

# What Will AML Tranche 2 Mean For Your Business?



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## Current Outlook

The Australian market has long been criticised as a land full of criminal opportunities. In the fourth round of Mutual Evaluations, the Financial Action Task Force (FATF) called Australia an “Attractive destination” for corruption-related activities and unaccounted foreign proceeds (FATF, 2015).

The current AML/CTF regime is weak and highly outdated for the influx of sophisticated corrupt activities taking place. The legal landscape allows criminals to receive facilitative services in moving wealth, creating a business, and conducting operations without incurring any risk of being reported.

The lack of due diligence, customer background checks, AML training, and obligation to report suspicious activities for DNFBPs makes Australia a safe environment for criminal operations. This calls for a stronger corporate regulatory system that brings the otherwise hidden criminal processes under the spotlight.

### Why Tranche 2?

The Senate Standing Committee on Legal and Constitutional Affairs published its report *“the adequacy and efficacy of Australia’s anti-money laundering and counter-terrorism financing regime”*.

The report discussed the current deficits and vulnerabilities of the existing AML regulatory landscape and called for key professional service sectors to be covered under the existing AML regime as they play an important role in ML/TF processes (Legal and Constitutional Affairs References Committee, 2022).

“The Financial Action Task Force (FATF) called Australia an “Attractive destination” for corruption-related activities and unaccounted foreign proceeds.”

These professionals include important facilitative agents such as lawyers, accountants, real estate agents, high-value dealers, and other relevant service providers. This proposed change is informally referred to as “Tranche 2” and marks the first step toward a serious commitment and effort to becoming up to date with the global AML regime set by the Financial Action Task Force (FATF).

### A Powerless Governing Body

The regulating body in charge of monitoring ML/TF activities in Australia, AUSTRAC, is not allowed sufficient power and the necessary scope needed to capture country-wide criminal activities. Currently, DNFBPs like accountants, lawyers, and real estate agents are not required to enroll with AUSTRAC. For this reason, many key indicators, red flags, and suspicious activities that can be detected go unnoticed, resulting in a lack of investigations (Transparency International Australia, 2021).

“The legal landscape allows criminals to receive facilitative services in moving wealth, creating a business, and conducting operations without incurring any risk of being reported .”

### Overreliance on Reporting

Despite a very clear link established between money laundering and DNFBPs, AUSTRAC is still powerless when it comes to detecting criminal activity related to the sector. DNFBPs are under no obligation to monitor all transactions, identify a threat, and take action. Even in cases, a threat is suspected, DNFBPs may not be able to or willing to file a report in a timely manner (Legal and Constitutional Affairs References Committee, 2022).

Tranche 2 will make it mandatory for all DNFBPs to assess risks and identify any suspicious activity proactively. Inability to do so will result in significant penalties, resulting in stronger enforcement.

## Low Barriers to Entry

Entering the Australian market is made easy with a number of gaps, outdated laws, and weak enforcement in the current regime. Criminals can form a corporation with the help of accountants, lawyers, and other service providers without facing the need to disclose their identity and the ultimate beneficial owner (UBO) (HM Treasury, 2020). Tranche 2 will help enforce customer due diligence (CDD), transaction monitoring, and ongoing risk assessments in the DNFBPs sector. This will make criminal activity much harder to remain hidden and will ultimately deter future activity.

## Circumnavigation

For some criminals, registering a company by disclosing their identity may come with immediate legal repercussions. Australia's DNFBPs can act as highly potent loopholes that allow criminals to form a company, hide the UBO, create false accounting books, and legitimize their illegal proceeds without attracting any legal attention (Transparency International Australia, 2021). The implementation of Tranche 2 will close this gap and minimize the ability to circumnavigate the legal landscape.

“Tranche 2 will help enforce customer due diligence (CDD), transaction monitoring, and ongoing risk assessments in the DNFBPs sector.”

## FATF Non-Compliance

FATF non-compliance is the single most compelling factor in highlighting the need for and accelerating the implementation of Tranche 2. Since the revised recommendations by FATF in 2003, Australia has been one of the only three countries that are non-compliant with its DNFBP coverage standards (FATF, 2015). The Australian Government is now under immense pressure to increase its quality of compliance in order to preserve its global reputation and capacity for trade and overall economic growth.

“FATF non-compliance is the single most compelling factor in highlighting the need for and accelerating the implementation of Tranche 2.”

## Lack of Transparency

Money launderers often use the process of “Layering” to hide their ultimate operations, source of funding, and the UBO. To date, Australia's accountants, company service providers, lawyers, and agents are able to provide their services indiscriminately to everyone. With the help of such services, criminals can seek expert advice that gives them legal leverage, helps them create confusing legal corporate structures, buy high-value goods, and falsify their transactions. This is another key reason for the attraction of Tranche 2, as it will mandate the “Know Your Customer” requirement and enforce ongoing monitoring of every client and transaction when applicable.



