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Committee Secretary
Senate Legal and Constitutional Affairs Committee
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The adequacy and efficacy of Australia's anti-money laundering and counter-terrorism financing (AML/CTF) regime.

Dear Sir/Madam,

Thank you for the opportunity to provide this submission to the Parliamentary Inquiry into the adequacy and efficacy of Australia's AML/CTF regime.

The basis for the observations, comments and suggestions included in this submission are based on over 15-years' experience as a risk and compliance practitioner, both as a Program Manager responsible for implementing both the AML/CTF and FATCA (Tax Evasion) Programs for the retail division of Macquarie Bank and as the founder of Arctic Intelligence, a regulatory technology firm that provides enterprise-wide ML/TF risk assessment and compliance assurance software to AML regulated entities in over 18 industry sectors and 10 countries.

In preparing this submission, I have noted both the terms of reference and the associated discussion paper, as well as the questions for consideration and have made comment on the following areas:

- Progress against the 84 recommendations made in the AGD's statutory review (April 2016)[1]
- Progress against the 14 FATF 3rd Enhanced Follow-Up Report (Nov 2018)[2]
- Other suggestions for strengthening Australia's AML/CTF regulatory arrangements.

1. Progress against the 84 recommendations made in the AGD's statutory review

The Attorney-General's Department (AGD) published its statutory review report in April 2016, followed by a project plan released in February 2017. Since these recommendations were first published over five-years ago, there has been only moderate progress in achieving the general and specific recommendations. The key recommendations where further progress should be prioritised includes:

Simplifying the AML/CTF Act and Rules – whilst there have been additional rules added, some modified and others repealed, the structure and content remains largely unchanged from when they were first enacted in December 2006 and remain complex to decipher, and present challenges for many of the 14,000 regulated entities to understand, interpret and implement them.

Expanding the AML/CTF Act – to include Tranche 2, DNFSBPs such as, lawyers, conveyancers, accountants, high-value dealers, real estate agents and trust and company service providers. This remains the weakest link in Australia's AML/CTF regime and makes Australia an attractive country for organised criminal networks to launder the proceeds of crime through these unregulated sectors.

[1] https://www.homeaffairs.gov.au/how-to-engage-us-subsite/files/report-on-the-statutory-review-of-the-anti-money-laundering.pdf
[2] https://www.fatf-gafi.org/media/fatf/documents/reports/fur/FUR-Australia-2018.pdf

There are over 200 FATF member countries and Australia is one of only a handful of countries that has systematically failed to expand AML/CTF laws to regulate these sectors and is well over a decade behind AML/CTF regimes in other comparable economies.

In New Zealand, the AML/CFT laws were first introduced in 2009, three years behind Australia, but these were then expanded to Tranche 2 sectors in a phased approach to become fully compliant by 1 July 2018 (lawyers/conveyancers/TCSPs), 1 October 2018 (accountants), 1 January 2019 (real-estate agents) and 1 August 2019 (high-value goods dealers), respectively, many years ahead of Australia even passing AML/CTF laws or setting any assisted compliance periods for impacted businesses.

If New Zealand (and the majority of other FATF member countries) can recognise the ML/TF risks of Tranche 2 sectors and implement these laws efficiently, why is it that Australia cannot?

There is also overwhelming evidence that DNFSBPs present a significant risk to the Australian economy and numerous examples of how the real-estate, legal, accounting, and high-value goods sectors have been used to facilitate money laundering, which has also been clearly articulated by AUSTRAC in numerous ML/TF risk typology papers[3].

Despite not having legislation to regulate these sectors, AUSTRAC's CEO Nicole Rose, has been quoted in the media appealing to these sectors to report suspicious activity[4], due to the concerns that AUSTRAC has about the vulnerabilities of these sectors to exploitation by organised criminal networks.

The primary barrier to implementing DNFBSPs as a priority has been the incomprehensible lack of political will within various Australian Government Departments – notably the AGD and the Department of Foreign Affairs, who have ultimately failed to act and should be held primarily responsible for the delays and exploitation of Australian businesses to launder the proceeds of crime.

