HOLLEY NETHERCOTE
commercial lawyers

Anti money laundering and terrorist financing

You are probably aware of moves to improve Australia's anti-money laundering regime. We suspect this awareness may prompt the following questions:

- What is money laundering, how does it occur and what is my role as a financial adviser in stopping it?
- How will it affect me? In particular:
  - What impact will the mooted changes have on my business?
  - What additional compliance measures will I need to put into place?
  - Will I need to incur significant expense, over and above what I have recently incurred to comply with the new FSR regime?

In this article we describe the way money laundering takes place. This will provide a backdrop for understanding how financial advisers could unwittingly assist criminals and terrorists in hiding their money and financing their illicit activities. An outline of the additional steps that will be required of financial advisers and institutions will then be given.

The classic definition of money laundering is:-

"*the process by which criminals attempt to conceal the true origin and ownership of the proceeds of their criminal activities. If undertaken successfully, it allows them to maintain control over these proceeds and, ultimately, to provide a legitimate cover for their source of income.*[1]"

How is it achieved? There are typically three stages in laundering money: placement, layering and integration.

The first stage, **placement**, has the purpose of getting illicitly obtained ("dirty") cash into the non-cash economy. For example, a criminal or terrorist may make a large cash payment into a bank account, or a financial service provider's trust account. Often the dirty money will be mixed with legitimate deposits. It may be deposited in small amounts or in several accounts. One of the early ways of "washing" money was for criminals to own laundrettes. They would deposit the cash, in the form of coins, into coin operated washing machines. The criminal organisation could then reclaim the money as the business proceeds from conducting the laundrette. Rumour has it that this led to the practice being called money laundering.

The second stage, **layering**, has the purpose of breaking the link between the criminal and the proceeds of the crime. The origin of the initial deposit is disguised through multiple transfers and transactions. The criminal may instruct the financial service provider to pay the "dirty" money deposited into an account into his lawyer's trust account, or to split it between other accounts or service providers. Those providers may then be instructed to make payments to other parties, or to use the money in a series of transactions, for example in foreign exchange transactions. The whole idea is to confuse the audit trail.

Finally the "dirty" money re-enters or **integrates** into the clean economy by being used to purchase a legitimate asset. For example, the money may be used to purchase a legitimate business, property or shares. The proceeds of that business, property or shares, is then available for the criminal to use. It has become "clean".

The scope for financial services providers to be the unwitting vehicles for money laundering should be apparent from this description. They could become involved in any of the three stages.

When a client deposits cash money, either in a series of small transactions or in large amounts, there is always a chance that the money may be **placing** the proceeds of criminal activity.

[1] British Bankers Association

When a client instructs a financial services provider to use funds in an account to finance a number of different transactions, or moves funds from one account to another without any apparent reason for doing so, the client may be **layering** the proceeds of criminal activity. For those AFSL holders who are foreign exchange dealers, customers who change large amounts of cash, and send them overseas may be involved in layering. Clients that are constantly buying and selling securities for no apparent reason (i.e. there is no apparent financial advantage in them doing so) may be layering.

If a client purchases securities that don't appear appropriate, having regard to other things you know about that person, or purchases securities in cash, or is putting a large amount of money into a managed investment or buying a property or business, and these things appear out of place, or inconsistent with other things you know about the person, they may be **integrating** the dirty money into the legitimate economy.

Of course, most clients won't be doing this, even if they do like to pay cash, enjoy trading or buying properties at great prices, etc. It is tempting to believe that all of our clients are honest, hard working people who are not involved in crime and that "criminals" use firms or providers which are probably knowingly complicit in the arrangements. That is a comfortable thought, but probably naïve.

According to the Financial Action Task Force (FATF), hundreds of billions of dollars (US) are laundered worldwide each year. The International Monetary Fund estimated in 1996 that money laundering constituted between two and five per cent of the world's gross domestic product that year.[2]

The reality is that there is a real risk that financial service providers may be unwittingly used for the purpose of money laundering. This risk is being recognised by the Government, which enacted new legislation last year to reduce this risk. The legislation is the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006.*

The impetus to improve our money laundering regime was provided by the report of FATF into money laundering and terrorist financing. Australia's anti-money laundering regime and its regulator AUSTRAC (the Australian Transaction Reports and Analysis Centre) have enjoyed a good international reputation. FATF is the leading international body against money laundering and is made up of 29 member countries. It released a report in October, 2005. It was estimated that the amount of money laundering in Australia ranges between AUD 2-3 billion per year.

