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13 October 2024
Committee Secretary
Senate Legal and Constitutional Affairs Committee
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Secretary,

Anti-Money Laundering and Counter-Terrorism Financing Amendment Bill 2024

Thank you for this opportunity to make a submission on the Anti-Money Laundering and Counter-Terrorism Financing Amendment Bill 2024.

I am a financial crime scholar who has researched and advised on money laundering laws in a range of countries since 1994.

I confine my brief submission to three matters:

1 Concern about FATF greylisting if the Bill is not adopted
2 An evidence-based approach to the problem
3 Proliferation financing obligations: Conditions for successful implementation

1 Concern about FATF greylisting if the Bill is not adopted

Concerns have been expressed that a failure to adopt the Bill in its current form may lead to Australia being greylisted by the Financial Action Task Force (FATF). The FATF is an intergovernmental group that sets and oversees the quality of implementation of global anti-money laundering and financing of terrorism and proliferation (AML/CTF/CPF) standards.

Australia is a member of the FATF. FATF members are the leading economies globally and regionally and its decisions are taken by consensus. The Australian government has therefore been an active and committed participant in the drafting and adoption of all of the FATF standards, including those this Bill is seeking to implement.

The FATF assesses compliance by its members with its standards. Working with FATF-style regional bodies (FSRBs) similar compliance assessments are also undertaken of non-FATF members. All assessments are done applying a standard mutual evaluation methodology to determine a country's technical compliance levels as well as the effectiveness of the measures it implemented. If a country is assessed as having strategic deficiencies and an action plan to address them it may be listed by the FATF on its list of Jurisdictions Under Increased Monitoring (informally known as its grey list).

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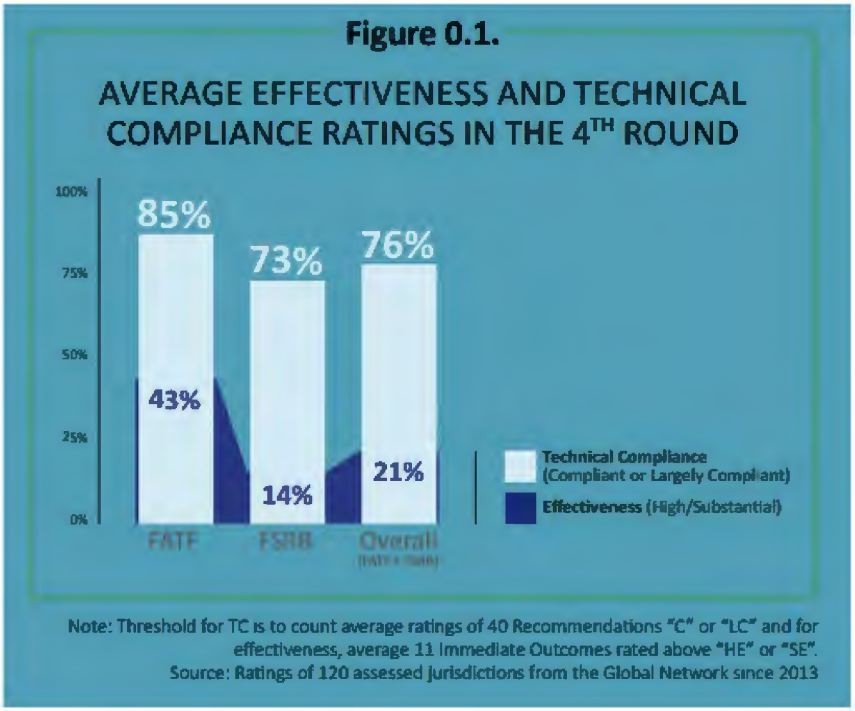
In a study published open access in 2023, Nicholas Morris, John Howell and I analysed economic data regarding greylisting.[1] We identified significant correlations between a number of financial variables and FATF listing events. Countries, especially developing countries, have reason to be concerned about the risk of greylisting. Currently more than half of the greylisted countries are from Sub-Saharan Africa.

It is worrying that there are government concerns that Australia may be greylisted if the current Bill is not adopted. The global community is still working towards compliance with the FATF standards and no country has yet been assessed as fully compliant. FATF's 2022 review of global compliance levels, based on outcomes of the current round of evaluations at that time, reflected the following compliance levels of FATF members, compared to FSRB members:[2]



FATF members were therefore generally at an 85% technical compliance level but the effectiveness of their technical rules and AML/CTF/CPF system was rated at 43%. FSRB members on the other hand were at a 73% technical compliance level but their effectiveness level was rated at 14%. Additional standards were added in the past few years and the technical compliance levels may in practice now be lower than in 2022. Much more work therefore remains to be done to improve compliance levels globally.

