Victorian Legal Services
BOARD + COMMISSIONER

Submission to the Australian Government, Financial Crime Section of the Attorney-General's Department Consultation Paper

Legal Practitioners and conveyances: a model for regulation under Australia's anti-money laundering and counter terrorism financing regime

Summary

- In principle, the Victorian Legal Services Board and the Victorian Legal Services Commissioner (VLSB+C) supports the extension of anti-money laundering and counter terrorism financing (AML/CTF) obligations where necessary to negate the risks posed by certain business and financial activities engaged in by legal practitioners on behalf of their clients.
- Any new regulatory measures should not unduly burden legal practitioners' legitimate business operations or disproportionately increase the costs of regulation to the community.
- VLSB+C recognises there are risks such activities could be infiltrated by criminals either with the knowing or unwitting involvement of the legal practitioner. More information and data about the risk profiles of these legal practitioners is sought.
- As VLSB+C regulatory activities largely aim to protect the consumer, data collected about legal practitioners does not typically identify money laundering and terrorism financing (ML/TF) risks. Nonetheless, aspects of current regulatory activity undertaken by VLSB+C supports some AML/CTF obligations, particularly in the area of trust account regulation.
- Further consideration of the impact of AML/CTF obligations on legal professional privilege and the particular impact of regulatory costs on small legal practices is warranted.
- A risk-based approach is endorsed, as it is cost-effective and targeted and allows legal practitioners to make valuable assessments of their own businesses and make informed decisions about appropriate allocation of resources.
- VLSB+C supports simplified due diligence options being made available to legal professionals operating low-risk services, particularly in small practices.
- VLSB+C supports a transitional period for any AML/CTF amendments ultimately proposed to become effective.
- VLSB+C supports a cooperative model with AUSTRAC as lead regulator.

Introduction

The Victorian Legal Services Board and the Victorian Legal Services Commissioner are the independent statutory authorities responsible for the regulation of the legal profession in Victoria under the *Legal Profession Uniform Law* (Uniform Law), both authorities being accountable to the Victorian Parliament. The two authorities effectively operate as one body, the VLSB+C.

VLSB+C acknowledges the importance of Australia's compliance with its international obligations and that the threat posed by criminal groups active in money laundering and terrorism financing requires a strong regulatory response. It understands the AML/CTF regime as it currently operates in Australia complements the criminal justice system by providing a framework for information gathering from the private sector, particularly the financial services and banking sectors, about the movement of money and assets by criminal networks. The consultation paper proposes

Board ABN 82 518 945 610 **Commissioner** ABN 66 489 344 310

that this regime, which is focused on client due diligence and suspicious matter reporting obligations, be extended to certain activities undertaken by legal practitioners viewed as vulnerable to infiltration by criminals.

VLSB+C welcomes the opportunity to assist in the generation of discussion about the development of options for regulating legal practitioners under the AML/CTF Act.[1] VLSB+C supports the Australian Government in finding the most efficient and effective way to address the risks specifically posed by legal practitioners as professionals, without unduly hampering their legitimate business operations or disproportionately increasing the costs of regulation to the community relative to that risk.

The risk-based and co-operative elements of the model supporting AML/CTF regulation share similarities with VLSB+C's approach; however, there are also important differences. VLSB+C's detection of regulatory breaches is largely reliant on clients' complaints about legal services received. As criminal elements are highly unlikely to complain about these services, VLSB+C typically does not identify legal practitioners' inadvertent or deliberate provision of services to such groups. Moreover, while VLSB+C monitors and audits trust accounts, its activities are designed to reveal irregularities to uncover potential incompetent and fraudulent management of funds resulting in client losses, rather than reporting on the reason clients have money in trust. While conduct involving money laundering or terrorism financing would be met with regulatory action if it came to VLSB+C's attention, the framework it operates under is focused on protecting consumers rather than detecting these crimes.

Existing Regulation – Overview

This section includes information in response to Discussion Question 5

The legal profession has been regulated in Victoria for over a century. The Uniform Law currently provides a robust and effective regulatory framework with a strong consumer protection focus through promotion, monitoring and enforcement of the high professional standards of legal practitioners.[2] VLSB+C works co-operatively with the Law Institute of Victoria (LIV), the Victorian Bar (the Bar)[3] and a range of other organisations, including regulators forming part of the Uniform framework,[4] in support of these standards. 20,593 lawyers received practising certificates in Victoria in 2015-16.[5]

The Uniform Law commenced on 1 July 2015 in Victoria and New South Wales, establishing a common 'uniform' framework for regulation across both states. In Victoria, the Uniform Law forms Schedule 1 of the *Legal Profession Uniform Law Application Act* (Vic) 2014 (Application Act) and is implemented in Victoria through that Act. One of the main objectives of the Uniform Law is to provide and promote interjurisdictional consistency in the regulation of legal practitioners.