For many years AML/CTF practitioners concerned at the lack of action by the Australian Government have resorted to lobbying for change through various publications, events, social and mainstream media, as well as, to opposition political leaders and without this level of proactive commitment by the risk and compliance community would likely have not given rise to this Parliamentary Inquiry.

2. Progress against the 14 FATF 3rd Enhanced Follow-Up Report

The FATF published its 3rd Enhanced Follow-Up Report in November 2018 following the 2015 Mutual Evaluation Report and highlighted 14 areas where Australia was non-compliant or partially compliant (including 3 recommendations – 22, 23 and 28 related to DNFSBPs, which was addressed above).

Unfortunately, due to COVID-19, the FATF site visit to review Australia's progress against their previous recommendations in late 2020, has been postponed and no date has been published, as to when this will take place, which is probably to the advantage of Australia, since only moderate progress has been achieved in the nearly 3-years since November 2018.

Of the 14 recommendations, recommendation 1 (assessing risks & applying a risk-based approach), should be prioritised, since this is a cornerstone requirement of AML/CTF laws, but is often cited as a common failing in enforcement actions and requires a closer focus.

2.1 Assessing risks & applying a risk-based approach (Recommendation 1) – AUSTRAC should be commended for issuing industry with guidance on ML/TF risks, red flags, and typologies, as well as the industry outreach that it has performed but we believe much more can be done to assist regulated entities in assessing ML/TF risks and applying a risk-based approach, including: -

2.1.1 Developing industry-specific baseline ML/TF risks and controls libraries

There are fundamental challenges in adopting a risk-based approach to ML/TF, which places the responsibility on 14,000 (mostly small) regulated businesses to identify and analyse their ML/TF risks related to customers, products and services, channels and jurisdictions and then design and implement effective controls in the form of an AML/CTF Program, to mitigate and manage these risks in a manner that is both appropriate and proportionate to the identified ML/TF risks.

[3] https://www.austrac.gov.au/sites/default/files/2019-07/sa-brief-real-estate_0.pdf;

[4] https://www.smh.com.au/politics/federal/lawyers-accountants-and-real-estate-agents-should-report-suspicious-activity-austrac-boss-20201020-p566ng.html

In practice, the 14,000 regulated entities can (and often do) interpret ML/TF guidance in different ways and can fail to base their ML/TF risk assessments on a sound and robust methodology or appropriately document the existence and effectiveness of controls in a way that is explainable and defendable to key stakeholders, including their Boards and AUSTRAC.

With around 300 staff, AUSTRAC does not appear to have sufficient resources to properly oversee the design and implementation of a different ML/TF risk-based approaches of the 14,000 regulated entities to provide effective enough oversight and several actions are recommended, including:

- **Building industry standard ML/TF risk and control libraries** – these could be developed based on AUSTRAC guidance with input from international sources (e.g., FATF and other AML regulators) and with input from industry (e.g., through the Intel Alliance) to develop a solid baseline of risk factors and controls that are expected to be assessed and with individual reporting entities, being able to enrich this content at their discretion prior to conducting enterprise-wide ML/TF risk assessments. These risk and control libraries could be published into various RegTech solutions, including those offered by Arctic Intelligence and provided to industry with numerous benefits around improving quality, standardisation, auditability of the risk assessment process, as well as real-time analytics and dashboards.

- **Publishing industry-wide benchmarking and reporting by sector/peer group etc.** – as a RegTech company that provides enterprise-wide ML/TF software, we support hundreds of clients in completing ML/TF risk assessments and have been able to use these anonymised results to provide deep insights into how ML/TF risks are conducted and the challenges that organisations face in an AML Industry Benchmarking Report, which is something AUSTRAC could achieve at scale, if it more strongly encouraged the adoption of RegTech solutions that encourage a level of standardisation.

