Law Council

OF AUSTRALIA

ANTI-MONEY LAUNDERING GUIDE FOR LEGAL PRACTITIONERS

DECEMBER 2009

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Abbreviations used in this document

AML/CTF	Anti-money laundering / counter-terrorism financing
AMLCO	Anti-money laundering compliance officer
AUSTRAC	Australian Transaction Reports and Analysis Centre
CDD	Client (or customer) due diligence ***Note:*** *When this Guide refers to AML/CTF obligations applying to financial institutions and Non-Financial Businesses and Professions it uses the term "**Customer**". When this Guide refers to AML/CTF obligations applying to legal practitioners it uses the term "**Client**".*
FATF	Financial Action Task Force
RBA	Risk based approach

Executive Summary

The Federal Government is currently engaged in reforming Australia's anti-money laundering and counter-terrorism financing (AML/CTF) regime. The aim of the reforms is to bring Australia into compliance with the standards published by the Financial Action Task Force (FATF), an international inter-governmental body that develops and monitors policies to combat money laundering and terrorist financing.

The *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) (the AML/CTF Act) represents Tranche One of the reforms and is aimed at the financial sector, the gambling sector and bullion dealers. The second tranche of reforms will focus on certain professions, including legal practitioners. Consultation on tranche two reforms is expected to resume in late 2009 or early 2010.

Tranche Two legislation is likely to implement the FATF recommendations, or at least a substantial part of them, and be comparable to compliance regimes in other jurisdictions. Compliance by legal practices and practitioners may involve:

- A risk based approach to AML/CTF;
- Initial client identification and ongoing client due diligence;
- Record keeping;
- Auditing;
- Employee training programs;
- The nomination of an anti-money laundering compliance officer (AMLCO); and
- Suspicious matter reporting.

Research from other jurisdictions suggests that such a regime will place a significant compliance burden on legal practitioners.

The introduction of the new AML/CTF regime will mean that practitioners could be at risk of criminal proceedings, civil proceedings, disciplinary action by relevant professional bodies and potential civil proceedings brought by clients or others. Some offences may carry custodial sentences and AML/CTF legislation in other jurisdictions has led to the imprisonment of legal practitioners for failing to disclose AML/CTF suspicions. Civil penalty provisions also exist with respect to detailed compliance issues.

A major issue for the legal profession is how any AML/CTF reporting obligations impact on client confidentiality and legal professional privilege.

Section 242 of the current legislation states that the AML/CTF Act does not affect the law relating to legal professional privilege, suggesting that a legal practitioner may not be compelled to make reports that are based on information subject to legal professional privilege. Legal professional privilege, however, has a narrower application than client confidentiality and may not be as wide as many legal practitioners assume. The rules on client confidentiality may not, therefore, exempt practitioners from AML/CTF reporting obligations and practitioners will need to develop a good understanding of when information was provided in privileged circumstances, and when legal professional privilege applies.

Another issue for the profession is who will regulate AML/CTF obligations for legal practitioners. The principal AML/CTF regulator under the existing legislation is the Australian Transaction Reports and Analysis Centre (AUSTRAC). Legal professional bodies are currently neither pursuing nor expecting any additional AML/CTF regulatory role, and there are no plans to take an intermediary role in suspicious transaction reporting.

Legal practitioners can anticipate and take steps to meet their AML/CTF obligations by recognising money laundering warning signs and adopting sound risk management strategies.

The Law Council has been actively engaged with the Government in representing the interests of the legal profession in relation to Tranches One and Two of the AML/CTF legislation and will continue to do so vigorously.

The Law Council will also continue working with its Constituent Bodies to provide up to date information to legal practitioners in relation to AML/CTF obligations and issues.

Introduction

> "It is estimated that up to $4.5 billion is involved in money laundering in Australia every year."

This particularly concerning statement starts the Commonwealth Attorney-General's Department's factsheet on why anti-money laundering and counter-terrorism financing (AML/CTF) reforms are required in Australia and regardless of whether the figures quoted are accurate or not, a new AML/CTF system is being progressively rolled out in this country.

The Government rationale for the new regulation is succinctly stated on the Commonwealth Attorney-General's Department's anti-money laundering customer website:[1]

> **Why has new legislation been introduced?**
>
> The new laws were introduced to:
>
> - Bring Australia's AML/CTF system into line with international standards,
> - Reduce the risk of Australian businesses being misused for the purposes of money laundering or terrorism financing, and
> - Meet the needs of law enforcement agencies for targeted information about possible criminal activity and terrorism.

Existing Legal Framework

Tranche One of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth)

In Australia the original system implemented to monitor the flows of money in business and consumer transactions was the *Financial Transaction Reports Act 1988* (Cth). It relied on the reporting of transactions over threshold amounts and came at a time when banking and financial transactions were significantly different to those of today's interconnected global financial system.

To address concerns about money laundering in 1989 several nations formed the Financial Action Task Force (FATF), now comprising 34 members, who agreed *Forty Recommendations on Anti-Money Laundering and Nine Special Recommendations on Counter-Terrorist Financing*.[2] In 2003 lawyers were included within FATF's designation of 'Non Financial Businesses and Professions' which is the focus of recommendations relating to:

- Customer due diligence and record-keeping; and
- Reporting of suspicious transactions and compliance.

