SUBMISSION TO SENATE LEGAL AND CONSTITUTIONAL AFFAIRS COMMITTEE

Submission on AML/CTF Bill 2006

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1 SUBMISSION – TIPPING OFF

It is submitted that Section 123, the tipping off provision, should be amended so that it is limited in scope to prohibiting disclosure of:

- The fact a suspicious activity report has been made; and
- The contents of the report itself.

The section should be amended to ensure that the prohibition on disclosure is not capable of being interpreted to extend to:

- The suspicion that triggered the reporting obligation; and
- The business records and source information on which the suspicion is based.

The section should be amended as suggested because:

- Prohibiting disclosure of the suspicion and underlying business records is not required by FATF Recommendation 14 and prohibiting disclosure of the report is all that is required for Australia to achieve a rating of full compliance with the recommendation;
- A practical consequence of prohibiting disclosure of the suspicion and underlying business records will be that the rights of innocent third parties are prejudiced; and
- The UK case law on the equivalent to Section 123 in that jurisdiction shows that tipping off provisions, if drawn too widely, can have far reaching consequences that alter some of the fundamental assumptions on which our legal system is based.

It is submitted that Sub-sections 123 (2) and (3) (b) are likely to be interpreted to prohibit the disclosure of the relevant suspicion and supporting information and are not required for Australia to comply with FATF Recommendation 14. The Bill should be amended to delete those provisions.

2 SUBMISSION – SUPPORTING REASONS

2.1 Introduction

This submission relates to the *Anti-Money Laundering and Counter-Terrorism Financing Bill 2006* (the Bill). Infosys has previously made submissions to the Attorney-General's Department in response to the draft and revised draft Bills released in December 2005 and July 2006 respectively. The previous submissions deal with a range of issues in the previous drafts, many of which have been addressed by the Bill. This current submission, however, focuses on only one provision of particular importance, the 'tipping off' provision.

Infosys provides technology and business process consulting and re-engineering services to the financial services sector. Business processes that will need to be engineered or re-engineered in response to passing of the Bill include those relating to suspicious matters reporting and customer due diligence. Section 123 creates a new offence of 'tipping off'. The business processes mentioned will need to be designed in such a way as to minimise the risk of financial institutions breaching this new section. Practical issues that will need to be addressed in designing these processes will include:

- The need for some of the processes to be designed for call centre and other customer-facing staff who are not lawyers;
- The extent to which and method by which customer-facing staff are quarantined from details of suspicious matter reports so as to mitigate the risk of disclosure;
- Balancing the previous point against the need for customer-facing staff to be aware of a particular customer as having been flagged as suspicious to allow them to be an effective element in the enhanced due diligence strategy;
- Appropriate responses to requests by customers for information (e.g., "What is my risk rating? Why is my funds transfer being delayed? Why are you asking me additional questions about beneficial ownership?"); and
- How financial institutions should act when facts giving rise to a reporting obligation also give rise to other obligations (e.g., "I believe the person operating an account is not the person they claim to be; can I stop the account without tipping them off?").

2.2 FATF Recommendation 14

The justification for the Bill is that it will bring Australia into line with the international standards in relation to anti-money laundering and counter-terrorism financing (AML/CTF) set by the Financial Action Task Force (FATF).[1] These standards, expressed

[1] See, for instance, second reading speech for the Bill, *Hansard*, 1 Nov. 2006.

in the FATF 40+9 recommendations, strike a balance between the need for regulation to combat criminal activity and ensuring that this does not unnecessarily burden a country's financial efficiency. The goal is global consistency to remove competitive disadvantage caused by some countries implementing more onerous AML/CTF regimes than others.

Tipping off is specifically covered in FATF Recommendation 14, which reads:

Recommendation 14

Financial institutions, their directors, officers and employees should be:

a) Protected by legal provisions from criminal and civil liability for breach of any restriction on disclosure of information imposed by contract or by any legislative, regulatory or administrative provision, if they report their suspicions in good faith to the FIU, even if they did not know precisely what the underlying criminal activity was, and regardless of whether illegal activity actually occurred.

b) Prohibited by law from disclosing the fact that a suspicious transaction report (STR) or related information is being reported to the FIU.

There is an interpretive note on this recommendation as follows:

Interpretative Note to Recommendation 14 (tipping off)

Where lawyers, notaries, other independent legal professionals and accountants acting as independent legal professionals seek to dissuade a client from engaging in illegal activity, this does not amount to tipping off.

It is submitted that the recommendation to criminalise disclosure is limited to the disclosure of the report itself and the contents of the report. Nothing in the recommendation would require legislation that criminalises:

- Disclosure of the business records and facts that form the basis of the report; or
- Disclosure of the suspicion (i.e., subjective opinion or belief) that gives rise to the filing of the report.