## Key Terminology

DNFBP	Designated Non-Financial Businesses and Professions
Beneficial Owner	A beneficial owner is anyone that directly or indirectly owns a share/interest and stake in the company or a transaction.
PEPs	Politically exposed persons (PEPs) are individuals who are or used to be part of the political system of any country.
ML/TF	ML/TF is an acronym for money laundering and terrorist financing which may be conducted through money transactions, purchases, selling, or movement of funds from one country to another.
Recommendations	Recommendations refer to the anti-money laundering global standards set by FATF, which is responsible for guiding and assessing all countries on becoming compliant with the latest regulations.
Risk-based Approach	A risk-based approach is the center of AML compliance and refers to compliance and assessment conducted according to the unique and individual risk levels of different businesses and transactions.
RBA Guidance	FATF provides dedicated guidance for all businesses/professions covered under the current AML regulations and includes the requirements for compliance.
Gatekeepers	Gatekeepers are all professions that can play an internal part in ML/TF activities such as by providing advice, completing transactions, providing company formation services, or working on a client's behalf.
Exempt Intermediaries	Exempt intermediaries are individuals/entities that remain out of AML regulation coverage.
Funds	Funds can include anything that is used to buy a property, create a company, form a charity/NGO, or purchase other goods.
Control Structure	Control structure refers to the chain of command a corporation, or other organization uses to make decisions.
Risk Categories	Risk Categories are an important part of AML compliance and refer to different aspects of a business that carry ML/TF risks.

## When Will Tranche 2 Take Effect?

The time of implementation for Tranche 2 is still unclear. However, it is simply a matter of one amendment in the AML/CTF act 2006 before DNFBPs become part of the regulation. With multiple conferences, inquiries, and consultations taking place in 2022, it is expected to take effect soon.

However, the implementation will likely be gradual and rolled out for different DNFBPs at different times. Real Estate Agencies, Accountants, and other high-risk services may be the first to see the impact due to the increased attention from international governing bodies.

According to a 2017 PwC report, regulations for legal practitioners and high-value dealers may come after other services due to the complexity of their operations. Another expectation is that different requirements may be rolled out gradually according to the risk assessment and need for each compliance (PwC, 2017).

“Tranche 2 will make it mandatory for all DNFBPs to assess risks and identify any suspicious activity proactively. Inability to do so will result in significant penalties, resulting in stronger enforcement.”



## Chapter 1: Who Is Impacted?

In 2003, the Financial Action Task Force (FATF) revised its recommendations for international compliance and scope of coverage. It expanded the scope to DNFBPs, which it established have been playing a key role in certain Money Laundering and Terrorist Financing processes (FATF, 2003). According to *The Application of Group-Wide Programmes by Non-Financial Businesses and Professions* (FATF, 2021), FATF explained that DNFBPs include the following professions and businesses:

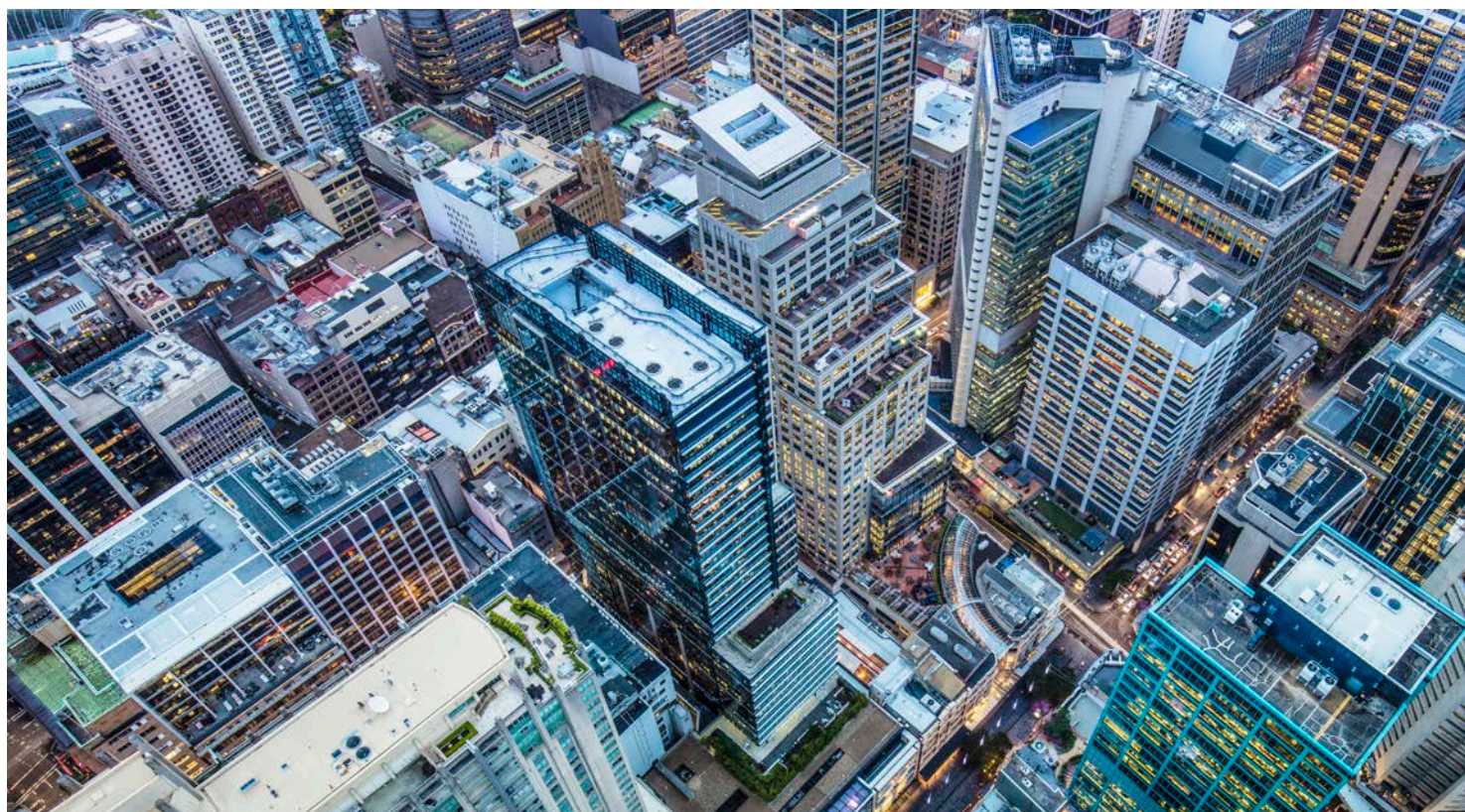
- Lawyers, notaries, and other relevant legal professionals
- Accountants/Accountancy Firms
- Real Estate Agents
- Precious Metals/Stones Dealers
- Trust and Company Service Providers.

The Revision made Recommendations 8 to 11 mandatory for all DNFBPs. In addition, other recommendations, including 13-15 and 21, were also to be applied in select cases of moderate to high ML/TF risk.

When Tranche 2 is implemented, DNFBPs of all sizes, nature, structures, and risk levels will be impacted. Whether it is a sole operator or a large-sized firm, the compliance responsibilities will be applied equally. However, both AUSTRAC and FATF support a risk-based approach which allows DNFBPs to create a compliance plan that is appropriate for the risk posed.

Therefore, smaller businesses, sole agents, brokers, and other businesses engaging in low-risk transactions, clients, and locations will be less affected than more risk-prone businesses. Section 229 and 248 of the AML/CTF Act will allow DNFBPs to receive an exemption from certain compliance processes related to business activities that do not pose an ML/TF risk (AUSTRAC, 2019).

“In 2003, the Financial Action Task Force (FATF) revised its recommendations for international compliance and scope of coverage.”



## Chapter 2: What Businesses Need to Know

As key Gatekeepers, all DNFBPs must understand the rules and regulations of AML/CTF regulations. An essential part of compliance is the risk assessment for each specific business. AUSTRAC does not have a standardized list of compliance activities for each business and recommends creating a personalized risk assessment program that complements the size, nature, and customer base of each specific business (AUSTRAC, 2020).

### Conducting Risk Assessment

A risk assessment will take into consideration all essential stages of the transactions, including running client background checks and identifying vulnerabilities and suspicious activities. Currently, there are no specific risk categories to be followed (AUSTRAC, 2021). However, some of the common risk areas identified by FATF are explained below.

### Geographic Risk

Purchasers from select countries can pose a greater threat if their funds come from an unregulated or weakly regulated environment. According to FATF Guidance, countries lacking adequate AML/CTF laws, suspected of funding terrorist activities, or having high levels of corruption should be followed with in-depth precautions. Other geographic qualities that may pose a threat include the presence of low or no mandates for the registration of real estate and other properties.

“A failure to implement the necessary actions can result in significant penalties according to Part 15, Division 2 of current AML/CTF Rules (Australian Government, 2022) and may put business reputation at risk.”

### Customer Risk

The way a customer behaves during the transaction can act as a sound indicator of risk levels. Some potential red flags provided by the FATF guidelines include:

- Unexplained distance between the customer's location and the agent.
- Customers operating with obscure structures that hide the Ultimate Ownership.
- Requests for cash-intensive transactions.
- Charities or NGOs exempt from regulatory supervision and monitoring.
- Usage of exempt intermediaries such as those free of AML/CTF reporting and supervision.
- Politically exposed Persons (PEPs).

### Transaction Risk

Some transactions, such as those from high-risk geographies, routing to a PEP, coming from an unidentified beneficial owner, or carrying a large value, may potentially have a connection to ML/TF activities (FATF, 2019).