- **Reducing subjectivity and increasing the frequency of risk assessments** – many reporting entities (including the Big 4 banks) appear to be over-reliant on spreadsheets to conduct EWRAs, which are both highly subjective (as opposed to objectively data-driven) and manual, introducing the potential for operational risk but also, meaning that EWRA's are often conducted too infrequently, rather then being embedded as part of a continuous ML/TF risk assessment process.

- **Encouraging wider adoption of RegTech by regulated entities and AUSTRAC** - The majority of AUSTRAC reporting entities, including many banks use manual spreadsheet-based approaches when conducting enterprise-wide ML/TF risk assessments which have many limitations compared to purpose-built platforms specifically designed for this purpose and encouraging greater adoption of RegTech from AUSTRAC, as well as, leveraging these solutions for their own benefits should deliver cost and efficiency savings for both the private and public sectors.

In respect of the questions posed for consideration, our recommendations include:

- **AUSTRAC to publish the findings of the annual compliance reports** – These mandatory reports contain insights into many aspects of AML/CTF compliance and it would be helpful for AUSTRAC to publish anonymised analysis into the findings, particularly in relation to the ML/TF risk-based approach in terms of frequency, method and methodology, triggers for updating and so on, so that a better understanding of how well industries understand the ML/TF risk-based approach.

- **Building capabilities for better application of enterprise-wide ML/TF assessment frameworks** – by building industry-specific ML/TF risk and control models that can be used as to uplift the capabilities of industry sectors in assessing, analysing, and evaluating their risks and controls.

3. Other suggestions for strengthening Australia's AML/CTF regulatory arrangements

In addition to previous suggestions, there are several other areas that should be prioritised to strengthen Australia's AML/CTF regulatory response, including:

3.1 Increase the frequency and effectiveness of independent reviews

Under the current AML/CTF laws reporting entities are required to have Part A of AML/CTF programs subject to *regular* independent review but since *regular* is undefined and there is no mandated timeframe, unlike jurisdictions like New Zealand that have rules specifying that independent reviews must be conducted at least every two-years, rather than at the reporting entities discretion.

It could be argued for higher risk industry sectors and/or systemically important financial institutions that their ML/TF risk assessments and assessment of controls, should be subject to at least an annual independent review.

The implications for failing to proscribe a defined timeframe is that it is expected that a considerable number of the 14,000 regulated entities, may never have had an independent review performed or if they have, may have been conducted a long time ago and may not reflect the latest AML/CTF Rules, Typologies or changing circumstances in relation to the nature, size, and complexity of a regulated entity.

In addition, since the scope of independent reviews is currently limited to Part A, but not Part B (Customer Identification Program), as a result, many enforcement actions have identified material issues with collection and verification of know your customer (KYC) data, which has resulted in multi-year (and multi-million-dollar), KYC remediation programs going back 5+ years or longer, initiated by many major Australian financial institutions.

We recommend as well as a proscribed frequency every 2-years, that the scope of independent reviews also be expanded to Part B, such that if there are issues with identifying and/or risk assessing customers that these issues are detected and rectified far sooner than currently appears to be the case.

3.2 Increase personal accountability for material non-compliance

In the event of material non-compliance with AML/CTF laws which has resulted in over AUD$2bn in fines being levied it is often the shareholders that are directly impacted through falling share prices, fines, class actions, expensive remediation projects, whilst Board Directors who are ultimately supposed to be responsible for AML/CTF oversight, go largely unpunished.

The Financial Accountability Regime (FAR)[5] and its predecessor Board Executive Accountability Regime (BEAR) are designed to address the issue of personal accountability, but given systemic ML/TF issues in other sectors, limiting this to just financial institutions, does not appear to go far enough and should be applied more broadly, to encourage compliant behaviours through the application of material fines, bans or other criminal or civil sanctions, to ensure that financial crime compliance is treated as seriously as it deserves to be taken.

Yours Sincerely,

Anthony Quinn

Arctic Intelligence - Founder / Director

www.arctic-intelligence.com

[5] https://treasury.gov.au/sites/default/files/2021-07/c2021-169627_exposuredraftlegislation_2.pdf