SUBMISSION FROM TRANSPARENCY INTERNATIONAL AUSTRALIA

TRANCHE 2 and the LEGAL PROFESSION - particular benefits of regulation

In the time available, we write to affirm our support for extending AML/CTF regulation, taking a risk-based approach to a range of services provided by the legal profession that are seen to pose high ML/TF risks.
We acknowledge that, in doing so, increased funding of AUSTRAC will be important to enable it to conduct the essential supervision.

The Purpose of Regulation - Enhanced Intelligence and Behavioural Change

As one category of designated non-financial businesses and professions (DNFBPs) the current lack of AML/CTF due diligence and reporting obligations for lawyers in Australia- referred to critically in the 2014 FATF Review of this country, may impair intelligence gathering regarding ML/TF risks and threats. Such an intelligence gap potentially frustrates efforts to accurately assess the degree to which lawyers and other DNFBPs are currently, or have previously been, involved in ML/TF activities.

Additionally, and perhaps more importantly, the lack of coverage of lawyers and other DNFBPs reduces the capacity of law enforcement and regulators to address money laundering by these entities committed as a deliberate act.

The use of lawyers' trust accounts, for example, to move money anonymously internationally is widely known. Of itself that should be reason enough to expand coverage of AML/CTF legislation to encourage lawyers to assess the source of such funds, reject transactions for which they cannot identify a legitimate source and report the individual beneficial owners of bulk funds moved through trust accounts.

Foreign Proceeds - Lawyers and Real Estate Agents

As one category of designated non-financial businesses and professions (DNFBPs) the current lack of AML/CTF due diligence and reporting obligations for lawyers in Australia- referred to critically in the 2014 FATF Review of this country, does significantly impair its intelligence gathering regarding ML/TF risks and threats in these sectors. This intelligence gap frustrates efforts to accurately assess the degree to which lawyers and other DNFBPs are currently, or have previously been, involved in ML/TF activities.

Illicit flows of finance into this country, sourced from organised crime, drugs, corruption and other criminality should be of huge concern. Flows of illicit funds are not diminishing, and the reported links of money laundering and/or terrorism financing to organised crime, drugs, corruption and other criminality are of huge concern. TI Australia (TIA) believes that covering lawyers will help in both **detection and deterrence** of those who are involved in such illicit activity. The new laws will greatly help deter and prevent criminals from hiding behind Australian companies and trusts to move illicit funds and hold tainted assets.

It will help to prevent Australia being considered a soft target by international crime networks that may seek to use Australian corporate vehicles to trade on the good name of Australia and use 'shell' offshore haven vehicles by Australian residents as arms of those networks.

Not only does Australia's acceptance by law firms of these funds indicate a tacit acceptance that crime committed outside our borders is of less concern to us than crime committed in Australia, receipt of these funds provides a de facto welcome mat to criminals of all types to set up business in Australia.

The linkages between criminality and funds flowing into or around Australia are often identified through the analysis of transaction reports and suspicious matter reports that are submitted to AUSTRAC during the course of day-to-day financial transactions. This analysis is the very foundation of an effective financial intelligence capability.

Extension of the laws has the potential to ensure that lawyers are not unwittingly misused to circumvent existing controls in the financial sectors. The reporting requirements will also help to detect criminality through "red flag" transaction reporting by lawyers. This will provide valuable financial intelligence.

Client scrutiny and due diligence under a proper KYC program has the potential to identify early indicators of criminality or potential misconduct, thereby reducing the risk of unwitting breaches being facilitated by particular firms.

TIA strongly supports the expansion of AML/CTF regulation to cover lawyers, real estate agents, conveyancers and any other entity or business that receives funds from other countries in a manner that is likely to be opaque – such as a trust account funds – requiring those entities to conduct CDD, refuse transactions for which there is no identifiable legitimate source and report the beneficial owner of funds when they are moved.