A 2005 review by FATF of Australia's implementation of these recommendations found that the Australian systems were well behind best practice.

The response by the Australian Government was the release of the *Anti-Money Laundering and Counter-Terrorism Financing Bill* in December 2005 for consultation which became an Act (the AML/CTF Act) on 12 December 2006.

The reforms implemented were designed to be rolled out in various tranches with the first directed toward the financial sector, gambling sector, bullion dealers and businesses that provide particular 'designated services'. The Commonwealth Agency, the Australian Transactions Reports and Analysis Centre (AUSTRAC), which had responsibility for administering the *Financial Transaction Reports Act 1988,* was to be the regulator for the new obligations under the AML/CTF Act.

1 At www.ag.gov.au/aml.

2 The recommendations are available at www.fatf-gafi.org.

The implementation of these first tranche obligations has been staged:

- Some record-keeping obligations started on 12 June 2007 and others started on 12 December 2007;
- Customer identification and verification of identity obligations started on 12 December 2007;
- Establishing and maintaining AML/CTF program obligations started on 12 December 2007; and
- Ongoing customer due diligence and reporting (suspicious matters, threshold transactions and international funds transfer instructions) started on 12 December 2008.

Implications for Legal Practitioners

The scope of those enterprises subject to the first tranche obligations has been somewhat unclear.

AUSTRAC has advised that legal practitioners generally are not intended to be subject to these first cut of obligations but where legal practitioners hold an Australian Financial Services License or deal with financial securities as an agent of a person such obligations may arise. Legal practitioners would be well advised to review the existing legislation to ensure their activities do not give rise to these obligations.

Due to broad definitions in the AML/CTF Act there has also been some concern that legal practitioners were subject to obligations under the Act because some legal services may inadvertently fall within the ambit of:

- Items 31 and 32 (receiving or making property available under a designated remittance arrangement); and/or
- Items 46 and 47 (providing a custodial, depository, or safe deposit box service).

The primary concern was that ordinary trust account activities might fall within the definition of designated remittance arrangements.

In order to clarify the position in relation to designated remittance arrangements AUSTRAC introduced Chapter 23 of the *Anti-Money Laundering and Counter-Terrorism Financing Rules Instrument 2007 (No. 1)*, which relevantly included:

> 23.2 For subparagraphs 10(1)(a)(v) and 10(1)(b)(v) of the AML/CTF Act[3], the following persons are specified:
>
> (1) a person who in the course of carrying on a law practice, accepts money or property from a transferor entity to be transferred under a designated remittance arrangement and/or makes money or property available to an ultimate transferee entity as a result of a transfer under a designated remittance arrangement; and
>
> …
>
> 23.3 In this Chapter:
>
> …
>
> (2) 'law practice' means a business carried out by either of the following:
>
> (a) a legal practitioner (however described) that supplies professional legal services; or
>
> (b) a partnership or company that uses legal practitioners (however described) to supply professional legal services.

This rule is understood to give effect to the intention of AUSTRAC that legal practitioners are not subject to obligations under the AML/CTF Act in relation to designated remittance arrangements entered into in the ordinary course of legal practice.

There was also concern that activities such as holding certain items of property for example in estate matters might fall within the definition of providing a custodial, depository, or safe deposit box service.

3 When an arrangement is not a *designated remittance arrangement* for the purposes of the AML/CTF Act.

In order to clarify the position in relation to custodial, depository or deposit box services AUSTRAC introduced Chapter 40 of the *Anti-Money Laundering and Counter-Terrorism Financing Rules Instrument 2007* (No. 1), which relevantly provides:

> 40.1 These Anti-Money Laundering and Counter-Terrorism Financing Rules (Rules) are made under section 229 of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (AML/CTF Act) for the definition of 'exempt legal practitioner service' in section 5 of that Act.
>
> 40.2 A service is taken to be an 'exempt legal practitioner service' if:
>
> (1) it is provided in the ordinary course of carrying on a law practice and is a custodial or depository service other than conduct that under section 766E(1) of the *Corporations Act 2001* constitutes providing a custodial or depository service; or
>
> (2) it is provided in the ordinary course of carrying on a law practice and is a safe deposit box or similar facility other than in relation to physical currency.
>
> 40.3 In this Chapter 'law practice' means a business carried out by either of the following:
>
> (1) a legal practitioner (however described) that supplies professional legal services; or
>
> (2) a partnership or company that uses legal practitioners (however described) to supply professional legal services.

Current Developments

Status of Tranche Two legislation

With the first tranche of the legislation passed and being implemented Government attention turned to the second tranche of obligations which were to be focused on certain professions, including legal practitioners. The Attorney-General's Department announced in July 2007 that the following sectors would be affected by the second tranche of the legislation:

- Lawyers, notaries, other independent legal professionals and accountants when preparing for or carrying out certain transactions;
- Real estate agents in relation to buying and selling of real estate;
- Dealers in precious metals and stones engaged in transactions above a designated threshold; and
- Trust and company service providers when they prepare for or carry out certain transactions

Government consultation commenced on the composition of the second tranche in the latter half of 2007 with various bodies on some very preliminary draft amendments. The Law Council of Australia made a detailed submission on the initial proposals.[4]

However, the processes of consultation were delayed by the 2007 Federal Election and with a change of Government. Neil Jensen, chief executive of AUSTRAC was quoted in *The Age* on 12 December 2007 saying that the process had stopped until the new Government decides what its policy is as regards the second tranche.