Although VLSB+C operate effectively as one body, each is allocated separate regulatory functions under the Application Act. The Board is responsible for a broad range of regulatory functions, including most relevantly to this submission:

- issuing, renewing, suspending, cancelling and imposing conditions on practising certificates including making decisions about the whether the applicant is a fit and proper person to practice law;
- maintaining the Victorian legal profession register and register of disciplinary action;
- monitoring, inspecting and conducting investigations of law practices' trust accounts;

[1] The *Anti-Money Laundering and Counter-Terrorism Financing Act* 2006 and the associated Rules and Regulations
[2] The six objectives of the Uniform Law are set out in section 3 of Schedule 1 of the Application Act
[3] Some statutory functions are delegated to these bodies, for example, fidelity fund claim investigations is a function delegated to the LIV
[4] Including the Commissioner for Uniform Legal Services Regulation, the Legal Services Council and the NSW regulators
[5] Extensive further data may be found in our Annual Report for 2015-2016

- administering a range of external interventions into law practices from compliance audits to the appointment of a receiver; and
- prosecuting breaches of the Application Act, including applying for removal of lawyers' names from the Supreme Court roll where necessary.

The Commissioner is responsible for the receipt, management and resolution of complaints about the conduct of lawyers by members of the community or by own motion, which can extend to a lawyer's conduct outside of legal practice. Any such investigation may result in the Commissioner taking a variety of disciplinary actions. Regulatory actions against lawyers are in addition to any other criminal or civil sanctions imposed and both authorities are obliged to report serious offences to the relevant prosecuting authority.[6]

The Commissioner also has an important role in the education of the community and the legal profession as to regulatory and other issues of relevance to the legal profession and the delivery of legal services to the community.

Risks and Costs

This section includes information in response to Discussion Questions 1 to 4, 6, 7 and 11

The discussion paper has identified a range of financial and business services provided by legal practitioners for their clients that are open to misuse and facilitation of criminal activity, based on international standards and experience. These services have the potential to disguise beneficial ownership of assets, hide the source and purpose of transactions and provide a 'veneer of legitimacy' and legality by association with the business of a legal professional. Services identified internationally by the FATF[7] include the creation and management of client accounts, money and other securities and complex company and trust structures, as well as the buying and selling of property and business entities. The New Zealand experience highlights activities involving professional client accounts, formation of trusts and companies and conveyancing as particularly attractive for ML/TF operatives.[8]

VLSB+C's own experience in detecting organised crime groups' use of legal practitioners to improperly procure these services is limited. While there have been instances of legal practitioners developing inappropriate associations with underworld figures and crossing the line to engage in criminal activity, these have been infrequent and appropriate regulatory action taken. VLSB+C is not aware of systematic criminal infiltration of these activities within the legal profession. The VLSB+C would be interested - as part of this review - in information being made available that reveals the extent to which legal practitioners are either inadvertently or deliberately providing services to criminal organisations; the profiles of these legal practitioners; and the types of indicators used to detect them.[9]

While VLSB+C's regulatory approach is not designed to reveal the procurement of legal services by organised criminals, it is adept at exposing rogue lawyers working alone for personal benefit. Typically these acts involve dishonest and large trust defalcations, exposed through complaints, claims on the fidelity fund or trust account irregularities. The intervention of the trust account inspection regime, a function delegated to the LIV, is also a critical element in the detection and ultimate criminal prosecutions of legal practitioners brought by the Board or Victoria Police.

VLSB+C also finds that a poor standard of record keeping by legal practitioners is not uncommon and can lead to a range of regulatory issues. The Financial Action Task Force (FATF) has identified that there is a lack of awareness of ML/TF risks amongst legal practitioners which inhibits their ability to identify those risk factors in the particular

[6] See Section 465 of the Uniform Law

[7] By FATF, the Financial Action Task Force, an inter-governmental policy making body responsible for AML/CTF standards and compliance

[8] Information paper on exposure draft amendment bill for NZ AML/CTF reforms, December 2016

[9] The New Zealand Government in its Information Paper exposure draft of its AML/CTF bill has noted evidence received from the NZ Police Financial Intelligence Unit

transactions being performed. Therefore VLSB+C acknowledges the benefits envisaged in including activities performed by legal practitioners within the AML/CTF regime espoused in section 2.1; however, a greater understanding of the extent and nuances of the problem would be advantageous.