Beneficial Ownership of Legal Entities

Imposing a requirement on lawyers to implement customer due diligence procedures, even on a risk-basis approach has the potential, in our view, to enhance visibility of beneficial ownership of trust accounts and company and trust structures established for Australian and international clients.

Such structures are known to be used to obfuscate beneficial ownership and provide anonymity. Enhanced visibility may encourage lawyers and trust and company service providers to more effectively ascertain the real purpose of such structures.

The record keeping provisions of an expansion will assist investigators pierce the corporate veil in criminal cases. This will provide a mechanism to look through companies and trusts to find the ultimate beneficial owners or natural person pulling the strings. Law enforcement agencies would use the transaction and identity records of lawyers to "follow the money" in criminal investigations.

TIA welcomes active consideration by the Australian Government to establish a Register of Beneficial Ownership (BO)and we trust that such a Register will be made available to citizens as well as relevant authorities. Such a Register would ensure Australia is fulfilling FATF recommendations which require countries "to ensure that adequate, accurate and timely information on the beneficial ownership of corporate vehicles is available and can be accessed by the competent authorities in a timely fashion".[1]

We note "the purpose of the FATF standards on transparency and beneficial ownership is to prevent the misuse of corporate vehicles for money laundering or terrorist financing. However, it is recognised that these FATF standards support the efforts to prevent and detect other designated categories of offences such as tax crimes and corruption. In this respect, the measures that countries implement to enhance transparency in line with the FATF Recommendations may provide a platform to more effectively address serious concerns such as corruption, as well as to meet other international standards."[2]

We trust reforms will also help Australia to provide international cooperation to counterpart law enforcement agencies. There will be another source of BO information available to law enforcement – at the moment, law enforcement can share information but this is not helpful if the BO information is not available.

At the same time, we observe that even without a comprehensive beneficial ownership (BO) register of companies, covering lawyers would be a significant detection step in the right direction.

It seems, and we accept, that the lack of reporting from DNFBP's has resulted in a clear intelligence gap, particularly in relation to the innocent involvement or unwitting facilitation of money laundering activities. Until such time as DNFBPs are obliged to conduct robust customer due diligence, Australia's financial intelligence function will be limited in its ability to identify elements of criminality conducted by clients of professional service providers who engage with firms deliberately to take advantage of their know-how and gain a cloak of legitimacy.

Imposing a requirement on lawyers to implement customer due diligence procedures, even on a risk-basis approach, will in our view also enhance visibility of beneficial ownership of trust accounts and any company and trust structures established for or used by their Australian clients. That is, the real purpose of the structures will then be more sufficiently tested as part of the process. Not only will this enhance Australia's AML/CTF regime, but it will also serve to mitigate the risk of law firms being exploited by criminal or corrupt networks.

Client scrutiny and due diligence under a proper KYC program should then identify early indicators of criminality or potential misconduct and thereby reduce the risk of unwitting breaches being facilitated by particular firms. In our view one cannot ignore the risk

[1] http://www.fatf-gafi.org/publications/fatfrecommendations/documents/transparency-and-beneficial-ownership.html p 3
[2] http://www.fatf-gafi.org/publications/fatfrecommendations/documents/transparency-and-beneficial-ownership.html p 4

potential of professionals being caught up, even in serious and organised criminal activities, and the potential of deliberate disregard of "red flags" of such conduct.

The main publication of TI-UK on the issue of regulating AML/CTFs in that country was *Corruption on Your Doorstep (2015)--* http://www.transparency.org.uk/publications/corruption-on-your-doorstep/ , which pulled together previously unseen data from the National Crime Agency on investigations involving the proceeds of corruption in property and Land Registry data on overseas companies owning property in the UK to help illustrate the scale of the potential risk of money laundering through the UK property market.

Enhanced Awareness and Risk Mitigation

The FATF has assessed that a lack of awareness of ML/TF risks and attendant lack of education amongst DNFBPs, inhibits the identification of ML/TF "red flags" and increases the vulnerability of DNFBPs being exploited by clients seeking to misuse otherwise legitimate services for ML/TF activities.