During March and April 2008, officers from the Attorney-General's Department and AUSTRAC met with industry stakeholders, including the Law Council to commence discussions on what AML/CTF obligations will apply. On 20 May 2008, the Minister for Home Affairs chaired a meeting of the AML/CTF Council (which included representatives of the Law Council of Australia) to resume ministerial level consultation and to engage again with industry.

In the wake of the global financial crisis, tranche two consultations were largely suspended throughout 2009. It is anticipated that they will recommence in late 2009 or early 2010. It is anticipated that the Tranche Two reforms will be implemented with a staggered implementation period of at least two years, but without a "non prosecution period", as occurred with Tranche One.

4 Available at http://www.lawcouncil.asn.au/initiatives/aml-ctf.cfm.

Likely Elements in and Impact of Tranche Two Legislation

Tranche Two legislation will be likely to implement the FATF recommendations, or at least a substantial part of them, as they relate to 'Non Financial Businesses and Professions'. Tranche Two legislation is also likely to adopt a risk based approach as discussed in FATF's *Risk Based Approach Guidance for Legal Professionals* (the RBA Guidance for Lawyers), which was finalised in October 2008.[5] The Law Council provided input to this document.

FATF recommendations 12 and 16 apply record keeping, customer due diligence obligations and suspicious transaction reporting requirements to 'Non Financial Businesses and Professions' and in particular to legal practitioners when they prepare for or carry out transactions for their clients concerning the following activities:

- ◊ Buying and selling of real estate;
- ◊ Managing of client money, securities or other assets;
- ◊ Management of bank, savings or securities accounts;
- ◊ Organisation of contributions for the creation, operation or management of companies; and
- ◊ Creation, operation or management of legal persons or arrangements, and buying and selling of business entities.

As the FATF recommendations apply to financial institutions and 'Non Financial Businesses and Professions', they generally refer to customers. The RBA Guidance for Lawyers states that such references should be understood by lawyers as references to clients. Any references in this Guide to obligations for lawyers will therefore refer to clients rather than customers.

Legal practitioners are generally referred to as lawyers in FATF documents. Lawyers are defined along with notaries, other independent legal professionals and accountants as:

> Sole practitioners, partners or employed professionals within professional firms.

The definition is not meant to refer to 'internal' professionals that are employees of other types of businesses nor to professionals working for government agencies, who may already be subject to measures that would combat money laundering.

Therefore, Tranche Two legislation is unlikely to extend to government lawyers or in-house counsel or to activities of legal practitioners which do not fall within the categories above. Some legal practitioners, who practise as barristers may not be involved in any of the above activities and therefore may not be subject to AML/CTF obligations.

The time at which a transaction commences may also affect whether a legal practitioner is subject to AML/CTF obligations. The RBA Guidance for Lawyers states that the FATF recommendations would not cover an initial meeting before any preparatory work is done or the usual level of advice given at legal aid clinics.

It is anticipated that Tranche Two legislation may facilitate the following FATF recommendations as they apply to legal practitioners.

Recommendation 5 – Client Due Diligence

A legal practitioner should not keep anonymous accounts or accounts in obviously fictitious names.

A legal practitioner should undertake client due diligence measures, including identifying and verifying the identity of their clients, when:

- ◊ Establishing business relations;
- ◊ Carrying out occasional transactions:
  - (i) above an applicable designated threshold;[6] or
  - (ii) that are special wire transfers;

5 This document is available at www.fatf-gafi.org/dataoecd/5/58/41584211.pdf.

6 In Australia under the current anti-money laundering legislation aimed primarily at the financial sector, the threshold amount for cash transactions is $10,000.

◊ There is a suspicion of money laundering or terrorist financing; or

◊ The legal practitioner has doubts about the veracity or adequacy of previously obtained client identification data.

The client due diligence (CDD) measures to be taken are as follows:

(a) Identifying the client and verifying that client's identity using reliable, independent source documents, data or information.

(b) Identifying the beneficial owner, and taking reasonable measures to verify the identity of the beneficial owner such that the legal practitioner is satisfied that he or she knows who the beneficial owner is. For legal persons and arrangements this should include the legal practitioner taking reasonable measures to understand the ownership and control structure of the client.

(c) Obtaining information on the purpose and intended nature of the business relationship.

(d) Conducting ongoing due diligence on the business relationship and scrutiny of transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with the knowledge of the client, their business and risk profile, including, where necessary, the source of funds.

A legal practitioner should apply each of the CDD measures under (a) to (d) above, but may determine the extent of such measures on a risk sensitive basis depending on the type of client, business relationship or transaction. The measures that are taken should be consistent with any guidelines issued by competent authorities, such as AUSTRAC. For higher risk categories, a legal practitioner should perform enhanced due diligence.

