ALLEN & OVERY

"Phase 1.5" in Australia's Anti-Money Laundering and Counter-Terrorism Financing Reforms

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On 17 October 2019, the Australian Government introduced a bill into Parliament to implement the next phase of reforms to the country's anti-money laundering and counter-terrorism financing ("AML/CTF") laws. If enacted, businesses will have the opportunity to save time and money when performing customer due diligence, though will also need to update their AML/CTF programs to ensure continued compliance.

Australia took a major step forward in implementing its international obligations to deter money laundering and terrorism financing when it enacted the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) ("AML/CTF Act"). In the intervening thirteen years, however, the AML/CTF Act has been the subject of increasing criticism due to the delay in implementing further reforms.

The Government's introduction of the *Anti-Money Laundering and Counter-Terrorism Financing and Other Legislation Amendment Bill 2019* (Cth) ("Bill") into the House of Representatives last month aims to address some (but not all) of those criticisms. Notably, the Bill does not implement Australia's "second tranche" of AML/CTF reform, which is expected to expand the coverage of the AML/CTF Act to apply to designated non-financial business and professional sectors (including real estate agents and lawyers).

This article examines (i) the background to the Bill, (ii) its proposed reforms, and (iii) what the impact of those reforms would be on businesses, including in relation to:

– opportunities to improve businesses' efficiency in performing customer due diligence;

– new restrictions on providing designated services and correspondent banking relationships; and

– positive developments in exceptions to the offence of tipping off.

The Bill must be passed by both Houses of Parliament before it can come into force. Although the dates for those votes have not yet been fixed, the Bill is not expected to reach this stage until early 2020.

Businesses should remain alert to the progress of the Bill given that each breach of a civil penalty provision under the AML/CTF Act can leave businesses exposed to a fine of up to USD21 million. In the meantime, businesses can take the initiative by considering any updates that will be required to their AML/CTF programs and their strategy for taking advantage of the time and cost savings offered by the proposed amendments to the customer due diligence provisions.

Background to the Bill

Set out below is a timeline examining the development of Australia's AML/CTF regime.

2005:	Prior to the AML/CTF Act, Australia had a patchwork legislative framework for reporting, investigating, and punishing money laundering and terrorism financing. The Financial Action Task Force (**FATF**)[1] – an inter-governmental body responsible for setting international standards for combatting money laundering and terrorism financing – reviewed this framework in 2005, and found that Australia complied fully with fewer than a quarter of the FATF's published recommendations.
2006:	Australia enacted the AML/CTF Act as its "first tranche" of reform to address the FATF's concerns. This legislation covered the financial and gambling sectors, bullion dealers, and lawyers and accountants (in limited circumstances only). In his second reading speech, the Hon Philip Ruddock MP (the Attorney-General at the time) explained that the AML/CTF Act would later be expanded to cover real estate agents, jewellers, lawyers, and accountants (professions subject to increased money laundering risks) in a "second tranche" of reform.
2009:	The Government decided to delay the introduction of the "second tranche" of reform in light of the global financial crisis and the difficulties that businesses may face in bringing themselves into compliance with the new regime.
2015:	The FATF conducted another review into Australia's AML/CTF legislative framework in 2015. In its report, the FATF recognised that Australia had made progress in complying with the FATF's published recommendations, but noted a number of deficiencies, including that Australia did not explicitly require regulated entities to terminate a business relationship where they were unable to comply with customer due diligence requirements, and that the AML/CTF Act did not extend to designated non-financial business and professional sectors (including real estate agents and lawyers).
2016:	The Attorney-General's Department released a report on the statutory review of the AML/CTF Act as required under that Act. This report also considered the FATF's 2015 report and ultimately made 84 recommendations.
2017:	The Government decided to implement the Attorney-General's Department's recommendations in phases. The first phase was implemented by the *AML/CTF Amendment Act 2017* (Cth). In overview, that legislation: – expanded the AUSTRAC CEO's powers and functions, including to issue infringement notices in respect of a greater range of offences, to require reporting entities to retrospectively rectify contraventions of the AML/CTF Act, to supervise the registration of remitters, and to share information; – permitted reporting entities to disclose information to related bodies corporate for the purposes of informing them about the risks involved in dealing with a customer; – expanded the scope of the AML/CTF Act to cover digital currency exchange providers (such as businesses that trade in Bitcoin); – narrowed the scope of the AML/CTF Act to exclude the cash-in-transit sector and some insurance intermediaries and general insurance providers; and – clarified due diligence obligations relating to correspondent banking relationships.
2019:	The Government's next round of amendments to the AML/CTF Act had been expected to include the "second tranche" of reforms expanding the sectors covered. However, the mostly incremental changes proposed in the Bill have instead been dubbed "Phase 1.5" in Australia's AML/CTF reforms. These changes do propose to substantially amend some parts of the AML/CTF regime, including by simplifying numerous procedures and requirements, but do not take the step of expanding its coverage to designated non-financial business and professional sectors. This means that financial institutions in particular can expect to continue to bear the brunt of the regulatory burden of scrutinising customers and their transactions for potential money laundering and terrorism financing risks.

1 https://www.fatf-gafi.org/.

The Bill's proposed reforms and their impact on businesses

An overview of the Bill's key proposed changes to the AML/CTF regime is set out below, together with their implications for reporting entities:

CUSTOMER DUE DILIGENCE ARRANGEMENTS

Change: The Bill permits reporting entities to rely on customer due diligence carried out by another person rather than performing those procedures itself in two scenarios.