At the same time in relation to the legal profession, FATF noted the particular challenge:

> "However, investigators have found that a frequent obstacle to accessing information about corporate vehicles is the use of client privilege to refuse to divulge information relevant to the ownership and control of a corporate vehicle. The recent FATF study on Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals also legal professional privilege and legal professional secrecy could impede and delay the criminal investigation. This is appropriate when such claims are made correctly and in accordance with the law. However, some of the case studies do evidence that occasionally extremely wide claims of privilege are made which exceed the generally understood provisions of the protections within the relevant country. **To help address these issues, competent authorities and professional bodies should work to ensure that there is a clear and shared understanding of the scope of legal professional privilege and legal professional secrecy in their own country. In particular, countries should ensure that there is a clear understanding of what is, and what is not covered to ensure that investigations involving suspected corporate vehicles are not inappropriately impeded**.[3]"(our bold)

The absence of risk management training in this area, far less anything like a robust AML/CTF program in most law firms (particularly in those smaller firms likely to be targeted by criminals) and a lack of regulatory obligations to monitor ML/TF risk exacerbates this lack of awareness amongst them.

In fact, the lack of regulation means that these professionals are likely to be less vigilant than other regulated services, rendering them more vulnerable to innocent and unwitting involvement in unlawful activities. In instances where DNFBPs have been unwittingly involved in money laundering activities, lax due diligence regarding the source of money or identity of clients is often a major contributing factor to their exploitation.

[3] http://www.fatf-gafi.org/publications/fatfrecommendations/documents/transparency-and-beneficial-ownership.html p 38

Important Caveat

In this context, it is important to appreciate that quite apart from differences between the States, across the spectrum of the legal profession in this country there is quite a huge diversity of legal practices. Differences in the nature, personality, scope and scale of individual legal practices are a hallmark of the profession.

In our view, the strong contrast between the large, integrated and international firms at the "big" end of town ranging right across to the very many family firms and solo practitioners in the suburbs or country must be fully taken into account in relation to any regulatory change in this area.

That factor alone justifies the proposed round tables mentioned in the government's Consultation Paper. Here we do not espouse differentiated standards for types of law firms.

However, firms in the former category, particularly with their corporate law specialisations, profile and reputation to protect, would be able to and can be expected to comply with regulatory requirements in this area, albeit at some significant administrative cost.
These firms, rather than train all practitioners in the detail of the requirements, may well invest in a specialised internal A M-L compliance group with software. Their standards and scrutiny procedures of engagement of incoming clients can be expected to be high in any event. They can also be expected to responsibly handle and conform to a risk-based approach as described in the AGD paper and to act defensively by reporting in detail rather than casually.

At the other end of the spectrum, however, many such firms will not see the relevance, will be very reluctant to undertake the necessary training and not easily comply.

Those smaller firms who could be "used" by money launderers to offer a veneer or cloak of respectability, may well at times be subject to a combination of pressures- to avoid extra costs and shortage of time or aptitude for training and of course a competitive desire not to lose the client. In that position, they may well be vulnerable to the risks above and can at times become compromised. Firms working in collaboration with real estate agents can be particularly vulnerable.

We suspect many can be subjected to pressure or persuasion by existing or incoming clients, so as to turn a blind eye to "red flags" and not to report simply as the price of retaining the client.

As a result, notwithstanding compliance by the majority of firms- and of course depending on just how it is framed and implemented- one outcome of any proposed regulation of the profession may be a lack of effectiveness.

Time does not permit us in responding to the Consultation to cover the many important questions raised in the Paper. Also we would like to reserve our right to comment at a later stage on the possibility of "red flag" reporting obligations on law firms rather than "suspicious" reporting.

Subject to the point as to differentiation above, we would endorse the governing principle in Para 7 of the Consultation Paper that any obligations proposed for the legal profession "should be **efficient, proportionate to the ML/TF risks and tailored to the nature of the services provided** by the profession". How onerous the compliance regime turns out to be is clearly a very large issue on which the detail will be vital. For instance, if lodgement of SMRs is to be required of lawyers it is likely that the reporting rates will be proportionately higher than for other reporting entity types given the typical risk averse nature of practitioners. Hence we can see good arguments that the scope of "designated services" should be reasonably narrow and any obligations to report to AUSTRAC should be carefully delimited.