2.3 Current Section 123

Section 123 of the Bill creates the new tipping off offence, with the prohibited conduct being defined in Sub-sections (1) to (3).

Sub-section (1) covers the s41 report itself while Sub-section (2) deals with the suspicion that gives rise to the reporting obligation. Sub-section (3) covers s49, which provides a mechanism for AUSTRAC to seek additional information in relation to an s41 report.

The expansion of the offence beyond the report to the underlying suspicion and information from which the suspicion can be inferred are understandable from the perspective of ensuring a tightly drawn offence provision. However, this is only one

matter to consider in drafting this provision. Another important policy objective is that the provision should not unnecessarily or unfairly prejudice the rights of innocent third parties. It is submitted that the legislation as presently drawn does not strike the appropriate balance.

For instance, consider the following hypothetical set of facts. A bank operates a trust account for a sole legal practitioner. The practitioner's relationship manager becomes aware that funds are being drawn from the trust account in suspiciously large round-dollar amounts that may not be supported by client instructions. The relationship manager informs the bank's legal department and the case is identified as one for which an s41 notice needs to be filed. The bank has received a very large round-dollar-amount cheque for payment that will exhaust most of the balance of the funds in the account.

Ideally, AUSTRAC and law enforcement would be contacted by the bank at this point. This would, however, be subject to AUSTRAC and other agencies resourcing and priorities. The bank might be advised to take one of the following steps in addition:

- Contact the relevant professional standards body directly;
- Seek additional information from the practitioner to confirm authority for the withdrawal;
- Contact the beneficial owner of the funds for confirmation that the withdrawal is authorised;
- Stop the account if, for instance, the beneficial owner has given the bank notice that the withdrawal is in fact not authorised or the bank is aware that such authority is not possible, for instance where the funds are held on behalf of an infant; or
- File urgent proceedings in court, where two parties are in dispute, seeking a declaration.

Any of the above actions may amount to tipping off under Section 123 as presently drawn. To take the hypothetical case a step further, what is the position if the bank, after consulting with AUSTRAC, does not honour the cheque for fear it may be exposed to suit by the beneficial owner of the funds, but it subsequently turns out the cheque was legitimate? If the bank had sought further information either from the lawyer or the client, the matter may have been capable of quick resolution. Arguably, refusing to pay is not a thing done in 'purported fulfilment of a requirement under this Act' and so the good faith protection in s235 would not be available. In that case, the bank would probably bear any loss flowing from its breach of contract in failing to honour the cheque.

A reporting entity, such as a bank, could protect itself from action, at least from its customer, by including an appropriate term in its customer agreement. However, it is submitted that this would also result in an undesirable outcome. It simply shifts the loss to another innocent party who will not be entitled to receive any notice of the suspicion or opportunity to explain the true circumstances.

2.4 Consequences upon Breach

The penalty for breach of Section 123 is imprisonment for 2 years or 120 penalty units or both, and breach could also lead to AUSTRAC exercising other powers with significant financial consequences, such as the power to give remedial directions[2]. As with other aspects of the Bill, a failure to comply could also result in reputational damage, or in the case of a lawyer or other professional, loss of entitlement to practice.

In summary, the negative consequences to a reporting entity and its officers as result of breach of Section 123 are considerable.

2.5 Exemptions

Broadly speaking, exemptions in Section 123 itself fall into these categories:

- Disclosure by a legal practitioner or a qualified accountant for the purpose of dissuading a client from evading tax or committing an offence;
- Disclosure to a legal practitioner for the purpose of seeking advice;
- Disclosure relating to Part 4 of the *Charter of the United Nations Act 1945* (i.e., the enforcement of UN Security Council sanctions);
- Disclosure to other members of a designated business group;
- Disclosure to owner managed branches; and
- Disclosure under compulsion of law.

In addition, the general defence provisions of acting in good faith (s235) and having taken reasonable precautions (s236) may be applicable on a case-by-case basis.

While one or more of these defences may arguably be available in a given situation, the serious consequences that flow from breach will largely dictate both the processes adopted within a regulated entity to follow when a suspicion arises and its likely response to any given case. With the threat of criminal conviction and custodial sentences for regulated entity officers, the processes are likely to be on the conservative side, potentially to the prejudice of third parties and the financial institution itself.

2.6 Overseas Experience – UK

There is an equivalent provision in the UK *Proceeds of Crime Act 2002*, s333. In that jurisdiction, the process is a little different. Where a suspicion arises that a transaction will involve dealing in proceeds of crime, a reporting entity is required to obtain consent from the UK Financial Intelligence Unit (FIU) before processing the transaction. The tipping off offence relates to any disclosure that may prejudice a consequent investigation – hence it is not limited to the report itself.

