Stakeholders noted that the requirement to determine whether a customer is a politically exposed person (PEP), or person designated for targeted financial sanction prior to commencing to provide a designated service are complex, and would undermine customer onboarding processes and the customer experience.

The requirement to determine whether a customer is a PEP or a person designated for targeted financial sanctions prior to receiving a designated service is a FATF requirement. This requirement is underpinned by the inherently higher money laundering and terrorism financing risk these customers may pose, as they often hold positions that can be abused for money laundering, particularly related to corruption offences.

FATF Recommendation 10 also requires that reporting entities 'should be required to adopt risk management procedures concerning the conditions under which a customer may utilise the business relationship prior to verification'.

Responding to stakeholder feedback and the FATF standards, new section 29 would provide the power for the AUSTRAC CEO to make rules that would facilitate delayed verification. This could include delayed verification of the customer's status as a PEP or person designated for targeted financial sanction, where essential to avoid interrupting the ordinary course of business, it is appropriate to the money laundering and terrorism financing risk of the customer, and the additional risk from delay is low, managed and mitigated. To make such an assessment, reporting entities may need to obtain further information to ensure they comply with the risk-based systems and controls outlined their AML/CTF program.

AUSTRAC intends to make rules to give effect to this position, and will discuss this and other potential delayed verification scenarios during its engagement with industry on the AML/CTF Rules.

Keep open notices

Some stakeholders have raised concerns in relation to new section 39A, which would require for reporting entities to assess whether compliance with CDD obligations would or could reasonably be expected to 'tip off' a customer.

The legislative drafting of this measure addresses inconsistencies with FATF standards and applies best practice. The scope of the current Chapter 75 exemption is too broad and is inconsistent with FATF standards related to CDD. In particular, Criterion 10.20 of FATF Recommendation 10 notes:

- *'in cases where financial institutions form a suspicion of money laundering or terrorist financing,* ***and they reasonably believe that performing the customer due diligence process will tip-off the customer,*** *they should be permitted not to pursue the customer due diligence process, and instead should be required to file a suspicious transaction report' (emphasis added).*

The wording in the current Chapter 75 goes beyond this standard, as it provides a blanket exemption from complying with CDD obligations and other specified provisions (outlined in paragraph 75.3 of the AML/CTF Rules), regardless of whether the reporting entity believes that performing certain CDD measures will tip off a customer. In many circumstances, it may be possible for reporting entities to undertake some CDD measures without engaging with the customer and therefore not risk alerting them to law enforcement attention.

Rather than the current blanket exemption, the Bill specifies that a reporting entity is permitted to not undertake certain CDD obligations in relation to the provision of a designated service, if they receive a 'keep open notice' and reasonably believe that compliance with those obligations would or could reasonably be expected to alert the customer to the existence of a criminal investigation. CDD obligations that can be carried out without alerting the customer, such as transaction monitoring, must still be undertaken.

Importantly, reporting entities will retain the discretion to choose whether to continue to provide a designated service to a customer after receipt of a keep open notice. The Bill does not require reporting entities to keep providing designated services. Instead, the Bill would create a safe harbour from liability from the relevant provisions of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (AML/CTF Act) for a reporting entity that continues to provide a customer with designated services so long as it conforms with the requirements of the AML/CTF Act, AML/CTF Rules and the details in the keep open notice.

Some stakeholders have also requested the Bill be amended to change the definition of a 'serious offence' to an offence against a law of the Commonwealth, or a law of a State or Territory, that is punishable by imprisonment for 3 years or more.

The department is not considering amending the definition of 'serious offence'. The definition in the Bill ('… punishable by imprisonment of 2 years or more') aligns with current definition in Chapter 75 of the AML/CTF Rules. The 2-year threshold is also consistent with the definition of 'serious offence' in Part IAA of the *Crimes Act 1914* —Search, information gathering, arrest and related powers.

Further, increasing the threshold would lower the availability of keep open notices, which may result in more exposure to legal risk for reporting entities. As above, keep open notices would provide a safe harbour from liability—reporting entities retain the discretion to choose whether to continue to provide a designated service after receipt of a keep open notice.

Scope of designated services

Multiple stakeholders have raised concerns that the Bill would capture barristers (and some other legal professionals) under the professional service provider designated services in Schedule 3.

The FATF standards apply to all legal professionals when they carry out specific activities. FATF guidance explicitly identifies barristers as part of the definition of legal professionals.[2] If barristers perform the designated services, they would, and should, be captured by the AML/CTF regime. This is the intended operation of the Bill, and reflects illicit financing risk of the designated services.

