Chapter 3 Implementing Anti-Money Laundering Legislation and the Professions

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Introduction

In October 2007, the Internal Revenue Service (IRS) in the United States commenced a federal investigation into a high-end prostitution ring operating out of a New York City club known as Emperors Club VIP.[1] The IRS was investigating wire transfers which showed up on transaction records as QAT Consulting. QAT and the Emperors Club had the same listed address in New York. The investigation gathered more than 5,000 telephone calls and text messages, and over 6,000 e-mails, along with bank records, travel and hotel records and surveillance. Conversations were recorded about someone identified as 'Client 9', including one where a prostitute identified as 'Kristen' should take a train from New York to Washington for a tryst on the night of February 13. The wiretaps enabled government agents to listen as the woman later told the ring's booking agent that she had secured $4,300 in cash from her client. 'Client 9' was later identified as New York Governor Eliot Spitzer. Three wire transfers amounting to just $5,000 apiece set alarm bells ringing. Spitzer was caught in this web of deceit because the prostitutes he hired were so expensive that he needed to shuffle several thousands of dollars around each time. Realising that banks often reported suspicious money transfers to the IRS to combat financial fraud and money laundering, Spitzer had tried to structure his money transfers to avoid suspicion. These acts were enough to trigger red flags at his bank and a suspicious activity report was submitted to the Financial Crimes Enforcement Network. Spitzer resigned as Governor of New York in March this year and faces a number of money laundering and other charges.

The lesson to be learned from former New York governor Eliot Spitzer's scandal-driven fall (aside from the most obvious one), is that the dynamics of the money laundering environment are today much more sophisticated, yet often unassuming. It is estimated that about $1.5 trillion of illegal funds are laundered in both large and small transactions each year worldwide.[2] In Australia the Institute of Criminology has estimated that $4.5 billion of this is laundered in Australia.[3]

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[1] Danny Hakim and William K Rashbaum, 'Spitzer is Linked to Prostitution Ring', *The New York Times*, (New York), 10 March 2008.

[2] Financial Action Task Force, *Money Laundering FAQ* <**http://www.fatf-gafi.org/document/29/0,3343,en_32250379_32235720_33659613_1_1_1_1,00.html**>.

[3] Australian Institute of Criminology, *How Much Money is Laundered In and Through Australia?* (2007) <**www.aic.gov.au/media/2007/20070913.html**>.

Who is affected by the AML/CTF legislation?

The fight against money laundering and terrorist financing has today become a priority for the international community prompting an array of legislation being enacted in numerous countries worldwide. Australia, like many other jurisdictions, has responded by introducing AML/CTF legislation.[4]

At present only the first 'tranche', or stage, of the legislation which relates to the financial services sector, the gambling sector and bullion dealers in Australia has come into effect. A second tranche of legislation, which will affect lawyers, accountants, trust and company service providers, real estate agents and jewellers has recently been drafted and was released for public comment in August this year.[5]

As we know the legislation imposes obligations on 'reporting entities'[6] offering specific services in the course of 'carrying on a business' that could be exploited to launder money or to finance terrorism. In the first tranche legislation there were more than 70 specific services identified as 'designated services'.[7] The proposed second tranche amendments, which directly relate to the professions, identify a new range of services as 'designated services'. Such activities may include for example, giving advice or acting on the management of, accounts, physical currency or property, giving advice or acting in connection with the sale or purchase of a business, giving advice or acting in connection with the formation of a new company, or giving advice or acting in connection with the creation of a trust or partnership. The breath of activities will invariably mean that almost all lawyers will be subject to the AML/CTF obligations.

Reporting obligations

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[4] In December 2003, the Australian Government announced a review of Australia's Anti–Money Laundering/Counter Terrorist Financing (AML/CTF) system as part of the implementation of international standards issued by the Financial Action Task Force (FATF). Following a lengthy consultation process, a new *AML/CTF Act* was proclaimed on 12 December 2006. It replaced the existing *Financial Transaction Reports Act 1988* (FTRA). On 12 April 2007, the *Anti-Money Laundering and Counter-Terrorism Financing Amendment Act 2007* (Cth), which amends the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006*, was enacted.