A legal practitioner should verify the identity of the client and beneficial owner before or during the course of establishing a business relationship or conducting transactions for occasional clients. A legal practitioner may be permitted to complete the verification as soon as reasonably practicable following the establishment of the relationship, where the money laundering risks are effectively managed and where this is essential not to interrupt the normal conduct of business.

Where the legal practitioner is unable to comply with paragraphs (a) to (c) above, he or she should not act for the client and should consider making a suspicious transaction report in relation to the client. However according to recommendation 16 legal practitioners are not required to report suspicious transactions if the relevant information was obtained in circumstances where they are subject to professional secrecy or legal professional privilege. Note this is a different threshold than merely being information confidential to the client.

These requirements should apply to all new clients, though a legal practitioner should also apply this recommendation to existing clients on the basis of materiality and risk, and should conduct due diligence on such existing relationships at appropriate times.

Recommendation 8 – Distant Clients

A legal practitioner should pay special attention to any money laundering threats that may arise from new or developing technologies that might favour anonymity, and take measures, if needed, to prevent their use in money laundering schemes. In particular, a legal practitioner should have policies and procedures in place to address any specific risks associated with non-face to face clients.

Recommendation 9 – Third Party Client Due Diligence Providers

A legal practitioner may rely on intermediaries or other third parties to perform elements (a) to (c) of the CDD process or to introduce business, provided that the criteria set out below are met. However, the ultimate responsibility for client identification and verification remains with the legal practitioner relying on the third party.

The criteria that should be met are as follows:

(a) A legal practitioner relying upon a third party should immediately obtain the necessary information concerning elements (a) to (c) of the CDD process. A legal practitioner should take adequate steps to satisfy themselves that copies of identification data and other relevant documentation relating to the CDD requirements will be made available from the third party upon request without delay.

(b) The legal practitioner should satisfy him or herself that the third party is regulated and supervised for, and has measures in place to comply with CDD requirements in line with recommendations 5 and 10.

The Law Council understands that in the United Kingdom, barristers are able to rely on CDD carried out by solicitors.

Recommendation 10 – Record Keeping

A legal practitioner should maintain, for at least five years, all necessary records on transactions, both domestic and international, to enable them to comply swiftly with information requests from the competent authorities, such as AUSTRAC. Such records must be sufficient to permit reconstruction of individual transactions (including the amounts and types of currency involved if any) so as to provide, if necessary, evidence for prosecution of criminal activity.

A legal practitioner should keep records on the identification data obtained through the CDD process (e.g. copies or records of official identification documents like passports, identity cards, driving licenses or similar documents), account files and business correspondence for at least five years after the business relationship is ended.

The identification data and transaction records should be available to competent authorities such as AUSTRAC upon appropriate authority.

Recommendation 11 – Recording Suspicious Transactions

A legal practitioner should pay special attention to all complex, unusual large transactions, and all unusual patterns of transactions, which have no apparent economic or visible lawful purpose. The background and purpose of such transactions should, as far as possible, be examined, the findings established in writing, and be available to help competent authorities and auditors.

Recommendation 13 –Suspicious Transaction Reporting

If a legal practitioner suspects or has reasonable grounds to suspect that funds are the proceeds of a criminal activity, or are related to terrorist financing, he or she should report promptly to AUSTRAC.

However according to recommendation 16, legal practitioners are not required to report suspicious transactions if the relevant information was obtained in circumstances where they are subject to professional secrecy or legal professional privilege. Note this is a different threshold than merely being information confidential to the client.

The FATF recommendations note that each country determines what matters fall under legal professional privilege or professional secrecy and that these concepts would normally cover information obtained in the course of ascertaining the legal position of the client or in the task of representing the client in judicial, administrative, arbitration or mediation proceedings.

The RBA Guidance for Lawyers also notes the protection of the lawyer-client relationship in the context of suspicious transaction reporting.

Recommendation 14 – Secrecy of Reporting

A legal practitioner should not disclose to a client that a suspicious transaction report has been made to AUSTRAC. Such disclosure is known as 'tipping off'. However, the FATF recommendations provide that where a lawyer seeks to dissuade a client from engaging in illegal activity, this does not amount to tipping off.

The legislation should protect legal practitioners 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 AUSTRAC, even if they did not know precisely what the underlying criminal activity was, and regardless of whether illegal activity actually occurred.

Recommendation 15 – AML/CTF Programmes

Legal practitioners should develop programmes against money laundering and terrorist financing. These programmes should include:

(a) The development of internal policies, procedures and controls, including appropriate compliance management arrangements, and adequate screening procedures to ensure high standards when hiring employees.

(b) An ongoing employee training programme.

(c) An audit function to test the system.

The Law Council understands that this recommendation has been applied in the United Kingdom in such a way that sole practitioners are not required to have programmes as such but are required to undertake CDD. Practitioners with employees are required to have programmes but these are not required to be significant in small practices.

Recommendation 6 – Politically Exposed Persons and Recommendation 21 – Special Treatment of Certain Countries

These recommendations are likely to apply only to practitioners, who act for certain persons.

Politically Exposed Persons

A politically exposed person is an individual who is or has been entrusted with prominent public functions in a foreign country, for example Heads of State or of government, senior politicians, senior government, judicial or military officials, senior executives of state owned corporations or important political party officials.