The effect of new designated services table 6 is to extend the AML/CTF regime in line with FATF Recommendations 22 and 23, which require designated non-financial businesses and profession to conduct AML/CTF obligations when they prepare for, or carry out, transactions for their client.

Where the designated services refer to 'assisting a person', the designated services are triggered when the professional service provider prepares for, or carries out, transactions for a client, and requires an underlying or proposed transfer or transaction. Barristers' advocacy and litigation work (including through alternative dispute resolution mechanisms), would not be expected to trigger the designated services.

Barristers acting on instructions from a solicitor on behalf of a client are not intended to be captured. In practice, an instructing solicitor retains the barrister on behalf of a client, and the barrister does not have a direct relationship with the client, or a role in the transaction. The Explanatory Memorandum provides examples around activities which would be captured by the planning and execution stages of a transaction (capturing planning activities is important as red flag indicators of suspicious activity may arise during planning stages). In most instances, the department expects these planning and execution activities to be done by a solicitor, not a barrister.

The designated services also provide an carve out for transfers of real estate or body corporates which are pursuant to, or resulting from, an order of a court or tribunal. Court orders would generally flow from barristers' litigation work, and would not be captured by the AML/CTF regime.

[2] Financial Action Task Force, 'Risk-Based Approach Guidance for Legal Professionals' (Paper, June 2019) <https://www.fatf-gafi.org/en/publications/Fatfrecommendations/Rba-legal-professionals.html>

Barristers would need to be mindful of the implications of accepting direct briefing from a client, or be alert to whether their activities go beyond pure advocacy or advisory work. If a barrister chooses to provide designated services, for example, subsequently in relation to any outcomes or decisions from advocacy or litigation work, they would be captured by the AML/CTF regime. This reflects the illicit financing risk of the designated services and the sector.

Lawyers can facilitate money laundering, including unwittingly, through their services. Lawyers provide a range of services that can benefit criminals in the money laundering process, and AUSTRAC's *Money Laundering in Australia National Risk Assessment 2024* noted lawyers pose a high money laundering vulnerability.[3]

Tipping off offence

Some stakeholders have expressed concerns that the repeal of the current exceptions to the tipping off offence may create uncertainty about whether disclosures of Suspicious Matter Reporting (SMR) information or information relating to a notice issued under section 49 of the AML/CTF Act would be permitted in specific circumstances.

The department heard through consultation that the existing tipping off offence in the AML/CTF Act and its exceptions does not strike the right balance between needing to genuinely disclose information to mitigate money laundering and terrorism financing risks without compromising law enforcement investigations. The broad scope of the tipping off offence currently prevents a large range of information sharing for legitimate business purposes, including sharing that would allow reporting entities to effectively identify, mitigate and manage their risks.

The new tipping off offence narrows and focuses on preventing the disclosure of SMR information or information related to a section 49 or 49B notice where it would or could reasonably prejudice an investigation. As a result, the amendments clarify that a reporting entity can disclose certain information for legitimately without the need for explicit exceptions.

The department's view is that re-introducing exceptions to the tipping off offence does not meet the reform's intent to simplify the AML/CTF regime. Adding specific exceptions would cast doubt on the generality of the 'would or could reasonably prejudice an investigation' standard, which could lead to a chilling effect in those circumstances where no specific exception applies which would undermine the intent of the reform. The current reliance on exceptions to the tipping off offence is also time-intensive for industry stakeholders and AUSTRAC.

The Explanatory Memorandum to the Bill sets out a range of disclosures that would not constitute tipping off. AUSTRAC will issue further industry guidance on the tipping off offence and common scenarios that will and will not constitute tipping off.

[3] AUSTRAC, 'Money Laundering in Australia National Risk Assessment 2024' (Report, 9 July 2024), <https://www.austrac.gov.au/business/how-comply-guidance-and-resources/guidance-resources/money-laundering-australia-national-risk-assessment-2024>

Suspicious matter reporting

Some stakeholders have put forward that the suspicious matter reporting obligation is incompatible with other duties of their professions. The department acknowledges that where suspicions arise about a client, the intersection with a legal professional's fiduciary or other duties may be complex, but the responsibilities are not irreconcilable.

The Bill and the AML/CTF Act provide a clear legislative basis for the obligation to report suspicious matters about their client under the AML/CTF regime. This legislative requirement supersedes a fiduciary duty to a client. Exempting legal practitioners from reporting obligations under the AML/CTF regime would not be compliant with the FATF Standards.