[5] See Attorney-General's Department, *Second Tranche of Reforms* (2008) <**http://www.ag.gov.au/www/agd/agd.nsf/Page/Anti-moneylaundering_SecondTrancheofReforms**>. Submissions concerning the proposed reform and the draft Second Tranche Designated Services Table can be found at the Attorney-General's Department's website.

[6] See AUSTRAC, *Public Legal Interpretation No 4 of 2008*: *What Constitutes a Reporting Entity* (2008) <http://www.austrac.gov.au/files/pli_4_reporting_entity.pdf>. For the definition of business, see s 5 of the *AML/CTF Act 2006*.

[7] See s 5 of the *AML/CTF Act 2006*.

Professionals who provide any of these services will, in due course, be subject to the AML/CTF obligations. Such obligations include a requirement to undertake specified customer identification procedures and undertake ongoing customer due diligence. Reporting entities are also required to report suspect transactions and suspicious matters. Further to this obligation, reporting entities are required to report suspicious threshold transactions and international funds transfer instructions. Reporting entities must make a suspicious matter report where they form a 'reasonable suspicion' in relation to certain matters. A 'reasonable suspicion' must be based on the facts and information available to the reporting entity, and is both an objective and subjective standard. The AML/CTF Act contemplates that in some circumstances a reporting entity will not have formed a reasonable suspicion that a matter specified in s 41 of the *AML/CTF Act* has arisen, unless it has conducted an investigation into the customer's behaviour or information.[8]

AML compliance programs

As a result of these obligations most professionals will, in due course, be required to establish, maintain and comply with an anti-money laundering compliance program.[9] As part of the program, professionals will have to appoint an Anti-Money Laundering Compliance Officer (AMLCO). At the end of a specified period they will be required to produce a report setting out the reporting entities' compliance with their specific requirements.

According to Paddy Oliver, Director of Legal Risk, SSAMM Management Consulting, in order for firms to comply with the legislation they will need to implement a 'robust programme'. Oliver suggests that the programme include the following elements:[10]

> An Anti-Money Laundering Compliance Officer (AMLCO) or a similar position. The AMLCO needs to be a senior person with a good overall view of the firm, its services, clients, and risk profile;
>
> Robust identification and verification procedures. Each relevant member of staff should be conversant with the ID requirements for each type of client;
>
> A system for opening new matters. In a risk based system, AML/CTF should be part of the risk assessment for every new file. Do not allow matters to be opened which by-pass the firm's procedures. Change the firm's retainer letter to outline the extent of the AML/CTF procedures and how it will affect them;

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[8] See AUSTRAC, *Public Legal Interpretation No 6 of 2008: Suspect Transactions and Suspicious Matter Reports* (2008)
<http://www.austrac.gov.au/files/pli6_sustrs_and_smrs.pdf>.
[9] See pt 7 of the *AML/CTF Act* for the three different types of AML compliance programs.
[10] See Paddy Oliver, *Money Laundering Lessons for Lawyers* (2008) 2–3.

Rules and controls around the use of the firm's trust account. Ensure that the account is only used when there is an underlying legitimate transaction.

A policy on accepting cash from clients. This is client due diligence. Cash can easily be from proceeds of crime;

An effective suspicious matter reporting (SMR) system. SMRs need to go to the AMLCO quickly so that the AMLCO can act upon it. The SMR should be treated as confidential and not placed on the client file. Also, the client should not be billed for the time taken in investigating the potentially suspicious matter;

Records need to be kept for the statutory period of time. This may be longer than the firm's current file destruction policy for that type of matter;

Training for staff. All staff will need to be appropriately trained in what is a suspicious transaction, common money laundering strategies, why the AML/CTF regime exists etc. Obviously lawyers, accounts staff and certain other front line staff will need a higher level of training. Tipping off will be an important topic, as will issues around legal professional privilege.