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[2] s191

The sort of practical issues that can arise are illustrated by Sqirrell Ltd v. Natwest [2006] 1 WLR 637. In that case, Natwest filed a suspicious activity report (based on possible tax evasion,) then froze its customer's account pending consent from the FIU. To its customer, the bank provided no reasons for freezing the account although the customer sought them from its relationship manager. The customer commenced legal action to unfreeze the account and was represented by a director. He indicated that, with its funds frozen, the company did not possess the capacity to engage lawyers. In that case, the bank was found to have acted properly and the account remained frozen. It should be emphasised that this would have been the result whether or not:

- The suspicion was well founded; and
- The extent of the suspect criminal conduct actually justified freezing the entire business operations of the company.

Likewise, the Australian 'tipping off' provision, if it extends to the suspicion and supporting facts, would prevent any inquiry into these matters.

As noted above, the UK regime differs from the Australian in that the UK approach to proceeds of crime is to report, freeze and await consent. Under the Australian Bill, s51 will continue the current regime of report and continue to deal with the customer. However, s51 only excuses reporting entities from breach of Division 400 of the Criminal Code. The reporting entity may be under other legal obligations to freeze an account, such as where it suspects terrorism, or where there are civil consequences of a criminal action. In those situations, the reporting entity will be in the same difficult position as financial institutions in the UK, or arguably in a worse position as there is no express statutory authority to freeze or consent mechanism to unfreeze in a set time frame in the Australian Bill.

A UK example of this sort of situation was Bank of Scotland v A Ltd [2001] 1 WLR 751. In that case, a bank sought declarations after discovering a customer was being investigated for money laundering. The bank argued that if it was to pay monies out of its customer's accounts, it risked being liable to third parties as a constructive trustee. If it refused to pay monies from those accounts, it might be required to give reasons for not making funds available and hence run the risk of 'tipping off'[3]. In Australia, the Section 123 offence is not limited to disclosure that could prejudice subsequent investigations, so an application to the court of this nature could amount to a prohibited disclosure and would probably not be possible.

A reputable UK text dealing with tipping off[4] notes the difficulties that can arise, particularly where the customer is dealing with call centre staff, and recommends that a financial institution formalise a set of 'excuses' for transactions not proceeding. This

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[3] See note in *JIBLR* 2004 19(8): 284-288.

[4] *Money Laundering: Business Compliance*, Beasley & Foster, Lexis Nexis, 2004, paras. 7.17 to 7.23.

might be regarded as an institutionalised form of misleading customers and in Australia would offend trade practices legislation.

The text also notes the difficulties that can arise where the customer makes a complaint to the relevant Ombudsman.

It is submitted that the UK difficulties can be avoided if Section 123 is limited to prohibiting disclosure of the fact of a report being filed and does not extend to the suspicion or the information on which it was based. This leaves existing rights and obligations intact, but complies with the FATF Recommendation 14.

2.7 Overseas Experience – US

In the US, there is a disclosure prohibition but it is limited in scope. It only extends to disclosure of the fact of filing a suspicious activity report and only to persons involved in the transaction. The Mutual evaluation of the US by FATF undertaken this year states in relation to tipping off:

This prohibition does not preclude disclosure of business records that are the basis of the SAR, as long as the disclosure does not state or imply that a SAR has been filed on the underlying information[5].

That evaluation rated the US as fully compliant with recommendation 14[6]. This was partly on the basis that although the legislative provision is limited, the regulator applies a more stringent regime as a matter of standards (without criminal consequences if it is not supported by statute). This is discussed in the following passage of the evaluation:

The statute and the implementing regulations state clearly that the prohibition on disclosure applies only with respect to any person involved in the transaction. However, FinCEN holds that it interprets the requirement much more tightly than the statutory language[7].

AUSTRAC publishing a policy or guideline that does not attract criminal sanctions would be another potential solution to the practical issues created by enacting Section 123 in its present form. It is submitted that the US limitation of the prohibition to the fact of the SAR itself being filed is a sensible and practical approach.

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[5] *FATF Mutual Evaluation Report of US*, 23 June 2006 - para. 652.

[6] Page 152.

[7] Para. 653.

3 BACKGROUND ON SUBMITTER AND AUTHOR

Infosys Australia is a wholly owned subsidiary of Infosys Technologies, a NASDAQ-listed company with annual revenue of more than US$2 billion.

Infosys Australia is a leading provider of business-driven technology solutions for the enterprise. We work with our clients in the spirit of partnership to assist them to gain competitive advantage, achieve future growth and increase profitability. We deliver world-class solutions cost effectively, predictably and in the shortest possible time, using outstanding local talent backed by vast global capability, in-depth industry knowledge and technical excellence.

For any questions in relation to this submission, please contact the author, Victor Bennetts (victor_bennetts@infosys.com).

Please note: this document is produced solely as a submission to the Senate Inquiry into the Bill and should not be relied on for any other purpose.