### Identifying Risk Assessment Needs

All businesses must implement risk assessments, reporting, supervision, and internal controls that are appropriate for their size and operations. Some businesses will likely have higher adherence and compliance requirements than the rest. A failure to implement the necessary actions can result in significant penalties according to Part 15, Division 2 of current AML/CTF Rules (Australian Government, 2022) and may put business reputation at risk.

When it comes to risk Assessment guidelines, AUSTRAC gives businesses higher control:

“Because you understand your business or organisation better than anyone else, you are best placed to identify and assess the level of ML/TF risks it faces.” --- (AUSTRAC, 2021)



Currently, reporting entities gauge risks in the following areas:

### Customer Type

AUSTRAC heavily mentions the risk related to PEPs and the obligation to treat it as a high-risk situation.

### Type of Service

All designated services are not expected to implement the same precautions and controls. Some high-risk services such as buying/selling, company formation, and nominee dictatorship may carry more risk than other services.

### Nature of Interaction

The distance and format of communication between the agent and client can also indicate risk level. A local client engaging in face-to-face interactions will pose a lower threat than an international client with a rigid chain of communication.

### Location

Countries with low, weak, or outdated AML regulations may be riskier to conduct business with. Likewise, a country active in terrorist acts or financing will also pose a similar threat. For this reason, businesses will be required to handle clients from certain geographies with higher precautions and give them more risk weightage (AUSTRAC, 2021).

### Assigning Risk Levels

After accurately gauging the risks, each customer, service, interaction, and location must be assigned a risk rating. AUSTRAC requires businesses to rank each risk as low, medium, or high. The assigned rating must be taken into account when creating the AML/CTF program (AUSTRAC, 2021).

When developing customer identification and verification procedures, DNFBPs must also consider the risk posed by:

- the beneficial owner/s of its customers
- whether the customers or their beneficial owners are PEPs
- the customers' source of funds and wealth
- the nature and purpose of business relationship with the customers
- the control structure of customers who are not individuals, such as companies and trusts (AUSTRAC, 2021).

### Reviewing Risk Assessment

All DNFBPs will be required to continually review and amend their risk assessment as the risk environment changes. A review will be due if a business makes any of the following changes:

- Starts providing a new service.
- Changes the way of delivering service.
- Adopts new technologies for services.
- Starts catering to a new jurisdiction.

These must be followed by an appropriate change in risk ratings of previous risk assessments and the addition of risk ratings for the new changes.

### External Changes

Besides internal changes, a review and update will also be mandatory if an outside change occurs. This can include:

- A change in the client-agent relationship
- Replacement of the previous beneficial owner
- Change in corporate or control structure of client's business (AUSTRAC, 2021).

### What This Means for Businesses

All these requirements bring a huge responsibility to businesses for conducting in-depth background checks and preparing for risk management. This will impact both the initial due diligence processes and the internal controls. Currently, real estate agents, TCSPs, and other relevant DNFBPs are not required to know information related to the Ultimate Beneficial Owner, identify suspicious activity, or know the ultimate geographical location of the client. New risk assessment requirements will require businesses to go many layers back and compile all risk categories. This translates into a high compliance burden, an increase in hiring and training costs, the need to outsource risk and compliance processes, and a steep learning curve to learn how to gauge risk appropriately.

“Because you understand your business or organisation better than anyone else, you are best placed to identify and assess the level of ML/TF risks it faces.”  
--- (AUSTRAC, 2021).”

## Implementing the Program

The implementation process can be summarised in four areas of documentation, monitoring, controls, and reporting.

### Documentation

All eligible businesses must document:

- The processes used to monitor transactions and identify suspicious activity.
- All the implemented risk-based controls and systems (AUSTRAC, 2019).

### Monitoring

A business must have a responsive system that alerts of suspicious activity and triggers further review and assessment. The system must be able to address both common and unusual red flags such as:

- Unusually large, frequent, or complicated transactions.
- Business from high-risk customers or geographies.
- Payments routing to a sanctioned individual or company.
- Unusual activity from a previous or current customer (AUSTRAC, 2021).

### Controls

All reporting entities will also be required to establish a comprehensive internal control program that helps them systematically monitor, assess, and deal with various risks as soon as they are identified or suspected. The program must be refined based on the nature and risk of each business but typically includes:

- Having senior management oversight and supervision.
- Hiring an AML/CTF compliant officer.
- Creating a transaction monitoring program.
- Having sufficient processes to deal with a suspected risk effectively.
- Training employees and conducting an employee due diligence (EDD) program.
- Conducting Ongoing customer due diligence (if and when applicable).
- Systems and controls to ensure fulfilment of all parts of an AML program.
- Getting an independent review of the Compliance program (AUSTRAC, 2020).