The burden on smaller firms might well be relieved by the provision of software applications and training to assist CDD and reporting.

Moreover, we believe that the early creation of a Public Register of beneficial ownership and a reliable register of PEPs will be important cost-reducing ways that burden can be relieved. These initiatives would be greatly welcomed by both the profession and the wider public.

KYC Deficiencies

TIA is of the opinion that the current method that regulated entities are expected to use to identify politically exposed persons and high risk customers is fundamentally flawed and must be addressed as a matter of priority.

Regulated entities in Australia are expected, by default, to obtain information on PEPs and high-risk customers from proprietary databases such as Thomson Reuters World-Check or Accuity, however, TIA has reason to believe that AUSTRAC does not and has never audited these databases to ensure that the information on them is fit for purpose.

World-Check for example, does not contain the names of convicted Australian offenders, except for those who have been convicted of Corporations Law offences. Despite there being potential advantages to banks and other entities knowing when their customer has been convicted of a serious profit-motivated crime in assessing whether to submit an SMR or reject a transaction, such information is unavailable to them.

Furthermore, World-Check information does not include details of more than a few Local Government officials. Salim Mehajer, the controversial former Deputy Mayor of Auburn Council for example, was not included in World-Check until November 2015, several months after his rather extravagant wedding and long after much of the behaviour that is alleged to have generated several million dollars in suspected illicit funds[4].

[4] http://www.news.com.au/finance/work/salim-mehajer-and-father-moved-20m-to-lebanon/news-story/227ab95e008f3cd40725c2f10bc97dc3 ; http://www.smh.com.au/nsw/yo-you-da-man-and-da-groom-20150816-gj07dw.html ; http://www.smh.com.au/business/salim-mehajer-disqualified-from-managing-corporations-for-three-years-20160905-gr8tpz.html ; http://www.abc.net.au/news/2016-02-17/auburn-council-administrator-reverses-salim-mehajer-decision/7178732

Tax Haven/Offshore Entities

The use of a legal entity registered in a tax haven (or secrecy haven) to move illicit funds around the world is a money laundering and terrorist financing method so widely known that it is routinely mentioned in films, books and the media.

For an example of how easy it is to obtain a bank account using a tax-haven-domiciled company one might try www.sfm-offshore.com which will allow you, in a matter of minutes, to obtain a company in any one of 20 jurisdictions and bank account in any one of 19 jurisdictions without providing any form of identification at all.

Despite this, Australia has not sought fit to declare such entities "high-risk" for the purposes of AML/CTF regulation. A declaration, if it were to be made, could be made by AUSTRAC and could require regulated entities to conduct enhanced due diligence on all transactions conducted to and from accounts held by legal entities created or domiciled in tax haven jurisdictions.

TIA has reason to believe that the proceeds of corruption and other crime from around our region are being moved into Australia using bank accounts obtained through legal structures domiciled in tax havens.

TIA strongly encourages such a declaration to be made by AUSTRAC requiring enhanced due diligence on all transactions conducted by legal entities created or domiciled in tax haven jurisdictions.

Intended Effects

Other international experience indicates that the regulation of DNFBPs, by enhancing awareness of ML/TF risks among professional service providers, does increase the likelihood that the activities of corrupt practitioners will be identified and reported to authorities. It is likely that regulation in Australia would have the same effect.

Money laundering activity through professionals such as law firms faces lower risks of detection compared with activities facilitated by the finance sector. At present they also represent an unregulated conduit or "back-door" through which illicit wealth can enter the strongly regulated and monitored banking and finance sector. This places the AML/CTF programs of businesses in the banking and finance sector at risk and detracts from the overall effectiveness of Australia's AML/CTF regime.