The programme will need to be implemented by firms irrespective of their size. This means that all firms will need to train staff, appoint an AMLCO, maintain effective records, and implement effective technology to identify customers whether they are a large firm or a sole rural practice.

Implications of the AML/CTF Legislation

These requirements imposed by the Act greatly concern the professions. One of the biggest concerns is the expected economic and practical cost of implementing the compliance programme. Experience abroad has shown that implementing an anti-money laundering programme is very costly. PricewaterhouseCoopers has stated that the biggest challenges are technology implementation and staff training followed by the need to work towards global standards.[11] From administration to staff training to the provision of storage space for records, the costs of complying are a struggle for many of the smaller accountancy, financial and legal firms. A recent study in the United Kingdom (UK) by LexisNexis has revealed that one in four firms say they faced difficulties implementing the new regulations.[12] The study also revealed that more than half of smaller firms (50 to 100 staff) experienced significantly more problems maintaining awareness of regulatory obligations than medium-to-large sized firms (101 to 250 staff and 251 to 500 staff, respectively) who did not.

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[11] See Stuart Fagg, 'Risk-based Laundering Approach Yields Little Fruit', *Lawyers Weekly*, 10 August 2007.

[12] LexisNexis, 'Small Firms Struggle with Money Laundering Regulations Six Months After Implementation', *Lexis Nexis UK* (18 June 2008).

The main concern for the professions is that there will be a large number of professionals unable to meet the cost of implementing this program. This is due to the structure of the professional marketplace and the dominance of sole practitioner firms. In New South Wales, for example, sole practitioners constitute more than 80% of legal practices. The situation is similar for financial planners and real estate agents.

In addition to the cost, there is a concern that onerous reporting obligations will place additional pressure on firms to manage their practice to comply with the legislation. For the larger firms the impact of this extra pressure may not be problematic but for the sole practitioner it can be. Sole practitioners or practitioners in smaller firms may find the demands of professional practice more difficult. Unlike larger firms, sole practitioners deal not only with client demands but also with the demands of day-to-day practice management. Thus the skills needed for a successful sole practice include not only technical skills in the relevant profession but also business skills, communications skills, technological skills, personnel skills and management skills. Not every practitioner is able to cope effectively with these demands. Consequently these practitioners often find themselves the subject of complaints to my office, the Office of the New South Wales Legal Services Commissioner (OLSC). This is particularly true for the legal profession. Evidence from my Office indicates that among practice groups, sole practitioners unfortunately bear the brunt of complaints. The increased demands of compliance and the added pressure of an AUSTRAC audit will almost definitely result in further complaints.

Inconsistent obligations with the practice of law

Another concern is that the reporting obligations, such as the suspicious reporting requirement, place almost impossible ethical requirements on professionals to conform. This is particularly true for the legal profession because the reporting requirements present a substantial danger to the foundations of legal practice and adversely interfere with the fiduciary relationship between lawyers and clients.[13]

Among the greatest threats to the legal profession is the incompatibility between the proposed compliance requirements with the principles of client confidentiality and legal professional privilege. Legal practitioners are bound by a conduct rule which prevents them from disclosing to any person who is not a partner, proprietor, director or employee of the practitioner's firm, any information which is confidential to a client and acquired by the practitioner's firm unless the client authorises disclosure or the practitioner is compelled by law to disclose the information.[14] Similarly, legal professional privilege is a fundamental rule

[13] See Law Council of Australia, *Revised Anti-Money Laundering and Counter-Terrorism Financing Exposure Draft Bill* (28 August 2006) 4.