## Reporting

All DNFBPs will be required to document the applicable compliance processes, transactions, and report any suspicious activity detected. The three key reporting that may be applicable to certain DNFBPs under certain circumstances will include:

**Threshold Transaction Reporting:** According to Sections 43 and 44 of the AML/CTF Act, a report may be applicable when a cash-based transaction of over \$10,000 (which is also prone to ML/TF) is due or conducted (AUSTRAC, 2022).

**Suspicious matter reporting:** These reports may be required when an unusual behavior or activity is detected from the client or when dealing with any other high-risk situation that may be related to ML/TF activities (AUSTRAC, 2021).

**International funds transfer instruction reports:** IFTIs must be submitted regardless of the nature or value of the transaction. Any transfers of money that move into or out of Australia are mandatory for an IFTI report within ten business days (AUSTRAC, 2019).

## Annual Compliance Report

Unless an exemption is earned, all reporting entities are obliged to send an annual compliance report describing all the compliance functions conducted and compliance with other associated rules and regulations. DNFBPs must use a compliance report template which is updated and released by the AUSTRAC as needed (AUSTRAC, 2021).

### The Future of Transactions

Compared to the past, Tranche 2 will impact the transaction process at every stage of progress. This will be governed by the Transaction Monitoring Program which is currently the prominent requirement of all AML/CTF programs.

### Transaction Monitoring Program

According to Section 36 of the AML/CTF Act, all DNFBPs may be required to implement a transaction monitoring program for the following purposes:

- Identification of ML/TF risks
- Identification and reporting (to AUSTRAC) of suspicious activity
- Satisfying all customer due diligence requirements (AUSTRAC, 2021).

## Chapter 3: Real Estate Overview

Australia's real estate market remains one of the most internationally criticised industries for ML/TF criminals. The ability to purchase property without the need to go through due diligence, disclosing identity and the ability to store a large amount of wealth in just one place makes it an attractive industry for domestic and international criminals.

Some common ways real estate agents may be used by criminals were stated in a 2015 Strategic Analysis Brief by AUSTRAC (AUSTRAC, 2015). These include:

- Buying real estate using cash only
- Concealing the ultimate beneficial owner
- Renovating the property and making a profit.
- Legitimizing funds without attracting legal attention.

The same report mentions that criminals are drawn to the real estate market as it requires less complicated steps and almost no planning or expertise.

### Expected Compliance Responsibilities

Like other DNFBPs, real estate professionals will be expected to prepare for in-depth compliance obligations and set up new processes to monitor transactions. The current *RBA Guidance for Real Estate Agents by FATF recommends that real estate agents* conduct a risk analysis to understand where the ML/TF risks are the highest. However, no specific vulnerabilities or risk categories are yet disclosed. According to the guidance, all countries must conduct a risk assessment and adequately guide the agents on which risks should be looked out for (FATF, 2008).

Overall, the key FATF recommendations applicable to real estate agents include:

“According to FATF, the additional information is anything that can potentially play a part in ML/TF activities. For this reason, the team must be proactive in their approach and learn about the currently overlooked details such as the motive of a client, their reason for purchasing property, etc. (FATF, 2008).”





## Customer Due Diligence

Customer Due Diligence of varying extents will be required for clients and transactions carrying different risks. Professionals and real estate firms will be responsible for having a reasonable and adequate system in place that can:

- Identify and verify the true identity of a client.
- Accurately identify the ultimate beneficial owner.
- Help with Adequately and appropriately finding important additional information regarding the client's business, nature of transactions, and circumstances.

According to FATF, the additional information is anything that can potentially play a part in ML/TF activities. For this reason, the team must be proactive in their approach and learn about the currently overlooked details such as the motive of a client, their reason for purchasing property, etc. (FATF, 2008). This translates to more in-depth consultation, documentation, and careful monitoring at each step of the business relationship.

Furthermore, if an agent or firm is unable to gather all the necessary information, especially that related to the beneficial owner, reporting suspicious activity to the governing authority may be needed. Real Estate agents will need to take additional steps in being discerning and proactive, as failing to report in a timely manner can result in severe penalties (Australian Government, 2022).

## Internal Control Systems

All real estate professionals and their teams will be required to create a comprehensive internal control system that ensures company-wide compliance. According to AUSTRAC, reporting entities should have the following in their control systems:

- Regular review of management processes and risk assessment.
- Appoint a person or team at the management level responsible for ensuring AML/CTF compliance.
- Facilitate the AML/CTF compliance processes and functions.
- Ensure adequacy of controls before the launch of a new service or change in delivery.
- Inform the senior management of all compliance initiatives, deficiencies, remedial actions, and reports filed.
- Ensure compliance continuity irrespective of any change in employees, management, or corporate structure.

