

6 APRIL 2009

## Anti-Money Laundering and Counter-terrorism Financing Rules Update

### 1. BACKGROUND

The *Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (Cth)* (**AML/CTF Act**) represents Tranche One of Australia's anti-money laundering and counter-terrorism financing reforms, and is aimed at sectors that provide 'designated services' (the financial sector, the gambling sector and bullion dealers). The second tranche of reforms will focus on certain professions, including lawyers. An Exposure Draft of the Tranche Two legislation was expected during the first half of 2009, however the Federal Government has suggested the release date may be delayed. The Federal Government is concerned about burdening businesses with more 'red tape' during the global financial crisis.

Tranche Two legislation is likely to implement the Financial Action Task Force recommendations and be comparable to compliance regimes in other jurisdictions.

This memorandum is divided into two sections: recent case law and proposed developments to the *Anti-Money Laundering and Counter-Terrorism Financing Rules Instrument 2007 (No 1)* (**AML/CTF Rules**).

### 2. CASE LAW UPDATE

#### 2.1 Reasonable grounds in suspicious matter reporting

From 12 December 2008, reporting entities will be required to report suspicious matters to the Australian Transaction Reports and Analysis Centre (**AUSTRAC**) under s 41 of the AML/CTF Act. The AML/CTF Act requires that there be reasonable grounds for such a suspicion.

The reporting obligations under the AML/CTF Act replace similar obligations under the *Financial Transactions Reports Act 1988 (Cth)* (**FTR Act**), under which a cash dealer must make a report if they have 'reasonable grounds to suspect' that information the cash dealer has concerning the transaction may be relevant to:

- an investigation of evasion of taxation law;
- an investigation, or prosecution, of an offence against a law of the Commonwealth or of a state or territory;



# ARTICLE

- enforcement of the proceeds of crime legislation; or
- financing of terrorism.

Section 41 of the AML/CTF Act requires a reporting entity to report to AUSTRAC if it suspects, on reasonable grounds, that:

- the person, or agent of that person, is not the person they claim to be;
- information it has concerning the provision, or prospective provision, of the service may be relevant to the investigation, or prosecution, of a person for an evasion or attempted evasion of taxation law, or an offence against a law of the Commonwealth or a state or territory, or be of assistance in the enforcement of the *Proceeds of Crime Act 2002*;
- the provision or prospective provision of the service is preparatory to the commission of a financing of terrorism or money laundering offence; or

- information it has concerning the provision or prospective provision of the service may be relevant to the investigation or prosecution of a financing of terrorism or money laundering offence.

AUSTRAC concluded that the requirement of 'reasonable grounds to suspect' in the FTR Act and 'suspects on reasonable grounds' in the AML/CTF Act are essentially the same.

In its Public Legal Interpretation No 6 of 2008 – Suspect transactions and suspicious matter reports, AUSTRAC stated that the reporting entity must have a 'real suspicion of the relevant matters (subjective element) and the suspicion must be based on matters or evidence that support the truth of the suspicion (objective element)'. A suspicious matter reported to AUSTRAC must also contain a statement of the grounds on which the reporting entity holds the relevant suspicion.

In *Shah & Anor v HSBC Private Bank (UK) Ltd (Shah)*, the High Court of England and Wales discussed the requirement to report suspicious matters under the *UK Proceeds of Crime Act (POCA)*. The court rejected the argument that a suspicious matter report must be based on 'reasonable grounds'.

The claimants were account holders with the defendant bank. The claimants alleged that they had suffered substantial damage arising out of delays by HSBC in executing transfers from the claimant's account. HSBC suspected that the funds were criminal property, but before it could proceed with the transfers it was compelled under POCA to make an authorised disclosure to the relevant authorities and wait for appropriate consent under POCA. The court held that the issue of suspicion under POCA is a purely subjective matter and no legal requirement for the establishment of reasonable grounds existed for the suspicion.