[1] De Koker, Howell, Morris, Economic Consequences of Greylisting by the Financial Action Task Force. *Risks* 2023, *11*, 81.
[2] FATF, Report on the State of Effectiveness Compliance with FATF Standards (2022).

Importantly, there are very specific compliance triggers that need to be present before a country may be considered for greylisting due to compliance inadequacies. It must have achieved poor results on its mutual evaluation and, specifically:[3]

- it must have 20 or more non-Compliant (NC) or Partially Compliance (PC) ratings for technical compliance; or
- it must be rated NC/PC on 3 or more of the following Recommendations: 3, 5, 6, 10, 11, and 20; or
- it must have a low or moderate level of effectiveness for 9 or more of the 11 Immediate Outcomes, with a minimum of two lows; or
- it must has a low level of effectiveness for 6 or more of the 11 Immediate Outcomes.

Greylisting is typically associated with numerous compliance deficiencies. Concerns that Australia may be greylisted if it fails to adopt the Bill in its current form may point to additional deficiencies in the current system. If the Bill is adopted, it would raise Australia's technical compliance level but effective implementation is unlikely to have been achieved by December 2026 when Australia is slated to for its next onsite visit by FATF assessors.

It is submitted that the Committee should request the government to provide it with a brief technical analysis:

- **of the mutual evaluation methodology to be applied in the next round of evaluations; and**
- **the likelihood of that methodology resulting in findings in relation to Australia that would put it at risk of meeting of greylisting if the Bill is not adopted in its current form.**

2 An evidence-based approach to the problem

The businesses and professions that will be included in the AML/CTF/CPF scope (remaining components of the designated non-financial businesses and professions (DNFBPs) that were not included in Tranche 1) if this Bill is adopted, were first included in the FATF standards in 2003. At that stage their inclusion was not the result of comprehensive global studies of the costs and benefits of extending AML/CTF/CPF obligations to these entities. It was by and large part of the knee-jerk response to the 9/11 attacks and heightened global security concerns at that time.

It is not clear how successful or effective this approach has been. Globally DNFBP compliance levels are limited by their capacity. DNFPB supervisors have also not been particularly effective. We know from FATF's 2022 compliance study referenced earlier, that DNFBP supervision lags well behind the financial supervision in technical compliance as well as effectiveness. For FATF

[3] FATF, High-Risk and Other Monitored Jurisdictions (2024).

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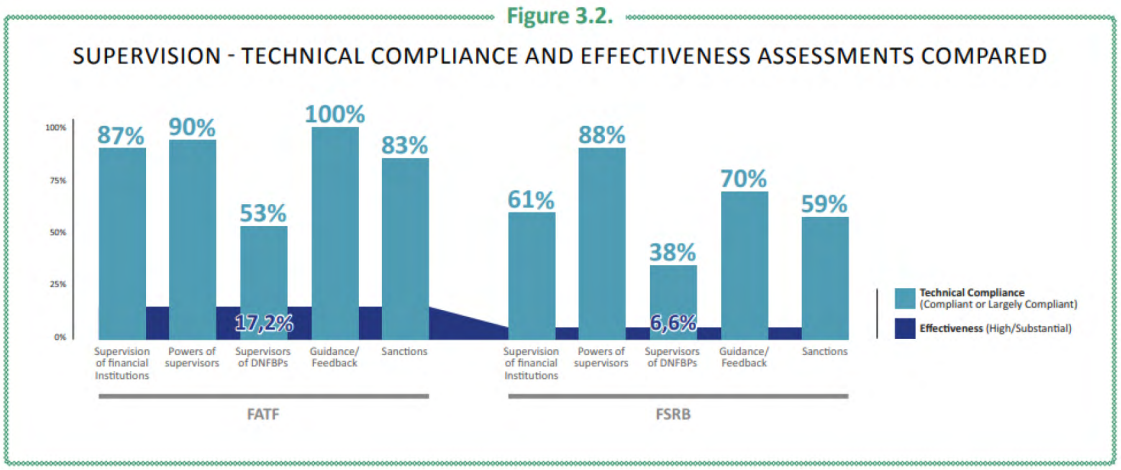
members DNFBP technical compliance levels for supervision was assessed at 53% and effectiveness at 17,2 %. For FSRB members it was 38% and 6,6% respectively:



Source: 120 assessed Global Network countries since 2013 (Recommendations 26,27,28,34 and 35 from left to right; Effectiveness for IO-3)

While their inclusion in 2003 was viewed as good by the FATF members we have now had the benefit of two decades of experience of DNFPB inclusion. In 2012 FATF embedded a mandatory risk-based approach relating to key elements of its standards. Would we be better off including only higher risk DNFBPs in the FATF framework? What has been the proven benefits of a blanket inclusion in our counterparts? Are money laundering, terrorist financing and proliferation risks lower in countries that extended these obligations to all real estate agents? Are smaller DNFBPs undertaking appropriate risk assessments and implementing the correct risk mitigation measures effectively? How many more investments of proceeds of crime were prevented in these countries that slipped past their financial institutions but were effectively identified and prevented by an estate agent?

Has the government determined the crime combating value of a blanket inclusion of all individuals and entities in each of the DNFBP categories by studying the experiences in its counterparts that were early implementers of the FATF's DNFBP standards?

It is submitted that the Committee should request copies of comparative studies done by the government on international experiences of benefits to date of extending AML/CTF/CPF obligations to all DNFBPs and request the government to advise why a risk-based approach focused on the inclusion of higher risk DNFBPs would be inappropriate globally and in Australia.

3 Proliferation financing obligations: Conditions for successful implementation

3.1 Measures and scope

Effective measures to prevent the proliferation of weapons of mass destruction are of key importance to national and global security. I whole-heartedly support the application of financial

integrity measures to bolster non-proliferation measures but also believe that obligations should be realistic and that implementation should be appropriately supported by government.

In 2020 the Australian government agreed with the other FATF members to impose proliferation financing risk assessment obligations on all AML/CTF/CPF-regulated institutions. I organised a number of international discussions to consider the impact of the measures and lobbied the FATF to consider be more sensitive to the capacity constraints of small AML/CTF/CPF-regulated entities.[4] As a result, they introduced an exception that allows governments to exempt institutions and sectors assessed as low risk from the risk assessment obligations:[5]

> "Countries may decide to exempt a particular type[6] of financial institution or DNFBP from the requirements to identify, assess, monitor, manage and mitigate proliferation financing risks, provided there is a proven low risk of proliferation financing relating to such financial institutions or DNFBPs. However, full implementation of the targeted financial sanctions as required by Recommendation 7 is mandatory in all cases."

I note that the Bill allows for an exception that is narrower than the exemption allowed by the FATF standards. It is proposed that section 26F (*Reporting entities must develop and maintain AML/CTF 19 policies*) will have the following exception in subsection 11:[7]

> "Despite subsection (1), a reporting entity is not required to develop or maintain policies, procedures, systems and controls that specifically deal with the risk of proliferation financing if:
>
> (a) the reporting entity reasonably assesses, under section 26C or 13 26D, the risk of proliferation financing that the reporting entity may reasonably face as low; and
>
> (b) the reporting entity reasonably assesses that its risk of proliferation financing can be appropriately managed and mitigated by its policies, procedures, systems and controls that manage and mitigate the risks of money laundering or financing of terrorism."

The FATF therefore allows the government to perform a risk assessment and to exclude entities at low risk from the risk assessment obligations, while ensuring that they continue name screening and other measures to comply with UNSC sanctions obligations. The government on the other hand proposes to impose this obligation on all reporting entities. Only when a reporting entity reasonably assesses its risk as low and appropriately mitigated will it be exempted from the requirement to take additional proliferation financing risk mitigation steps.

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[4] De Koker, FATF Submission - Financial Action Task Force Standards and Financial Inclusion: What Should Be Done – and What Should Not Be Done – to Improve the Alignment Between Integrity and Inclusion Policy Objectives? (2020).
[5] FATF, International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation (2012-23) n 3.
[6] Note that the FATF does not define "type" and countries may therefore interpret this broadly, for example distinguishing between lawyers specialising in family law and lawyers specialising in commercial law and trade.
[7] Note that in terms of subsection 12 a person who wishes to rely on subsection (11) bears a legal burden in relation to that matter.

Australia's national proliferation financing risk assessment published in 2022[8] discusses finanica institution and DNFBP risks in very generally terms and did not report on the risks of all the different types of institutions, businesses and professions in each sector, for example the different types of real estate agents, lawyers and law firms in urban and regional areas and their likely exposure to proliferations risks given the work they do. Where the assessment touched on DNFBP risk, the risk factors were mainly linked to the lack of AML/CTF/CPF regulation. Once that is addressed by this Bill, those risk considerations will need to be revisited.