Scenario 1: Where the reporting entity:

(i) has entered into a written arrangement with that other person; and

(ii) carries out regular assessments to maintain reasonable grounds to believe that the person has the systems and procedures in place to meet customer due diligence compliance requirements.

In Scenario 1, the reporting entity would be given "safe harbour"; it would not be liable for isolated breaches of customer due diligence compliance committed by the other person.

Scenario 2: Where:

(i) the reporting entity has reasonable grounds to believe that it is appropriate to rely on the other person's customer due diligence procedures, taking into account the reporting entity's AML/CTF risks in providing the designated service; and

(ii) the other person has satisfied the customer due diligence requirements prescribed in the *Anti-Money Laundering and Counter-Terrorism Financing Rules Instrument 2007* (No. 1) (Cth) ("AML/CTF Rules").

In Scenario 2, the reporting entity would remain liable for any breaches of customer due diligence compliance committed by the other person.

Impact: This proposal is intended to reduce the regulatory burden of performing customer due diligence, particularly for multinational corporations, resulting in an expected cost saving of up to USD3.1 billion over ten years. Businesses should begin to consider whether it would drive efficiencies to rely on third parties or related bodies corporate to conduct customer due diligence, and whether it would suit their needs and risk management to enter into a customer due diligence arrangement.

TIMING OF CUSTOMER DUE DILIGENCE

Change: The Bill explicitly prohibits reporting entities from commencing to provide a designated service if they have not carried out customer due diligence, except where:

(i) special circumstances justify carrying out the applicable customer identification procedure after the reporting entity has commenced providing the designated service;

(ii) the reporting entity has previously carried out the applicable customer identification procedures;

(iii) the reporting entity commenced providing the designated service before the AML/CTF Act came into force; or

(iv) the designated service is low-risk as prescribed by the AML/CTF Rules (no designated services currently fall within this exception).

Impact: This would not represent a substantial change to the AML/CTF regime. Although the Bill proposes introducing an explicit prohibition subject to exceptions, the current form of the AML/CTF already conditions a reporting entity's provision of designated services on the same exceptions. Businesses should nevertheless review their customer due diligence policies and procedures to ensure that they comply with this prohibition and require a suspicious matter report to be filed where customer due diligence cannot be completed.

CORRESPONDENT BANKING

Change:

(i) The Bill prohibits reporting entities from entering into, or continuing in, a correspondent banking relationship with another financial institution that permits its accounts to be used by a shell bank (i.e. one that does not have a physical presence in any country).

(ii) The Bill removes a defence previously available to reporting entities, namely that they were not reckless as to their correspondent banking relationships.

Impact: This proposed prohibition supplements the AML/CTF Act's existing prohibition on entering into, or continuing in, a correspondent banking relationship with a shell bank or another financial institution that has a correspondent banking relationship with a shell bank. Businesses should ensure that their due diligence of potential and current correspondent banks is sufficiently thorough and includes consideration of whether the financial institution permits its accounts to be used by a shell bank.

TIPPING OFF

Change: The Bill proposes to simplify the tipping-off offence in the AML/CTF Act. Specifically, it:

(i) expands the exceptions to the offence of tipping off to circumstances where a reporting entity discloses information to:

(A) a person appointed or engaged by the reporting entity to audit or review its AML/CTF program; or

(B) a related body corporate or member of a designated business group that is not a reporting entity (i.e. is outside of Australia), provided that the related body corporate or member of the designated business group is regulated by laws of a foreign country that give effect to at least some of the FATF's Forty Recommendations (2003), Special Recommendations on Terrorist Financing (2001), and Special Recommendation IX on Terrorist Financing (2004), and it has given the reporting entity a written undertaking regarding the confidentiality and use of the information; and

(ii) clarifies that the offence of tipping-off is not committed where a reporting entity discloses information:

(A) for the purposes of dissuading a customer from committing a crime or evading a taxation law;

(B) to a legal practitioner for the purposes of obtaining legal advice;

(C) to a related body corporate or member of a designated business group for the purposes of informing them about the risks involved in dealing with a customer of the reporting entity;

(D) to a registered remittance affiliate, where the reporting entity is a registered remittance network provider;

(E) to an owner-managed branch of the authorised deposit-taking institution, where the reporting entity is an authorised deposit-taking institution; or

(F) to an Australian government body that has responsibility for law enforcement, or where disclosure is in compliance with the law.

Impact: These proposed changes would bring much-needed certainty to businesses that may wish, or need, to disclose information to the persons listed above. Businesses should be prepared to procure written undertakings from related bodies corporate and members of designated business groups regarding the confidentiality and use of information shared under this exception. Businesses should also consider taking advantage of the opportunity this change would present to engage legal counsel and/or external auditors to review the adequacy and compliance of their AML/CTF programs.

Additional amendments

The proposals outlined above would each impact on businesses' AML/CTF programs, policies and procedures. In addition to these changes, the Bill also proposes to:

- expand AUSTRAC's ability to share information with Commonwealth, State, and Territory agencies, governments of foreign countries, and foreign agencies;
- expand the circumstances in which suspicious matter reports can be admitted into evidence in court and tribunal proceedings;
- create a single reporting requirement for the cross-border movement of monetary instruments, including physical currency and bearer negotiable instruments; and
- amend the *Criminal Code Act 1995* (Cth) to address barriers to the prosecution of money laundering offences, specifically by:

  (i) deeming property provided by undercover law enforcement to be proceeds of crime; and

  (ii) clarifying the circumstances in which a person can be prosecuted for dealing with property that is intended to become, or at risk of becoming, an instrument of crime.

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