Ultimately, it does not matter whether or not there are reasonable grounds for the suspicion, provided it was a genuinely held suspicion.

Significantly, the AML/CTF Act requires that there be 'reasonable grounds' for a reportable suspicion. The court in *Shah* commented on this requirement noting that there are good and practical reasons why requiring reasonable grounds is not appropriate. The court stated that 'unlike law enforcement agencies, banks have neither the responsibility nor expertise to investigate criminal activities to satisfy themselves that the grounds for their suspicion are well founded, reasonable or rational'.

The general position is that banks are unlikely to know whether or not the property is criminal property; but if a bank suspects that it is, then in order to avoid potential liability, it must make a disclosure and seek consent.

The AML/CTF Rules to date have not provided guidance as to factors that may be considered as reasonable grounds for a reporting entity to foster a suspicion.

## 2.1.1 Recommendations

- Section 41 requires reporting entities to report suspicious matters to AUSTRAC – failure to do so will attract civil penalties.
- Internal procedures in financial institutions need to be developed, if not already so, to allow for the reporting of suspicious transactions.
- banking contracts and arrangements will need to evolve to avoid potential breaches with clients.



## 2.2 Anti-Money Laundering and Counter-Terrorism Financing Rules

Under s229 of the AML/CTF Act, the CEO of AUSTRAC may make Anti-Money Laundering and Counter-Terrorism Financing Rules.

The following is a list of draft AML/CTF Rules open for public consultation in recent times:

### 2.2.1 Draft AML/CTF Rules to exempt certain reporting entities from threshold transaction reporting

These rules propose to exempt reporting entities from providing the threshold transaction reports required by s43 of the AML/CTF Act, if those threshold transactions take place wholly between:

- one authorised deposit-taking institution (ADI) and another ADI;

- one Exchange Settlement Account\* holder and another Exchange Settlement Account holder;
- the Reserve Bank of Australia (RBA) and Exchange Settlement Account holders; or
- a cash logistic carrier who provides item 51 (collecting physical currency) or item 53 (delivering physical currency) designated services under subsection 6(2) of the AML/CTF Act, where these designated services relate wholly to a transaction between one ADI and another ADI.

*\*An Exchange Settlement Account means an account held at the RBA which is used for the final settlement of obligations between Exchange Settlement Account holders.*

### 2.2.2 Draft AML/CTF Rules setting special circumstances for the applicable customer identification procedure

Section 32 of the AML/CTF Act specifies that an applicable customer identification procedure (ACIP) must be carried out before the provision of a designated service by a reporting entity. The AML/CTF Act also makes allowances for carrying out the ACIP after the commencement of the designated service (s33).

Section 34 allows the relevant period to be specified by the AML/CTF Rules, or if the AML/CTF Rules do not specify the period, a default period of 5 business days applies.

The AML/CTF Rules specify the circumstances where a reporting entity may carry out the ACIP after commencing to provide the designated services of:

- acquiring or disposing of a security, derivative or foreign exchange

contract on behalf of a person; and

- issuing or selling a security or derivative to a person.

In the case of securities, reporting entities may experience difficulties in carrying out the ACIP before the provision of a designated service, due to financial market conditions that may apply at the time the designated service is provided.

### 2.2.3 Draft AML/CTF Rules relating to applicable customer identification procedures in certain circumstances – assignment, conveyance, sale or transfer of businesses

These draft rules were previously listed for public consultation in early 2008, but as a result of that consultation, the draft rules have been amended and are now available for public consultation.

If a business restructure results in a customer of one reporting entity ceasing to be a customer of that entity and becoming a customer of another reporting entity, then under s32 of the AML/CTF Act, the second reporting entity must conduct an ACIP on that customer before providing them with a designated service.

Such business restructures may result in large customer transfers from one reporting entity to another, causing a significant business impact on the second reporting entity and significant inconvenience to the customer.