A legal practitioner should, in relation to politically exposed persons, in addition to performing normal CDD:

(a) Have appropriate risk management systems to determine whether the client is a politically exposed person.

(b) Obtain senior management approval for establishing business relationships with such clients.

(c) Take reasonable measures to establish the source of wealth and source of funds.

(d) Conduct enhanced ongoing monitoring of the business relationship.

Recommendation 21 – Special Treatment of Certain Countries

A legal practitioner should give special attention to business relationships and transactions with persons, including companies and financial institutions, from countries which do not or insufficiently apply the FATF recommendations. Whenever these transactions have no apparent economic or visible lawful purpose, their background and purpose should, as far as possible, be examined, the findings established in writing, and be available to help competent authorities, such as AUSTRAC.

FATF regularly issues warnings about certain countries which present greater risks in relation to money laundering.[7]

7 See www.fatf-gafi.org.

Offences, Sanctions and Other Risks

There are two major sources of offences and sanctions relating to money laundering and similar activity.

The AML/CTF Act contains many offences and sanctions associated with compliance with the reporting regime and other requirements. These requirements are not intended to apply to practitioners acting in the ordinary course of legal practice under the first tranche of the legislation but similar sanctions may form part of the second tranche.

The AML/CTF Act takes two approaches to sanctions including both offences and civil penalty provisions.

Offences are included in Part 12 and include up to ten years imprisonment[8] for:

- ◊ Producing false or misleading information;
- ◊ Producing a false or misleading document;
- ◊ Making or possessing a false document; and
- ◊ Making or possessing equipment for making false documents.

Five year imprisonment offences[9] exist for:

- ◊ Conducting transactions so as to avoid reporting requirements relating to threshold transactions;[10] and
- ◊ Conducting transfers so as to avoid reporting requirements relating to cross-border movements of physical currency.

Two year imprisonment offences exist for providing or receiving a designated service using false customer names or ensuring customer anonymity.[11]

Civil penalty provisions exist throughout the AML/CTF Act with respect to detailed compliance issues, including failing to:

- ◊ Carry out the applicable customer identification procedures before the commencement of the provision of a designated service;
- ◊ Conduct ongoing customer due diligence;
- ◊ Have an anti-money laundering and counter-terrorism financing program;
- ◊ Retain transaction records;
- ◊ Retain records of identification procedures;
- ◊ Retain records about electronic funds transfer instructions;
- ◊ Conduct money laundering and terrorism financing risk assessments; and
- ◊ Report a suspicious transaction.

Suspicious transaction reporting obligations arise when a reporting entity provides, offers to provide, or is requested to provide, a designated service. If the entity has reasonable grounds for suspicion, it must formally contact AUSTRAC within 24 hours for terrorist financing matters and three days for all other matters.

What must be reported includes:

- ◊ A person who is not who they claim to be;
- ◊ Having information likely to be of relevance to an investigation or prosecution of a person for an evasion, or an attempted evasion of Commonwealth, State or Territory taxation law;

8 AML/CTF Act sections 136 to 138.

9 AML/CTF Act sections 142 and 143.

10 The threshold is currently set at $10,000 for cash transactions.

11 AML/CTF Act sections 139 to 141.

- ◊ Having information likely to be of relevance to an investigation or prosecution of a person for an offence against a Commonwealth, State or Territory law; and
- ◊ Information that may be of assistance in the enforcement of the *Proceeds of Crime Act 2002* (Cth), or a State or Territory equivalent.

The AML/CTF Act also contains a criminal offence of 'tipping off' with a penalty of two years imprisonment.

A person must not disclose to a customer that a suspicious matter report has been made to AUSTRAC, that a suspicion has been formed, or any information that may assist someone to infer that a suspicion has been formed.

If these requirements are extended to legal practitioners they will pose a particular challenge because it will often be necessary to ask legitimate questions or seek additional information from clients to check the risk profile of a matter before a suspicion is formed. This should be clearly distinguished, however, from disclosing any information, or asking additional questions that may lead a client to infer that a suspicion has been formed.

Legal practitioners and staff will need to be trained on this issue, and arrangements implemented as required. A common approach is to consistently attempt to gain as much relevant information as possible from the client at the start of the matter – 'as standard'. This addresses risk management issues, limits the need or temptation for additional questions when suspicions have been formed, and also offers reassurance to the client that all questions are standard, and are not led by any suspicions. Another common arrangement is to restrict any knowledge of a suspicion or a suspicious transaction report to only those who 'need to know'. Best practice may be to remove, or keep separate from client files, report investigations or other documentation concerning suspicions.

The Commonwealth *Criminal Code Act 1995* also contains offences relating to the actual conduct of money laundering.

Division 400 of the Commonwealth *Criminal Code* relates to money laundering offences and provides numerous offences for dealing with money or property that is or is likely to become proceeds or an instrument of crime. For example in section 400.3 for money or property with a value of $1,000,000:

- ◊ Knowingly dealing with the proceeds of crime has a maximum imprisonment of 25 years or a fine of 1500 penalty units, or both;
- ◊ Recklessly dealing with the proceeds of crime has a maximum imprisonment of 12 years or a fine of 720 penalty units, or both; and
- ◊ Negligently dealing with the proceeds of crime has a maximum imprisonment of 5 years or a fine of 300 penalty units, or both.