It is possible however that a deeper and more comprehensive analysis of risks of different types and forms of institutions and DNFBP risk was as undertaken than published in the national risk assessment.

It is submitted that the Committee should request information to understand why the government decided not to use the leeway provided by the FATF standards:

- **Did AUSTRAC's national proliferation financing risk assessment exercise assess the risks of a range of different types of financial institutions and DNFBPs? If so, can they share their DNFBP risk assessment with the Committee?**
- **Was AUSTRAC able to identify any type (however defined) of reporting entity that could benefit from the FATF exemption? If AUSTRAC did consider that question and was unable to identify any such type of reporting entity, what is the likelihood of a significant number of reporting entities reasonably benefiting from the exception in subsection (11)?**

3.2 Definition of proliferation

The FATF's proliferation financing standards support the targeted financial sanctions of the United Nations. The definition in the Bill is arguably broader. I support a broader definition as it would provide better support for Australia's non proliferation policies and laws. Unfortunately the proposed definition is not currently clear as it depends on the publication of regulations and it is not yet certain what those regulations will prescribe. For example, the proposed section 5(d)(ii) of the definition of proliferation financing refers to the contravention of certain laws of the Commonwealth that will be "prescribed by the regulations for the purposes of this paragraph." It is not clear which laws the government currently intends to prescribe in these regulations.

The Committee should call for more information on the contents of the regulations that will determine the scope of key terms such as proliferation financing.

3.3 Proliferation financing risk assessments

The Bill envisages that reporting institutions will undertake proliferation financing risk assessments.

[8] AUSTRAC, Proliferation Financing in Australia: National Risk Assessment (2022).

Proliferation financing risk assessments are unfortunately very challenging to undertake appropriately as regulated entities require a measure of expertise and capacity to undertake appropriate risk assessments.

I studied private sector challenges relating to proliferation financing control and published my findings earlier this year.[9] I conducted interviews with proliferation experts and private sector representatives globally and identified a range of challenge faced by banks. The challenges can be clustered in the following groups:

- navigating different country definitions of proliferation financing;
- assessing and mitigating proliferation financing risk with limited information about the relevant threats and with a limited geopolitical and geo-economic capacity to identify and mitigate threats;
- monitoring trade-related transactions effectively to prevent proliferation financing while having limited or no information about the goods involved;
- efficiently and effectively combating PF-TFS without being allowed to simplify compliance measures where risks are lower, and
- a lack of considered policy about the purpose and strategic objectives of the new measures to be implemented.

Where well-resourced global banks face information and capacity challenges smaller Australian reporting entities will encounter major hurdles.

I was also interested in understanding what governments can do to support the appropriate implementation of the risk assessment obligations and concluded that the following would be helpful:

- adopting a meaningful definition of proliferation financing that fits with the country's general proliferation policy;
- implementing a phased approach that first focuses on a select group of higher risk institutions with capacity;
- embracing a collaborative approach bringing that select group together with the range of government authorities that address aspects of proliferation financing to explore best practice approaches to supporting effective and efficient compliance;
- making appropriate use of the FATF's low risk exemption to exclude low risk institutions from proliferation financing risk management obligations;
- facilitating PF-TFS compliance by supporting sectoral risk assessments and the development of appropriate compliance technologies;
- tailoring compliance expectations given the limited information that institutions may have; and

[9] De Koker, The FATF's Combating of Financing of Proliferation Standards: Private Sector Implementation Challenges. In: Goldbarsht, D., de Koker, L. (eds) Financial Crime and the Law. Ius Gentium: Comparative Perspectives on Law and Justice, vol 115. Springer, Cham (2024). https://doi.org/10.1007/978-3-031-59543-1_6.

- monitoring implementation for intended and unintended consequences and reporting on impact and progress.

It is submitted that the Committee should request more information on the government's implementation strategy and the extent to which it will support reporting entities, for example by:

- **implementing a phased approach focused initially on higher risk institutions with sufficient compliance resources and capacity to develop appropriate proliferation risk assessment and mitigation measures for Australia, and to use that to guide assessments by institutions with lower capacity; and**
- **supporting sectoral assessments that reporting entities in that sector can use as templates and the development of appropriate compliance technologies that small reporting entities can use for free.**

It would also be important to understand how positive and negative impact of the new measures will be tracked and assessed and reported on.

Yours sincerely,

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