The potential costs of imposing AML/CTF requirements for law practices would vary depending on their size and types of activities performed. Many legal practitioners operating in the financial sector are already subject to the regime while others may have to introduce systems improvements and training from a much lower base. The cost of compliance may deter legal practitioners from continuing to offer trust account related services. It is assumed that the majority of law practices, particularly larger ones, pass on the costs of regulation to clients and therefore much of the cost of ML/TF compliance would be borne by the users of legal services. It should be noted that clients using trust account services already bear a greater regulatory costs burden than other consumers of legal services in that interest earned on that trust money is forgone and mostly used to pay for regulatory activities in Victoria.[10]

The Victorian Government has identified that small businesses, being those of 20 employees or less, are often disproportionately affected by regulation and have less ability to pass on those costs. The majority of the legal profession in Victoria consists of businesses that meet that definition. There were 4,945 legal practitioners registered as 'sole practitioners' being over 25% of total legal practitioners registered.[11] VLSB + C data also shows this type of practice also features disproportionately in regulatory actions relative to the numbers of those practices. Data on the type of transaction undertaken by type of law practice is not collected and therefore the level of ML/TF risk to type of practice is not readily accessible.

How may current regulation address ML/CF risks for legal practitioners?

This section includes information in response to Discussion Questions 2 to 6

The consultation paper in section 3 at page 10, identifies that the trust accounting regime, although extensive and robust, is misaligned to deal with ML/TF risks. This is because it is focused on protection of client trust money and property from the dishonest and poor management of legal practitioners, rather than addressing the specific problem of legal practitioners ensuring that the client is not misusing the trust account as a vehicle for ML/TF purposes. This reflects VLSB+C's consumer directed regulatory model; nonetheless, AML/CTF obligations, particularly client due diligence, may be specifically supported by some aspects of these provisions. This makes trust accounts potentially less vulnerable to ML/TF and an area where existing regulation levels make compliance with AML/CTF requirements less onerous.

Chapter 4 of the Uniform Law and associated Rules contain extensive provisions concerning the handling of trust money and trust property by legal practitioners containing a range of civil and criminal penalties.[12] A law practice may not receive trust money, unless there is a legal practitioner holding a practising certificate with trust authorisation, thereby limiting the scope of the risk of this activity to around 18 per cent of legal practitioners.[13] All trust accounts operated by law practices must be disclosed to the VLSB+C and are closely monitored and then audited by an approved external examiner annually. In addition, a variety of trust account investigations may be initiated where there is a 'suspicion' regarding the trust money.[14] Extensive powers of investigation including search and entry powers are conferred on agents of the VLSB+C where there are trust concerns.[15]

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[10] Detailed information about the costs of legal profession regulation in Victoria may be found in "Review of Lawyers' Practising Certificate Fees – Discussion paper 2017 available on the VLSB + C website at: www.vlsbc.vic.gov.au

[11] Source: Internal Data

[12] The Uniform Law is supported by a number of sets of Rules concerning professional development, admission and ethical conduct as well as the *Legal Profession Uniform General Rules* 2015 (General Rules) which include rules supporting the trust accounting regime.

[13] In 2015-16, 17% (3, 490) of legal practitioners held a principle practising certificate with trust authorisation

[14] Section 163 of the Uniform Law

[15] See chapter 7 of the Uniform Law

AML/CTF due diligence obligations are supported by trust record keeping provisions which require the name, address and 'reason' the money was received. Cash payments are subjected to greater restriction and record keeping.[16] Penalties apply where a law practice knowingly receives money in a false name.[17] A law practice is also required to hold a register of investments and a register of powers and estates.[18] *Any* "irregularities' with respect to trust money and property must be reported to the VLSB+C by any legal practitioner associate of the law practice (not just the principal holding the trust certificate), the external examiner or the financial institution authorised to hold the account. The term "irregularity" is not defined. Reports received, however, have only ever concerned matters such as deposits being made into incorrect accounts or monies being withdrawn for office expenses, which may amount to serious breaches of the trust provisions, but are matters focused on protecting the trust money. Although technically possible, reports on an irregularity in the dealing of trust money by the beneficial owner do not occur. The provisions are simply not designed for the purpose of detecting ML/TF activities.

The trust accounting regime, however, is just one manifestation of the extensive and pervasive ethical obligations imposed upon lawyers both at common law and as embodied in statute. Central is the paramount duty to the Court and the administration of justice.[19] The *Legal Profession Uniform Law Australian Solicitors Conduct Rules* 2015, require lawyers to act only upon the lawful and proper instructions of clients and to be honest and avoid compromises to their integrity. As mentioned above, VLSB+C investigates and conducts audits and can impose a wide range of sanctions upon lawyers for ethical breaches, including loss of the right to practise law.

These ethical obligations generally militate against legal practitioners' descent into criminal activity or allowing their businesses to be misused for unlawful purposes; however, the VLSB+C experience is that a small minority will disregard these obligations. A lawyer found to be either colluding with criminals engaged in ML/TF activity or unwittingly allowing their businesses to be conduits for illegal activity, can expect regulatory action in addition to any criminal and civil sanctions imposed.