- Ensure all recordkeeping and reporting obligations are fulfilled.
- Facilitate timely amendments in case of regulatory changes.
- Implement appropriate CDD policies.
- Ensure adequate oversight for employees responsible for handling important transactions, Developing/monitoring/exempting any suspicious activity reports.
- Focus on training the relevant employees to become compliant with all AML regulations (AUSTRAC, 2020).

“According to the Australian Federal Police, residential property worth AUD5 million was restrained in a 2013 investigation. In another investigation, nearly AUD8.1 million in property was uncovered between the years 2012 and 2013 (Australian Federal Police , 2013).”

## The Good News

While this seems like much responsibility to handle, especially for self-employed individuals and small businesses, the requirements will not be overwhelming in practice. Both FATF and AUSTRAC require that businesses only take the measures appropriate for their size, nature of operations, and other risk assessments. In the 2008 *RBA Guide for Real Estate Agents*, FATF states:

*“The extent of the verification will need to take into account the level of risk that the customer poses and that the objective is to understand the overall ownership and control structure of the customer.... This should ensure that the requirement does not become disproportionately onerous, but that greater checks are made in higher risk situations.”*

It also states that:

*“In instances where risks are low, simplified or reduced controls may be applied.”* (FATF, 2008)

## Chapter 4: Legal Landscapes

Lawyers and other legal professionals such as notaries and company formation agents are increasingly at risk of criminal misuse. Their services can be used to facilitate a range of money laundering and illicit financing while allowing criminals to still seem legitimate. A primary reason criminals are drawn toward legal professionals is the opportunity to gain respect, legitimacy, and credibility quickly. Some of the frequently recorded ways legal professionals either intentionally or unintentionally help with ML/TF activities were reported in a 2013 FATF Report (FATF, 2013). According to it, key methods include:

- Using client accounts to transfer funds.
- Purchasing/selling real estate property
- Creating trusts and companies
- Creating mergers or acquiring companies.
- Secretly managing companies and trusts
- Secretly creating and managing charities.
- Committing tax crimes such as tax evasion.

The Australian Criminal Intelligence Commission (ACIC) reported that most of their investigations into criminal business models reveal the involvement of lawyers, accountants, and bankers, among other DNFBs. It told the senate committee that it identified “at least 185 individuals who are facilitating the activities of Australian Priority Organisation Targets (APOTs).” These are the biggest criminal entities impacting the Australian market and a key target of AML regulations. It further stated that “of these 185 facilitators, approximately one quarter are lawyers, financial advisors, accountants or real estate agents.” (Legal and Constitutional Affairs References Committee, 2022).

Another key organisation, The Australian Federal Police (AFP), also submitted to the same committee, stating that their bigger organized crime groups and asset confiscation activities often accompany the role of lawyers. It stated that “*You will see lawyers, accountants, realtors— that’s not uncommon.*” It concluded that such gatekeepers are very attractive to criminals and organized crime groups as they provide the ability to minimize the link between their assets and the organized crime.

While the below statement by Transparency International Australia (TIA) does not specifically mention lawyers and legal professionals, their services can be part of the stated problem:

*“What we are seeing is the proliferation of professional service firms whose business model is actually to assist foreign individuals or entities to secure a nominee director... and to assist with the registration of companies in Australia that can then be used as a vehicle for money laundering.”* (Legal and Constitutional Affairs References Committee, 2022).

“The Australian Criminal Intelligence Commission (ACIC) reported that most of their investigations into criminal business models reveal the involvement of lawyers, accountants, and bankers, among other DNFBs.”



## Lack of Comprehensive Laws

In response to an AUSTRAC consultation paper regarding DNFBP coverage, the Law Council published an in-depth report stating the prominent existing laws, and regulations, along with the absence of key AML regulations. While the report highlighted the efficacy of current laws, it also accepted that some gaps exist in the regulatory landscape. Most of the gaps were related to lack of enforcement:

*“Lawyers who inadvertently or unwittingly allow acts of money laundering to occur as a result of failing to make proper inquiries (because they are not required to by regulation) are liable to prosecution under Division 400. Yet after a decade of the AML/CTF Act and despite the application of Division 400 Criminal Code, there have been no convictions of an Australian lawyer under these provisions of which the Law Council has been made aware”. --- (Law Council of Australia, 2017)*

It further stated that:

*“The Government has come under significant criticism for failing to enforce the existing requirements of the foreign investment rules. A 2014 House of Representatives inquiry revealed that there had been no prosecutions for a breach of the rules since 2006 and that the penalties where imposed, were manifestly inadequate”. (Law Council of Australia, 2017)*

In a 2017 Submission to the Senate Committee, Transparency International Australia (TIA) stated that the current lack of AML/CTF obligations for legal professionals and lawyers impairs the ability to gather key information required to detect ML/TF risks.

The absence of in-depth customer due diligence and reporting obligations create a huge intelligence gap. This greatly impacts the possibility of identifying any lawyers that may be currently or previously involved in ML/TF activities, either wittingly or unwittingly.