While there are stepped offences for dealing with the proceeds of crime relating to the value of property the *Criminal Code* provides for a maximum imprisonment of 12 months for negligently dealing with $1,000 which is the proceeds of crime [section 400.7(3)].

For the purposes of the *Criminal Code* dealing with money or other property is defined as:

- ◊ Receiving, possessing, concealing or disposing of money or other property; or
- ◊ Importing money or other property into, or exporting money or other property from, Australia; and
- ◊ The money or other property is proceeds of crime, or could become an instrument of crime, in relation to an indictable offence.

While presently legal practitioners have not been the subject of conviction under these laws in Australia, in the United Kingdom there are examples of solicitors receiving custodial sentences for failing to disclose to the authorities:

- ◊ In *R v McCartan* [2004] NICA 43 solicitor Gavin David McCartan was convicted of failing to disclose information, contrary to article 44 of the *Proceeds of Crime (Northern Ireland) Order 1996* and of using a false instrument, contrary to section 3 of the *Forgery and Counterfeiting Act 1981* and was sentenced to two concurrent terms of imprisonment of six months and two months.

- In *R v Duff* [2002] EWCA Crim 2117 solicitor Jonathan Michael Duff was convicted of failing to disclose knowledge or suspicion of money laundering contrary to section 52(1) of the *Drug Trafficking Act 1994* and sentenced to six months imprisonment.
- In *R v Griffiths* [2006] EWCA Crim 2155 solicitor Philip John Griffiths was convicted of failing to disclose to the authorities that he knew or suspected that a money laundering offence was taking place and was sentenced to 15 months imprisonment which was reduced to 6 months on appeal.

Money Laundering Warning Signs

The second tranche of AML/CTF legislation may require legal practitioners to conduct ongoing monitoring of business relationships and to take steps to ensure that they identify and as necessary report clients or transactions that carry a greater risk of money laundering or counter terrorist financing.

Although different practitioners will face different risks, below are some key factors which may heighten a client's risk profile or raise suspicions.

Large quantities of cash	Large quantities of cash are one of the most obvious signs of potential money laundering. **Suggested risk management:** develop policies on handling cash: place a dollar limit on how much cash can be accepted.
Secretive clients	Although high levels of client contact or in-depth understanding of their business activities is not always necessary, unusually secretive or obstructive clients might give cause for concern. **Suggested risk management:** If a client appears unusually or unnecessarily secretive, consider whether you are comfortable continuing to act for them.
Unusual or unexpected sources of funding or settlement requests	Related transactions will often be funded and settled in similar ways – home purchases for instance might commonly be financed by a mix of mortgage, deposit and proceeds from the sale of a current property. Transactions that are funded through an unusual source or unusual mix of sources might be considered suspicious. Particular attention should be given to private funding, funds from an unrelated third party, and direct payments between buyers and sellers. **Suggested risk management:** Implement processes to check the source of funds. Do they come from the client? Similarly with settlements: where is the money going and why?
Unusual or unnecessarily complicated business structures or transaction paths	Any business structures or transaction paths which seem unnecessarily complicated, or that the client fails to adequately explain, should be treated as suspicious: what is the client trying to hide? **Suggested risk management:** Discuss all arrangements with the clients. Ask them to justify or explain arrangements
Loss-making or misvalued transactions	An unusual transaction value can be an indication of money laundering. Any transactions where the ultimate value is either significantly more or significantly less than what you might expect should be treated as suspicious. **Suggested risk management:** Ask how the client has valued the assets being traded. Is there a logical explanation for the discrepancy between the market and actual value of the transaction?

Litigation matters that are settled too easily	As with transactions, litigation matters that are settled for a value either significantly above or below what you might normally expect should be treated as suspicious. **Suggested risk management**: Ask your client to justify their approach to the settlement.
Suspect territories	Transactions involving some territories or jurisdictions may heighten the risk profile of those transactions **Suggested risk management:** The International Bar Association provides a summary of money laundering legislation around the world at www.anti-moneylaundering.org. This will help you assess the money laundering risks associated with different countries. FATF also regularly issues warnings about certain countries.
Unexplained changes in instructions or business entities	Any changes that have no logical explanation, or that the client fails to explain sufficiently should be treated as suspicious. **Suggested risk management**: Ask the client to explain or justify the recent changes.
Instructions outside your normal geographic area, area of expertise, or client market	Often clients will choose a legal practitioner specifically because they do not have any knowledge of the client or entities involved, or because they will not ask too many tricky questions. **Suggested risk management:** Don't dabble: stick to what you know. Distribute lists of work you will and will not undertake. Ask yourself: why is this client instructing me?
Clients wanting to take 'short-cuts' or forego standard processes or activities	Clients that request or apply pressure on legal practitioners to miss out key stages of a transaction, such as due diligence, may be attempting to hide or disguise evidence of criminal activity, and such transactions therefore might be considered suspicious. **Suggested risk management:** Ask the client to explain their approach and consider if you are happy accepting such instructions.