[14] For information regarding the confidentiality requirements of legal practitioners in New South Wales, see rule 2 of the Revised Professional Conduct and Practice Rules 1995

central to the practice of law. The rule exists for the benefit of the client: it is the client's privilege and not the lawyer's privilege which needs to be protected. The privilege protects confidentiality of certain communications made in connection with the giving or obtaining of legal advice or the provision of legal services. Legal practitioners who undertake identity checks and report suspicious transactions may be in breach of these principles.[15]

Notwithstanding the ethical inconsistencies, the reporting of suspicious transactions and matters can be contrary to the role and practice of legal practitioners. Lawyers are trained not to make subjective decisions about their clients. Nor are lawyers taught to make judgments about the client's guilt or innocence. In fact the Practice Rules specifically prohibit a lawyer from doing so. The *Crimes Act 1900* (NSW) states that a practitioner must report to the police a suspicion based on reasonable grounds that a crime is to be committed. This is however exactly the opposite of what the *AML/CTF Act* is asking lawyers to do. Public Legal Interpretation No 6 of 2008, released by AUSTRAC as guidance, for example, allows a reporting entity to 'investigate a suspicious matter' before forming a reportable suspicion.[16] My concern is that the invitation to 'investigate' one's own clients is an invitation for unethical behaviour and thus an invitation for complaints.

A solution to this predicament would be to utilise the philosophy of the *Crimes Act* which requires prospective reporting — reporting entities under the AML/CTF legislation would be required to report clients who they believe are about to commit a crime. Using this philosophy makes sense for two reasons. Firstly, practitioners would not be forced to subjectively assess the guilt or innocence of their client. Secondly, this is something that the legal profession is familiar with.

Practitioners who fail to comply with the legislation face the risk of prosecution for money laundering offences under Division 400 of the *Criminal Code Act 1995* (Cth) (Criminal Code). Offences under Division 400 include intentionally, recklessly or negligently dealing with the proceeds of crime or an instrument of crime. Penalties range from 12 months imprisonment and/or 60 penalty units to 25 years imprisonment and/or 1500 penalty units, depending on the monetary value and the degree of culpability. Of more potential concern to practitioners is the s 400.9 offence of receiving, possessing, concealing or disposing of money or other property where it is reasonable to suspect that the money or other property is the proceeds of a crime in relation to a commonwealth, state, territory or foreign indictable offence. The burden of proof is reversed and placed on the defendant. The penalty is two years imprisonment and/or 50 penalty units (s 400.9(1)). In addition to the

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(Solicitor's Rules), Law Society of NSW, available at <http://www.lawsociety.com.au/ForSolicitors/professionalstandards/Ruleslegislation/SolicitorsRules/index.htm>.

[15] See Law Council of Australia, *Legal Practitioners, Accountants and Company and Trust Service Providers* (4 May 2004).

[16] See< http://www.austrac.gov.au/pli.html>.

principal money laundering offences, there are accessorial offences, including attempting, aiding, abetting, counselling or procuring, incitement, and conspiracy.

The reporting regime imposed by the *AML/CTF Act* is overwhelmingly complex. The risk of prosecution will mean that nearly all legal practitioners as reporting entities, who will no doubt be caught under the Act because it is so broad, will have to be able to understand and implement the legislation. This is not going to be an easy task. The legislation as it currently stands contains over 296 pages of provisions, many of which would be unfamiliar to the sole practitioner or smaller law firms. For example, clause 41 of Division 2, Part 3 of the Act which sets out the suspicious reporting provisions provides that a reporting entity must report certain 'suspicious matters' related to the provision or prospective provision of a 'designated service'. An entity must report any suspicious transactions within three days of the entity having grounds for suspecting that it may relate to tax evasion or a criminal offence, and within 24 hours if it relates to terrorism financing.

The obligation is a big ask. It basically requires reporting entities to have knowledge about all of the offences that they are required to report on. A reporting entity would thus have to know all the offences that could amount to an evasion of taxation law, all offences that could amount to an offence against the Commonwealth or a Territory, all offences in relation to the *Proceeds of Crime Act* and all offences that could amount to terrorism. I doubt whether there are many professionals other than a select few criminal lawyers who would have this kind of knowledge.