Overall, we recognise it does present a distinct challenge. For instance, we note that despite all the red-tape and very strict obligations imposed presently in the UK on the professions, as well as upon the banks, our TI Chapter in London is clearly far from satisfied that enough is being achieved. See for instance their 2016 report previously referenced in this submission.

This assessed current AML supervision in the UK using three reports that set the standard for transparent and effective regulation in that country:

- Hampton: established principles around proportionate and risk-based regulation http://webarchive.nationalarchives.gov.uk/20121212135622/http://www.bis.gov.uk/files/file22988.pdf

- Macrory: set out the framework for ensuring sanctions and enforcement action achieve the desired regulatory effect e.g. deterrence against future non-compliance http://webarchive.nationalarchives.gov.uk/20121212135622/http:/www.bis.gov.uk/files/file44593.pdf

- Clementi: outlined how conflicts of interest should be managed within a regulatory environment http://webarchive.nationalarchives.gov.uk/+/http://www.legal-services-review.org.uk/content/report/report-chap.pdf

In summary, effective regulation of these sectors will assist in enhanced awareness of their ML/TF risks, increase the detection of criminality, and mitigate some of the threats posed by criminal groups to legal firms. In turn, this should lead to reduced ML/TF vulnerabilities.

As well we consider that extension to the legal profession of the AML requirements in a way which is not unduly onerous, should enhance Australia's financial intelligence gathering, increase the identification of suspicious activities, and enhance the capacity of law enforcement agencies to identify and analyse ML/TF risks.

Increased resources for AUSTRAC will be a necessary concomitant of Tranche 2 extensions as we expect that comprehensive supervision, especially across a gamut of different firms at the smaller size end, will be necessary to ensure effectiveness. Hence we underline the importance of ensuring AUSTRAC receives increased funding to strengthen capacity to fulfil an increased mandate.

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Supplementary Note

We note the forthcoming publication by Transparency International which we believe will assist the Minister and Attorney-General's Department officers with consideration of these matters. When the reports are available in coming weeks TIA will send a copy to the Minister and Department ahead of publication.

The forthcoming Reports so referenced are:

Top Secret: Countries Keep Financial Crime Fighting Data to Themselves (Australia Denmark Cyprus France Germany Italy Luxembourg Netherlands Portugal Switzerland UK USA)

Extract from Executive Summary: Where data is public, it is often not the result of transparency of national authorities themselves, but rather through the reports of international anti-money laundering bodies, in particular the Financial Action Task Force (FATF). This lack of information makes it very difficult for a citizen or journalist to get a full picture of the extent of anti-money laundering inspections, investigations, prosecutions and sanctions in their country. People want to know that regulators are keeping criminals out of their banks. The limit to public information begs the question of just how much oversight of the financial industry is actually taking place in practice. Our main recommendation is that **countries should be required to publish statistics on their anti-money laundering efforts on a yearly basis.**

2017 Doors Wide Open – Real Estate in 4 G20 Countries (Australia, Canada, UK, USA)

Methodology:

In 2015, an analysis conducted by Transparency International on the strength of the beneficial ownership transparency framework in G20 countries showed that many of the G20 countries do not adequately regulate professionals involved in the selling and purchasing of real estate. These so-called gatekeepers include real estate agents and developers, notaries, lawyers and accountants. Among the G20 countries identified as having weaknesses in this regard were countries that are currently highly attractive for real estate investment, including Australia, Canada, the UK and the US.

Drawing on the initial findings of the 2015 assessment, this reports explores the main weaknesses related to the real estate sector in these four countries and suggests a set of recommendations to improve the legal framework as well as implementation and enforcement of the law.

For each country, we analysed its current legal framework and its track record of implementing and enforcing these regulations. The analysis also looked into the countries' adherence to international AML standards as well as country-specific commitments. Finally, we also reviewed relevant anti-money laundering cases in the real estate sector.

Using international standards and TI´s recommendations as criteria of good practice, we classified each country's performance using a colour code.