More regulation of legal practitioners may be justified given the regulatory gap identified above, so long as it is targeted and proportionate to the risk both on the basis of the transaction contemplated, the client's particular profile and the nature of the retainer.

Experience in other countries

This section includes information in response to Discussion Question 9

The experience in the UK is informative in that it appears to have been initially misdirected with legal practitioners putting too much effort into low risk transactions. This highlights the importance of good practical guidance[20]. The Canadian experience is of particular importance and is discussed further below. The New Zealand government has now released their AML/CTF Bill for comment with both a six month phased implementation period and closer alignment to the statutory definition for legal professional privilege embodied in their Evidence Act.

[16] See for example Rule 36 of the General Rules
[17] Section 147(4) of the Uniform Law
[18] Rule 59 and 60 of the General Rules
[19] As currently embodied in Rule 3 of the *Legal Profession Uniform Law Australian Solicitors Conduct Rules* 2015
[20] Law Council of Australia, Anti Money Laundering Guide for legal practitioners, as updated January 2016 and Queensland Law Society AML & CTF reforms, Advance Guide for Solicitors, October 2008

Impact of AML/CTF obligations on the lawyer client relationship

This section includes information in response to Discussion Questions 10 to 15

Legal practitioners are well used to tensions between ethical and legal obligations. The profession has expressed genuine concerns about the application of the AML/CTF obligations upon legal professional privilege in particular. Legal practitioners are guided by their paramount duty to the Court and the administration of justice, a duty which prevails above all others, including to the client where there is an inconsistency. A difficulty with this is that the preservation of the privilege also furthers the administration of justice. The current section of the AML/CTF Act expressly states that the law relating to privilege is not affected and there are other safeguards such as immunity from suit and that reports made about suspicious transactions are not admissible.

Further consideration of these issues is warranted, especially in light of the Canadian experience. Here the Canadian Law Society successfully challenged the implementation of AML/CTF obligations upon legal practitioners on the ground the obligations unduly interfered with legal professional privilege. Nevertheless, the issue does not demand a blanket exemption for legal practitioners making suspicious matter reports without further exploration and the concerns should be appropriately accommodated. There is also the potential benefit in lawyers developing a greater awareness and understanding of the application of legal professional privilege.

Assessing the expected impacts of regulatory intervention would be assisted by analysis of data matching type of transaction to type of practice. For example, a sole practitioner operating a conveyancing practice with a trust account may present a greater risk than a large personal injury practice, as opposed to a corporate lawyer advising on complex business structures. VLSB+C questions the view expressed that criminal law and general firms will not be impacted, as many of these firms operate trust accounts.

VLSB+C supports the following proposals in the discussion paper:

- The risk-based approach, as it is cost-effective and targeted. It encourages legal practitioners to make valuable assessments of their own businesses and make informed decisions about appropriate allocation of resources. Some law practices will be better equipped to do this than others, but good guidance by regulators and professional associations would reduce the compliance burden.
- The simplified customer due diligence options being made available to legal professionals operating low-risk services.
- A transitional period for the AML/CTF to become effective based on VLSB+C's experience in implementing the Uniform Law.

A model for Regulation

This section includes information in response to Discussion Questions raised in Section 7 of the discussion paper

VLSB+C collects data about legal practitioners in accordance with the requirements of the Uniform Law - such as those holding trust accounts - but the data is limited in its application to a legal practitioner's ML/CT risk. For example, data demonstrating that legal practitioners have provided advice to clients about company or trust structures is not collected. Additional enrolment with AUSTRAC by those practitioners identifying their own exposure to ML/CT risk would address this. Similarly the VLSB+C are of the view suspicious matter reporting should be made to AUSTRAC, a body that already has the expertise to properly analyse and make appropriate decisions about information received.

VLSB+C may provide assistance by raising awareness of AML/CTF compliance with legal practitioners as an aspect of its education function. The VLSB+C may also seek to strengthen interagency co-operation with AUSTRAC to the

levels in place with other regulators and law enforcement bodies. VLSB+C have an existing duty under the Uniform Law to report suspected serious offences to the appropriate law enforcement authorities.[21]

More detailed analysis will be important in determining who should bear the regulatory costs. It is also important that there be a consistent approach across Australia to avoid exploitation by criminal groups in jurisdictions with weaker regulatory regimes. More specifically, a relevant factor to consider for Victoria and New South Wales is the processes under the Uniform Law for implementing changes to that law and the relevant Rules. Although each regulator operates independently of the framework, the uniform bodies have a statutory role in the formation of and guidance about implementation of the Uniform Law.

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Board CEO & Commissioner

[21] Section 465 of the Uniform Law