Noting the complexities, industry bodies have been quick to develop programs in countries such as the UK where legislation has come into force to assist the professions in the implementation process. The Consultative Committee of Accountancy Bodies (CCAB), for example, released an Anti-Money Laundering Guidance for the Accountancy Sector.[17] Similar efforts have been made by the legal profession in the UK to assist lawyers with the Law Society of England and Wales releasing a 130-page Anti-Money Laundering Practice Note.[18] The purpose of the Practice Note is to outline the legal and regulatory framework of AML/CTF obligations for solicitors within the UK, outline good practice on implementing the legal requirements, outline good practice in developing systems and controls to prevent solicitors being used to facilitate money laundering and terrorist financing; and provide direction on applying the risk-based approach to compliance effectively. The FATF has also

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[17] The Institute of Chartered Accountants, *CCAB Money Laundering Guidance* (2008) <**http://www.icaew.com/index.cfm/route/153375/icaew_ga/en/Technical_amp_Business_Topics/Topics/Law_and_regulation/Revised_money_laundering_guidance**>.

[18] See The Law Society of England and Wales, *Anti-Money Laundering Practice Note* (22 February 2008) <**http://www.lawsociety.org.uk/productsandservices/practicenotes/aml/amlprint.page**>.

released Guidance for legal professionals[19] and accountants.[20] The FATF Guidance supports the development of a common understanding of what the risk-based approach involves, outlines the high-level principles involved in applying the risk-based approach, and indicates good public and private sector practice in the design and implementation of an effective risk-based approach.[21]

In Australia efforts are also underway to assist the professions in implementing an effective risk-based AML/CTF program. The OLSC in conjunction with the Legal Services Commissioners in Queensland and Victoria and the Legal Practice Board in Western Australia have been working together with the Law Council of Australia to develop implementation guidelines for the profession. The guidelines will suggest best practice for implementing an effective anti-money laundering program that is practical and user-friendly for all law firms irrespective of their size.

Conclusion

We should however learn from experience. In 2006, Phillip Griffiths, a solicitor in the United Kingdom, was sentenced to six months imprisonment for a money laundering offence. Mr Griffiths had acted for an estate agent whom he knew and trusted in the purchase of a house for less than its value. The property had been sold by drug traffickers. Mr Griffiths was convicted of failing to disclose to authorities when he had reasonable grounds for knowing or suspecting that a transaction involved money laundering. What turned out to be a simple mistake, an oversight, according to Mr Griffiths, led to a serious conviction and ultimately resulted in the loss of his practice. Upon receiving his sentence, Mr Griffiths warned other money laundering reporting officers (MLROs) that 'it only takes one error' to find themselves in the same situation.[22]

This example of an individual caught under the AML/CTF legislation in the United Kingdom is informative. Mr Griffith knew his client, and accordingly, the provisions of the legislation in relation to identity would not have assisted. The whole concept of determining identity is about building a relationship with your client. This is true for any profession and is particularly good practice for the legal profession. Although Mr Griffith knew his client, he obviously did not know him as well as he thought. Better

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[19] See Financial Action Task Force, *RBA Guidance for Legal Professionals* (23 October 2008) <**http://www.fatf-gafi.org/dataoecd/5/58/41584211.pdf**>.
[20] See Financial Action Task Force, *RBA Guidance for Accountants* (17 June 2008) <**http://www.fatf-gafi.org/dataoecd/19/40/41091859.pdf**>.
[21] Similarly the UK Joint Money Laundering Steering Group (JMLSG) has produced a number of Money Laundering Guidance Notes to assist the financial sector. The Joint Money Laundering Steering Group, Industry Guidance is available at <**http://www.jmlsg.org.uk/bba/jsp/polopoly.jsp?d=758&menu=expand**>.
[22] See 'Solicitor Jailed for Money Laundering Offence Hits Out at Injustice of Sentence', *Law Society Gazette* (London), 9 November 2006.

communications with his client may have prevented Mr Griffiths from being prosecuted. Unfortunately this is something that professionals are not very good at. If Mr Griffiths had formed a closer relationship with his client and asked questions concerning the purchaser's identity, he may have found out that the property was being sold by drug traffickers. With this knowledge Mr Griffiths could then have ceased to act and would not have been prosecuted. In my view, legal practitioners in Australia will not find the client identification requirements too onerous and as a matter of good practice should be encouraged to conduct identity checks.