The draft rules exempt the second reporting entity from carrying out the ACIP on transferring customers, but only if it has:

- assessed the money laundering and terrorism financing (ML/TF) risk it may face in providing a designated service to



those customers;

- established whether an ACIP has been conducted; and
- considered whether it is reasonable for the second reporting entity to rely upon that procedure.

The rules also allow the second reporting entity to treat pre-commencement customers of the first reporting entity as if they were its pre-commencement customers, having assessed the ML/TF risk.

## 2.2.4 Draft AML/CTF Rules relating to applicable customer identification procedures for correspondent banking relationships

A vostro account is an account held by a financial institution on behalf of a foreign financial institution with which it has a correspondent banking relationship. Many individuals may give instructions for the operation of the account.

Thus, it is not feasible for financial institutions to carry out an ACIP each time an employee of another financial institution, which is the account holder, is added as a signatory to the vostro account.

The draft rules will:

- exempt financial institutions from the requirement to carry out an ACIP when a person who is an employee of an account holder is added as a signatory to the vostro account a financial institution provides for use in correspondent banking relationships; and
- ensure that financial institutions are exempted from carrying out an ACIP on a signatory to a vostro account before it allows a transaction to be conducted.

## 2.2.5 Draft AML/CTF Rules relating to premium funding loans for a general insurance policy

Following an exemption application from the Insurance Premium Funding Association Australia, the AUSTRAC CEO agreed to exempt reporting entities that provide insurance premium funding for general insurance, from performing the ACIP under s32 of the AML/CTF Act, except when the loan is cashed out or redeemed before the expiration of the term of the loan.

Provision of general insurance is not covered by the AML/CTF Act as a designated service.

## 2.2.6 Draft AML/CTF Rules amending the definition of 'designated business group' to allow law and accounting practices

The current definition of 'designated business group' (DBG) excludes partnerships such as law and accountancy practices from forming DBGs.

Upon review, AUSTRAC considered that the current definition does not accommodate the circumstances of the legal and accounting professions, as they were formulated for those reporting entities which operate within the corporate financial sector.

The draft rules suggest a broader definition of DBG to include law and accounting practices, subject to certain conditions. They also allow persons who assist in the provision of a designated service (such as administrative, paralegal or conveyancing companies) to be included.

AUSTRAC considers that the extension of the AML/CTF Rules to include non-reporting entities, officers of reporting entities or persons required to lodge specified reports, may be beyond the scope of the AML/CTF Act and thus have not been included in the draft rules.

## 2.2.7 Draft AML/CTF Rules for record-keeping obligations under section 107 of the AML/CTF Act

Section 107 states that if reporting entities make a record of information relating to the provision of a designated service to a customer, that record of information must be retained for 7 years after the making of the record.

The draft rules declare certain records as being exempt, noting that the record of information must be kept by a reporting entity providing a designated service.

Records that must be retained include:

- customer-specific documents (for example, account statements), correspondence and publicly available statements, forms and documents which a reporting entity routinely provides to its

customers and product or service information;

- general correspondence with customers;
- overdrawn notices and accompanying correspondence;
- information provided to a customer of a reporting entity to a customer which relates to product or service enquiries or comments from customers; and
- records of interviews or conversations with customers.

### Want to republish any of this article?

If you would like to republish any part of this article in your staff newsletter or elsewhere please contact our Marketing Team on **+61 3 9608 2168**

### Disclaimer

This alert is intended to provide general information on legal issues and should not be relied upon as a substitute for specific legal or other professional advice.



For further information  
please contact:

**Elpis Korosidis**, Partner

Phone (direct) **+61 3 9608 2215**

Mobile **+61 400 598 926**

Email **e.korosidis@cornwalls.com.au**

**Stephen Newman**, Partner

Phone (direct) **+61 3 9608 2219**

Mobile **+61 419 349 423**

Email **s.newman@cornwalls.com.au**