In addition, experiences in common law jurisdictions demonstrate that suspicions may more frequently arise in relation to other parties or a counterparty in a matter. In such circumstances, the obligation to report the suspicion would not interact with a legal practitioner's fiduciary duties.

Comparable jurisdictions such as the United Kingdom and New Zealand require lawyers to file reports about suspicious matters to either the financial intelligence unit or relevant regulator.

To further clarify, nothing under the AML/CTF regime obliges a reporting entity to stop providing a service to a customer who is the subject of a suspicious matter report. A reporting entity is required to follow the risk-based policies and controls outlined in its AML/CTF program. Any decision to terminate a business relationship with a customer or client should be tied to a determination of risk based on the reporting entity's AML/CTF program, rather than a suspicious matter reporting obligation.

It is not possible for reporting entities to disclose to a client that they have lodged, or will lodge, a suspicious matter report, or have received a notice for further information. This would be fundamentally incompatible with the objectives of the tipping off offence, and may impact law enforcement investigations.

As above, the Explanatory Memorandum to the Bill already sets out a range of disclosures that would not constitute tipping off—this includes disclosure to a legal or professional regulator.

The timing of a suspicious matter report is critical, as law enforcement relies on this information to track criminals and criminal activity. Where a reporting entity reasonably believes that information contained in a suspicious matter report is subject to legal professional privilege, the Bill already provides that the reporting entity has 5 business days to provide the report. This is an additional 2 days on top of the existing timing requirement. This approach is consistent with comparable international jurisdictions that prescribe a time period for SMRs to be reported in, such as New Zealand.

AUSTRAC are willing to work with industry on fit-for-purpose and tailored guidance that may be required on suspicious matter reporting obligation and tipping off offence.

International Value Transfer Services (IVTS) and travel rule requirements

Criteria for ordering and beneficiary institutions

Stakeholders have submitted to the Committee that the criteria that establishes whether an entity is an ordering or beneficiary institution within a value transfer chain are complex, and may be difficult for reporting entities to interpret. Submissions note that the criteria that determine whether an entity is an ordering or beneficiary institution (at new subsections 63A(1) and (4) of the AML/CTF Act respectively) require additional clarification through the AML/CTF Rules and AUSTRAC guidance.

The department notes that the value transfer provisions of the Bill are necessarily technical due to the constantly developing nature of payments technology and the highly technical nature of the processes involved.

In addition, stakeholders noted they consider the definitions of ordering and beneficiary institutions included in the Bill do not align with the FATF Recommendations, because the FATF Recommendations are tied to the entity that initiates the transfer of value. While the FATF is currently reviewing the relevant FATF Recommendation, it is clear that the FATF contemplates that the ordering institution may not hold the funds to be transferred and, instead, the FATF is focusing its consideration on the institution that accepts the instruction.[4] This is consistent with the approach proposed in the Bill.

Stakeholders may interpret the intent of the reforms as being to artificially force every transfer of value scenario into a single 'value transfer chain', regardless of how complex it is. However, to clarify, the intention (and effect) of the provisions in the Bill would be that a new value transfer chain commences each time a customer instructs an ordering institution. The scenarios outlined in the definitions of 'ordering institution' and 'beneficiary institution' do not alter this basic position but, instead, recognise that in modern payment systems (as well as in alternative remittance arrangements) the ordering institution may not necessarily hold the value to be transferred, nor will the beneficiary institution always make the transferred value directly available to the payee.

The proposed value transfer measures in the Bill reflect extensive consultation undertaken by AUSTRAC with the financial sector before the formal reform consultation processes. These consultations provide a solid foundation for clarifying outstanding issues through AML/CTF Rules and AUSTRAC guidance, which will also be supported by further consultation. Given the diversity of value transfer services available, guidance that includes detailed examples of common value transfer scenarios will be critical for industry and AUSTRAC to have a shared understanding of the framework. However, rules and guidance can only be developed once the fundamental concepts underpinning value transfer regulation are clarified with enactment of the Bill.

Delaying the reforms proposed in the Bill will delay the co-design of a modern approach to regulating value transfers to align with current technologies and payment systems.

[4] Financial Action Task Force, 'Public Consultation on Recommendation 16 on Payment Transparency ' (Consultation Paper, 26 February 2024) <https://www.fatf-gafi.org/en/publications/Fatfrecommendations/R16-public-consultation-Feb24.html>

International Value Transfer Services (IVTS) reporting commencement period

Stakeholders advised that the timing for the new International Value Transfer Services (IVTS) reporting, which are replacing the existing International Funds Transfer Instructions (IFTI) reporting framework, should consider other changes in the payments landscape. This is due to the underlying payments systems and protocols that give effect to IFTI reporting and which can be costly and complex to update.