In New South Wales several years ago, we handled a matter where a small firm received instructions over the telephone from an individual not previously a client, in relation to a purported purchase of industrial machinery in the UK. The caller asked whether the firm would be prepared to issue cheques from their trust account after receiving a deposit from the caller to provide an Australian address and the purported confidence that the Law Society trust account could provide.

After agreeing to the proposition, the firm received $300,000 electronically and at the conclusion of the purported deal, issued a number of electronic payments on the urgent instructions of the original caller. The solicitor had never met the client and only received correspondence by telephone and email through a hotmail account. Shortly after making the payments, the law firm received communication from an English bank informing them that they had just been defrauded of $300,000.

In this example, the practitioner was certainly negligent, and perhaps foolish and greedy, having received the grand fee of $1,500 for the transaction. Like Mr Griffiths, better client communication may have prevented this solicitor from proceeding with the matter. The AML/CTF legislation and accompanying guidelines will hopefully assist practitioners from making similar mistakes.

I think the main problem with the legislation is that we have not really turned our attention to its actual purpose. Committed, organised money launderers will always be able to circumvent the legislative provisions dealing with identity and present credibly to lawyers, which would obviate the exercise of the suspicious transaction provisions. It may also be the case that sophisticated legal practitioners who also happen to be criminally-minded may be able to avoid the operation of the proposed AML/CTF legislation.

The question that remains is whether the AML/CTF legislation, with all its complexities and extensive resource requirements, will minimise, if not eliminate, money laundering in Australia. This is a concern where the impact of the legislation, particularly as it may affect the legal profession could adversely affect the rights of parties traditionally protected by the principles of the rule of law. In my view, the adverse impact of the AML/CTF on the professions may outweigh its utility as presently drafted. Most lawyers are not involved in

money laundering or counter-terrorist financing related activities. In fact I have not been able to find any legal practitioner in New South Wales over the past five years who has been prosecuted for a money laundering or counter-terrorism related offence. The closest offences for which practitioners have been prosecuted involve fraud. And these are few and far between.

Since 2000, six legal practitioners have been prosecuted under the *Crimes Act 1900* (NSW) for fraud related offences. These offences have included fraudulent misappropriation, counts of obtaining money by deception pursuant to s 178BA of the *Crimes Act*, and obtaining money by false and misleading statements under s 178BB of the *Crimes Act*. In addition to these cases, a handful of practitioners have been prosecuted under the *Legal Profession Act 2004* (NSW) for misappropriating trust monies. Although it is difficult to be absolutely certain why these practitioners misappropriated funds, it appears that the majority prosecuted misappropriated funds to enrich themselves, not to launder money or participate in counter-terrorist financing activities. I am aware that this scenario is similar in other Australian states.

As the regulator of the legal profession in New South Wales, my two primary purposes are consumer protection and promotion of the rule of law. I attempt to achieve this by achieving cultural change. This requires, at times, a fine balancing act which, it seems to me, should also be central to those administering the AML/CTF program.

In my view, the challenge for the AML/CTF legislation is to have a strong educational impact, to the extent that the present levels of ignorance and perhaps negligence that exist in the community, and particularly in the legal profession, can be addressed. The OLSC is engaged in a program to develop guidelines for implementation of the proposed legislation and an education campaign to accompany it. Only time will tell whether our efforts and the approach taken by AUSTRAC will result in greater protection of the public, or unacceptable damage to our culture as a pluralist democratic society.