Another problem arises when the lack of existing data due to an exemption from reporting requirements hinders the ability of law enforcement to identify and prosecute the entities that help criminals deliberately.

The usage of a lawyer’s trust account to hide the beneficial owner’s identity is also widely criticized. With the exemption from AML regulations, lawyers are allowed to help a client move money anonymously without identifying the ultimate source of funds. This creates an opportunity for criminals to move large sums of money at a single time without facing a report for suspicious activity (Transparency International Australia, 2021).

## Compliance with the Global Regime

Australia greatly lags when it comes to global standards and continually draws criticism for non-compliance. According to FATF’s 2015 Mutual Evaluation Report, Australia is one of only three states that are non-compliant with FATF’s updated recommendations. The country is criticized for not only being non-compliant but not implementing a single AML recommendation to the DNFBP sector. Despite the recent failures to meet its promises to raise its regulation coverage, Australia is still slow with its implementation (FATF, 2015).

*“Australia greatly lags when it comes to global standards and continually draws criticism for non-compliance.”*

The Australian Committee also voiced its opinion at G20 Summit held in October 2021, stating:

*“The Commonwealth Government committed to FATF long ago and has repeatedly voiced its commitment to implementing Tranche 2 reforms. The process now should focus on how to implement these reforms, rather than if.” (Ross & Yates, 2022)*

*“Despite the recent failures to meet its promises to raise its regulation coverage, Australia is still slow with its implementation (FATF, 2015).”*





## Chapter 5: Accountability for Accountancy

The corrupt have increasingly been using key intermediaries like accountants and lawyers to circumnavigate the otherwise protective legal system. Transferring wealth, buying property, and moving their laundered money is usually done with the strength of expert knowledge possessed by accountants.

In some cases, accountants unknowingly help money launderers and terrorist financiers due to their lack of power over collecting and handling key information. A lack of customer due diligence processes, the obscurity of client location, and rigid corporate structures can cloud their view of the ultimate owner or the motive of the transaction (ICAEW, 2022).

Countries like the UK, USA, Canada, and New Zealand now include accountants in AML/CTF regulations. With the increasing global standards, Australia now faces huge pressure from governing bodies to increase the scope of its AML regulations and make accountancy services more accountable.

### The Attraction of Accountancy

Criminals are highly attracted to accounting services for the ability to gain expert insights, advice, and the creation of new businesses. Accountants can either intentionally or unintentionally help create obscure corporate identities that help criminals legitimize the transfer of otherwise illegal money (FATF, 2019). While there are many reasons accountants may provide a path for the movement of illicit or laundered money, some of the highest threats are posed by the following services:

#### Company Creation

The 2020 National Risk Assessment (NRA) identified company formation and associated trust and company services as being among the highest risk services provided by the accountancy sector. Accountants can play a role in helping criminals confuse the legal system with complicated corporate structures that cannot be traced back to them.

#### False Bookkeeping

Criminals can largely benefit from creating falsified books and hiding their underlying financial records. According to the NRA, false accounting poses one of the highest threats to money laundering. It is especially harmful due to its ability to:

- Hide the true source of funding.
- Move large amounts of money.
- Result in false audits that fail to detect criminal activity.
- Legitimize the frequency and pattern of transactions.
- Create invoices without any activity occurring.
- Falsely inflate the value of a product.
- Hide the presence of taxable income or assets.
- Verify the legitimacy of a criminal when making a purchase (HM Treasury, 2020).

“Accountants can either intentionally or unintentionally help create obscure corporate identities that help criminals legitimize the transfer of otherwise illegal money (FATF, 2019).”



## Other Vulnerabilities

Besides the common services, there are other gaps in accounting regulations that can allow criminals to navigate the legal landscape without gaining attention. According to the recent FATF *RBA Guidance for Accounting Professionals*, some of these include:

**Payroll Services:** Criminals often use accountants to create payroll documents that include salaries for employees that don't exist in reality. This can help them legitimize the proceeds from illicit activities or modern slavery and ghost employees.

**Tax Advice:** Criminals such as money launderers or PEPs can pose as a different entity and seek advice that helps them make more informed decisions in evading taxes and other future liabilities.

**Delegation:** Accountants can perform transactions on behalf of criminals and obscure the ultimate client. This can help criminals make cash deposits, withdraw money, or buy and sell properties without coming under legal scrutiny.

**Nominee Directorship:** Knowing the Ultimate Beneficial Owner is key to the identification of money laundering or terrorist financing. Modern accounting services sometimes offer nominee directorship services that allow the criminal individual or organization to remain hidden while they move funds or engage in business activities (FATF, 2019).

“One of the most prominent changes will be the conduction of Customer Due Diligence (CDD), reporting suspicious activities, and complying with recordkeeping requirements.”