Implementing AML/CTF Compliance Arrangements

Note: Whilst this guide has consistently used terminology directed at individual practitioners rather than a practice, for the purpose of implementing AML/CTF compliance arrangements, the practice rather than the individual practitioner should be the main focus. Compliance will require not merely justifying the actions of an individual practitioner, but demonstrating the implementation and observance of policies, processes, procedures and systems by everyone in a legal practice – including support and administration staff.

Although the legislation is not yet released, it is likely that the compliance requirements for legal practitioners in Australia will be similar to the requirements under Tranche One, reflecting the FATF Forty Recommendations and also the RBA Guidance for Lawyers. It is likely that Tranche Two will be comparable to compliance regimes in other jurisdictions and may involve:

- A risk based approach to AML/CTF;
- Initial client identification and ongoing client due diligence;
- Record keeping;
- Auditing;
- Employee training programs;
- The nomination of an anti-money laundering compliance officer (AMLCO); and
- Suspicious matter reporting.

A risk based approach to AML/CTF

The legislation is likely to require practitioners to take steps to be aware of transactions with heightened money laundering or terrorist financing risks. While guidance will highlight common risks, practitioners will need to identify the risks specific to their practice areas and client groupings, and then to manage and mitigate any risks arising.

As with other risk management, a risk based approach to AML/CTF involves four stages.

Identification	Identifying the potential AML/CTF risks specific to the practice – focussing both on client-related and matter-related risks.
Analysis	Understanding the risks. High risk or low risk?
Management	Designing and implementing arrangements (policies, processes, procedures) that limit the impact or likelihood of risks materialising.
Review	Are the arrangements effective? Could they be improved? Is everyone following the agreed procedures? Are all the risks addressed?

This process should result in the implementation of a number of effective risk management arrangements, which in addition to the formal requirements might or might not include:

- ◊ Policies on the handling of cash e.g. dollar limits;
- ◊ Opening and closing file risk assessments in relation to money laundering;
- ◊ Internal reporting or referral arrangements re AML/CTF suspicions;
- ◊ Checks on funding sources and settlement destinations;
- ◊ Transaction value thresholds; and
- ◊ Restricted access to account details to prevent unsanctioned deposits.

For a practitioner with effective risk management and other procedures already in place, these activities will require additions to existing arrangements rather than starting from scratch – many practitioners will, for example, risk assess new clients and instructions, maintain all relevant records, implement various risk management arrangements and adhere to ethical guidelines for dealing with suspected criminality.

For other practitioners, however, compliance will be a task requiring significant attention and necessitating a cultural change that can later be built on with other beneficial risk management or practice management arrangements. Research from the United Kingdom has found that compliance has been a particular burden for sole practitioners and smaller practices, but that the implementation of AML/CTF arrangements has led to a greater focus on general client engagement arrangements and has led to fewer negligence claims.

Initial client identification and ongoing client due diligence

Practitioners will have to develop appropriate processes for checking the identity of clients and for the recording of relevant client information. Arrangements will vary between individuals, charities, government and different corporate entities, between new or repeat clients, and there might need to be additional checks on, for example, overseas clients. Internal guidelines should be developed on what forms of identity are acceptable in what circumstances, and initial arrangements implemented to ensure these arrangements are consistently observed.

The introduction of client due diligence requirements is likely to contribute significantly to the general risk management strategies of legal practitioners. Data from legal insurers shows that high percentages of claims and complaints could have been avoided if practitioners engaged in more robust client selection and acceptance policies. In addition to conflict of interest considerations, a number of claims arise out of failing to adequately define the identify of the client, and from failing to identify the risks associated with specific clients and transactions.

Record keeping

Practitioners are likely to be required to maintain records of identity, transaction details and any AML/CTF suspicion reports for a number of years. This might require changes to a practitioner's file management and archiving arrangements, bur for many practitioners will only reinforce the importance of existing requirements and practices.

The Act currently specifies that records must be kept for seven years, which mirrors other requirements for legal practitioners in most States. It is important to note, however, that the seven years requirement applies for the life of the client relationship plus an additional seven years. In many instances, therefore, files and records, and specifically client identification records, will need to be kept for significantly longer than seven years.

Auditing

AML/CTF arrangements should be reviewed and audited on a regular basis, and any new arrangements implemented as required. It might be appropriate to develop new processes, new forms and new policies on issues such as identification requirements, tipping off risks, the acceptance of cash and transaction value thresholds. Audits can be conducted by either internal or external auditors.

As with a number of the AML/CTF compliance requirements, many practitioners will already have implemented auditing requirements as part of risk management strategies. Specifically, practitioners who undertake regular file audits will be able to check files for AML/CTF compliance in relation to, for instance:

- Initial AML/CTF risk assessment;
- Client identification records;
- Any noted suspicions;
- Any necessary checks on funding sources or settlements; and
- Closing matter AML/CTF risk assessment.

Practitioners should aim to produce an annual documented AML/CTF audit report based on either ongoing audit activities throughout the year and/or a single comprehensive audit of all arrangements and their compliance with both the requirements of the legislation and their own stated arrangements.

Employee training programs

Unless a practitioner employs no staff, compliance will be an issue for staff, who should be trained on, risks, internal procedures and consequences of non-compliance. 'All staff" applies to support staff as well as fee-earning staff because it is not uncommon for criminals or launderers to circumvent practitioners by dealing directly with accounts or other support staff.