The report contained 40 recommendations against which different countries were benchmarked. The Australian Government has moved to implement those recommendations. A summary, insofar as they affect financial planners follows.

The Act introduces a number of requirements which can roughly be described as:

- customer due diligence;
- transaction due diligence;
- reporting obligations; and
- compliance and record keeping obligations.

The obligations will be triggered when financial service providers provide a **designated service**. There are 54 financial services which are "designated services" listed in Section 6 of the Act. Those most relevant to financial planners are:

- arranging for a client to take out a life policy;
- buying and selling securities (for example, shares or interests in managed investment schemes) as an agent for the client;

[2] http://www.fatf-gafi.org/document/29/0,2340,en_32250379_32235720_33659613_1_1_1_1,00.html

- arranging for a client to buy or sell securities (for example, by instructing a stockbroker on behalf of the client); or
- arranging for a client to buy or sell derivatives.

You may recall that, while the legislation was being debated in Parliament, industry lobbied for the new regime not to apply to financial planners. The outcome of this lobbying was that providing advice will generally not be a "designated service". However, as you can see, a number of services which are often provided by financial planners will be caught.

Not all of the new obligations will apply straight away. They are being phased in over a period of two years.

The obligations include:

- verifying customer identity before providing a designated service to a new customer. This will extend to the beneficial owners of funds and require you to take reasonable steps to understand the ownership and control structure of corporate clients, trusts and partnerships. This requirement will start on **12 December 2007**.

- if you buy or sell securities as agent for the client or if you hold financial products on behalf of your clients – conducting ongoing risk-based customer due diligence throughout the relationship. Some thought will be required in relation to appropriate procedures to monitor clients' transactions throughout the relationship. Appropriateness will be determined by a risk-based assessment of the type of client and transaction. This obligation will start on **12 December 2008**.

- reporting suspicious matters, international funds transfer instructions and some high-value transactions to AUSTRAC. Readers will be familiar with the current requirement to report physical cash transactions exceeding $10,000. The new obligations will extend to e-currency transactions of $10,000 or more, reports of suspicious matters and reports of international funds transfer instructions. This obligation will start on **12 December 2008**.

- keeping records of dealings with customers. All records relating to the provision of the designated service will need to be kept for seven years after the service is provided. This obligations started in December 2006 so you should be doing this **now**.

- developing, maintaining and complying with anti-money laundering and counter terrorist financing programs. For "program", read "risk management plan for anti-money laundering and terrorist financing risk". Most readers will be familiar with the concept of a risk management process because the *Corporations Act* requires all AFSL holders to have one relating to other business risks. The requirements for the "program" will be set out in the Rules accompanying the legislation. The Rules will be developed over the course of this year, with public consultation. This obligation will start on **12 December 2008**, by which time the Rules will have been finalised, letting you know what to do.

Will I need to incur significant extra expense?

Undoubtedly there will be additional steps to build into current practices. There will be a need to be more thorough in taking instructions from clients. Staff will need to be equipped with new expertise to enable them to understand business structures and to spot suspicious transactions. Record keeping and risk management processes will need to be revised to incorporate the new requirements. These steps will cost money. Perhaps the most significant impact will be to the information technology budgets of larger financial services licensees. The spend by banks and funds managers is expected to be

substantial.

However, by now most AFSL holders will have a functional framework in place that will assist them to accommodate the new requirements. There will already be a staff training plan, a compliance plan and a risk management plan. There will be staff with the designated responsibility for compliance. In short, most readers should be well equipped to implement the new regime efficiently and effectively. Additional expense will be minimised through a sensible use of existing frameworks.

Grant Holley and Sam Kimpton

The law is current as at February 2007.
Please note that this paper is a summary of the law only and is not a substitute for legal advice. Holley Nethercote is able to assist companies in meeting their obligations in this area by providing practical and prompt legal advice.

Training and creation of compliance programs are also available via an associated business, Compact-Compliance and Corporate Training.

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