In considering the timing for the commencement of the new IVTS reporting provisions, the department and AUSTRAC have considered factors that may make it more difficult for reporting entities to comply with the revised provisions, such as updating their software used in this reporting. The department has also discussed with industry and accounted for the decommissioning of the Bulk Electronic Clearing System (BECS), and the transition of financial institutions to the New Payments Platform (NPP) as a result.

While Schedule 8 of the Bill is proposed to commence on 31 March 2026, the commencement for the IVTS provisions in Part 2 of the Schedule will be provided by transitional rules. These rules will maintain the existing framework for IFTI obligations until the new provisions come into force. This is required as the current IFTI provisions are dependent on the current value transfer provisions, which will be repealed to allow implementation of the modernised 'travel rule'. The timing for the commencement of the new IVTS reporting requirements will take into account the decommissioning of the BECS system, so reporting entities do not have to transition their systems multiple times.

Civil penalty issues

Burden of proof

Stakeholders raised concerns about some provisions of the Bill that impose the legal burden of proof on the reporting entity. This includes subsection 26F(12), which imposes a legal burden on a reporting entity seeking to rely upon the exception in subsection 26F(11). Subsection 26F(11) provides that a reporting entity does not have to develop policies in relation to proliferation financing if it assesses that the risk is low. Stakeholders considered requiring reporting entities to bear the legal burden of proof is too high a standard.

The department considers that it is reasonable that the reporting entity bear the legal burden of proof in the above, and other similar scenarios where reporting entities are relying on defences or exemptions. The information to give effect to these defences or exemptions will be particularly in the knowledge of the reporting entity, and it would be extremely difficult and overly burdensome for AUSTRAC to prove the matters in question.

Ongoing civil penalties

Submissions to the Committee also noted reporting entities should not be exposed to ongoing civil penalties once non-compliance with relevant sections of the AML/CTF have been rectified.

It is not the department's intent for civil penalties to continue to apply to reporting entities once the contravention has been remediated. The Federal Court determines the pecuniary penalty that would apply for a contravention of a civil penalty provision. The AML/CTF Act sets out that the Federal Court must have regard to all relevant matters, including the nature and extent of the contravention, and the circumstances in which the contravention took place.

Australia's risk of FATF grey-listing

In preparation for the next round of FATF Mutual Evaluations, changes will be made to the process by which countries can be referred to the grey-list. These have become more stringent to reflect the FATF's expectations that countries' technical compliance and the effectiveness of their frameworks have improved following their last Mutual Evaluation.

There are two pathways to grey listing. One based on Mutual Evaluation results and the other based on a nomination at any time due to long standing deficiencies that signify a lack of political commitment and/or risks to the global financial system.

The most significant change is that countries will be set a Key Recommended Actions Roadmap following their Mutual Evaluation, covering the most strategic recommended actions for the country to address. Compliant regulation of the legal profession, including for the purposes of reporting SMRs, will almost certainly be included in Australia's KRA Roadmap if not achieved prior to the Mutual Evaluation.

As a basic condition of membership, countries will be expected to have fully or largely addressed all KRAs in their Roadmap within 3 years. Failure to do so will open up an escalating list of consequences, including suspension of membership and nomination to the grey-list.

In addition to the Mutual Evaluation process, a direct nomination can take place. Regulation of tranche two entities has been required since 2003, over 20 years ago. Australia's 2005 and 2015 Mutual Evaluation identified the lack of regulation of tranche two entities as deficiencies, and the FATF has stated that jurisdictions without regulation in place "have unacceptably high exposure to the risk that these sectors could be misused (…)".[5]

A prolonged lack of action puts Australia at significant risk of direct nomination. As a result, it is critical that Australia address the areas of deficiency identified in the 2015 Mutual Evaluation to the greatest extent possible in order to avoid the serious consequences associated with potential grey-listing.

The FATF continues to highlight non-compliance with tranche two regulation, and has repeatedly urged Australia and other countries to take action. A report published by the FATF in July 2024 highlighted Australia as 0 per cent compliant with requirements to regulate tranche two professions, against an average of 74 per cent compliance for all FATF members.[6]

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[5] Financial Action Task Force, 'Horizontal Review of Gatekeepers' Technical Compliance Related to Corruption' (Report, 8 July 2024) <https://www.fatf-gafi.org/en/publications/Fatfgeneral/Gatekeeper-TC-Corruption.html>
[6] Ibid.