To be effective, AML/CTF training should be included as a part of all induction programs, and should be repeated on a regular basis, with supporting guidance or reference materials provided as required.

The nomination of an anti-money laundering compliance officer

Practitioners will need to identify themselves or a person with specific responsibility for ensuring that satisfactory internal AML/CTF procedures are maintained, ensuring that internal suspicions are raised, and ensuring that notifications are made or appropriate action taken.

The anti-money laundering compliance officer (AMLCO) should be someone who knows and understands the AML/CTF risk profile of the practitioner, and who has the authority to take the appropriate action – whether making suspicious transaction reports or declining instructions – as required.

Suspicious transaction reporting

Practitioners may be required to report any reasonable money laundering suspicions to AUSTRAC. However, suspicions based on information obtained in circumstances of professional secrecy or legal professional privilege may not be required to be reported.

Practitioners should therefore ensure that appropriate arrangements are in place to define reasonable suspicions, define how suspicions are raised and handled internally, and how any suspicions are reported.

Client Confidentiality and Legal Professional Privilege

One of the key issues to be resolved with the introduction of Tranche Two of AML/CTF legislation is how any requirement for suspicious transaction reporting will affect laws and rules relating to client confidentiality and legal professional privilege.

Section 242 of the current legislation states that the Act does not affect the law relating to legal professional privilege, suggesting that a legal practitioner may not be compelled to make reports that are based on information subject to legal professional privilege.

That, however, might not be the end of the matter. Legal professional privilege has a narrower application than client confidentiality, and the experience of the United Kingdom was that the application of privilege was not as wide as many practitioners thought. If the information came to a practitioner in privileged circumstances, it might not be necessary to report a suspicious transaction, but it is rarely a simple matter to decide if information was provided in privileged circumstances.

Practitioners should seek guidance from their respective professional bodies on the application of privilege in different circumstances. As with the United Kingdom and other jurisdictions, the application of privilege in relation to AML/CTF legislation might be an issue which is only given greater clarity by subsequent court cases following the release of any legislation.

The different State professional bodies have based their rules on confidentiality, in their respective Conduct Rules, on the Law Council of Australia's *Model Rules of Professional Conduct and Practice*.

Rule 3 states that:

> 3.1 A practitioner must never disclose to any person, who is not a partner, director or employee of the practitioner's firm any information, which is confidential to a client and acquired by the practitioner or by the practitioner's firm during the client engagement, unless:
>
> 3.1.2 the practitioner is permitted or compelled by law to disclose;

The rules on client confidentiality may not, therefore, exempt practitioners from AML/CTF reporting obligations. Whilst legal professional privilege may exempt practitioners from reporting obligations, practitioners will need to develop a good understanding of when information was provided in privileged circumstances, and when legal professional privilege applies.

Regulation

The principal AML/CTF regulator under the existing legislation is AUSTRAC. In addition to receiving suspicious transaction reports, AUSTRAC is able to:

- ◊ Appoint external auditors to assess reporting entities' risk management and compliance;
- ◊ Require annual compliance reports;
- ◊ Issue remedial directions to reporting entities; and
- ◊ Enter into enforceable undertakings with reporting entities.

The extent to which AUSTRAC will seek to use their powers in relation to audits and requiring annual compliance reports is still uncertain.

There has been discussion as to whether AUSTRAC will be the most effective regulator of legal practitioners, and what the role of State and Territory professional bodies such as the law societies and bar associations should be. Although these bodies currently have oversight of trust account regulations, and there is an argument that such expertise should be used, there are also concerns about both the funding of regulatory resources and the potential conflict between adopting AML/CTF regulatory roles whilst also pursuing an advocacy role and lobbying for change in the legislation.

The professional bodies are currently neither pursuing nor expecting any additional AML/CTF regulatory role, and there are no plans to take an intermediary role in suspicious transaction reporting. Instead the professional bodies will focus on providing education, guidance and support to practitioners in relation to anti-money laundering. The second tranche of AML/CTF legislation is, however, likely to impact on existing trust account regulation, and in future, the State and Territory law societies might also consider amending their Conduct Rules to address AML/CTF compliance.

Next Steps

The Law Council has been actively engaged with the Government in representing the interests of the legal profession in relation to Tranches One and Two of the AML/CTF legislation and will continue to do so vigorously.

The Law Council will make submissions on Exposure Draft legislation and any Bill introduced to Parliament.

The Law Council will also continue working with its Constituent Bodies to provide up to date information to legal practitioners in relation to AML/CTF obligations and issues.

The Law Council will keep this Guide updated and aims to provide a list of resources such as AML/CTF software programs and advisory services.

Subject to Government funding, the Law Council may be able to coordinate AML/CTF information sessions for the profession and a range of other resources, such as DVD presentations.

Further Information on AML/CTF

- The Law Council of Australia
  www.lawcouncil.asn.au/programs/national-policy/aml
- Commonwealth Attorney-General's Department
  www.ag.gov.au/aml
- Financial Action Task Force
  www.fatf-gafi.org
- Australian Transaction Reports and Analysis Centre (AUSTRAC)
  www.austrac.gov.au/amlctf_act_obligations.html

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