## Compliance Procedures

Accounting firms will be required to enroll with AUSTRAC and become part of a risk-based AML/CFT program. One of the most prominent changes will be the conduction of Customer Due Diligence (CDD), reporting suspicious activities, and complying with recordkeeping requirements.

## The AML/CFT Program

According to the current FATF recommendations for accounting professions, accountancy firms must:

- Conduct an ML/TF risk assessment which includes firm-wide operations and accompanies continual updates and reviews.
- Ensure the oversight of an internal governing entity such as a board member/senior management or the equivalent.
- Hire an AML/CTF compliance officer trained in assessing and ensuring firm-wide compliance.
- Implement an employee due diligence (EDD) program to identify employees who may result in non-compliance or expose you to any ML/TF threat.
- Implement an employee training program to help employees understand the key requirements of AML/CTF regulations.
- Have adequate internal controls and systems to monitor, identify, review, and report any surfacing risks.
- Conduct ongoing Customer due diligence (OCDD) to find out about the ultimate beneficial owner and other customer information that can help indicate red flags (FATF, 2019).



## Chapter 6: Overview of High-Value Dealers; and Trust and Company Service Providers

High-Value goods have the highest vulnerabilities to criminal misuse and illicit financing. Because they concentrate a lot of value in a small space and allow for anonymous buying/selling, criminals can avoid legal prosecutions which are highly dependent on recorded transactions and centralized institutions (HM Treasury, 2020).

The international standards set by FATF recommend all countries to include High-Value Dealers (HVD) in their AML/CTF regulations (FATF, 2003). Despite the presence of high-value trading ML/TF cases, Australia remains largely non-compliant with the FATF standards. Tranche 2 will bring HVDs into accountability and significantly increase their responsibility to conduct customer due diligence, report transactions to AUSTRAC, and implement an in-depth internal controls system to monitor risk at all times.

### Popular High-Value Choices

The types of goods that attract the most attention include jewelry, art, precious metals, and motor vehicles. In Australia, less obvious high-value goods such as building materials, bathroom supplies, and kitchen supplies are also common purchases of criminals. This is related to the Real Estate market being weakly regulated, which provides criminals freedom to buy, renovate and sell a property without facing any legal repercussions (Australian Government, 2016).

### International AML/CTF Standards for HVDs

While the exact requirements and obligations for HVDs are not clear, the FATF can be used to understand the most probable changes. Applicable FATF international standards for AML/CTF obligation are likely to be followed in case Australia implements Tranche 2 (FATF, 2019). Some key standards targeted toward similar businesses (precious stones and metals dealers) include:

### Customer Due Diligence (CDD)

All HVDs will be expected to include a customer due-diligence process that helps it:

- Identify the ultimate customer accurately.
- Identify the individual beneficial owner of a non-individual entity.

To complete these requirements, a CDD must:

- Collect and verify all key details of customer identification, including identity documents with verified legitimacy.
- Verify that the beneficial owner is exactly whom the customer claims it to be.
- Identify and handle with care all the PEPs and their acquaintances/associated people.
- Take all necessary steps needed to uncover the ultimate source of financing used for transactions.
- Obtain information that justifies the purpose of purchase and the nature of the client/dealer relationship (FATF, 2008).

It is likely that these will be the key compliance requirements for HVDs, along with the general application of enrollment with AUSTRAC and implementation of an AML/CFT program.

### Taking Reasonable Measures

Currently, AUSTRAC and FATF expect all reporting entities to take “reasonable measures” to validate every piece of information about the beneficial owner. This includes taking certain steps that complement the risk level of each transaction/customer. If a business is not able to reach accurate information, it must not engage in any business with customers and terminate the relationship (AUSTRAC, 2021).

“If a business is not able to reach accurate information, it must not engage in any business with customers and terminate the relationship (AUSTRAC, 2021).”



## Using a Risk-Based Approach

Not all HVDs need to implement a CDD process. Both AUSTRAC and FATF recommend using a risk-based approach that includes risk reviews, monitoring, and controls that are appropriate for the size and nature of each business (FATF, 2003). In 2016, the Australian Government released a consultation paper regarding the regulation model for HVDs. According to it, all high-value deals must be assigned a risk rating of low, medium, or high. Transactions related to low or medium risk (Individual purchasers, regulated geographies, moderate value purchases) may proceed with a simplified CDD process (Australian Government, 2016).

The consultation paper states:

*“There may be circumstances where an HVD accepts a large sum of cash as payment for goods and services, and the transaction carries a lower risk. The AML/CTF regime does allow regulated businesses to apply simplified customer due diligence measures in such circumstances. This provides businesses with some regulatory relief”.*

## Trust and Company Service Providers

Trust, and Company Service Providers (TCSPs) can knowingly or unknowingly facilitate activities related to money laundering and terrorist financing. Due to their ability to pose as a representative, act as a reliable intermediary, and conduct financial transactions on the client's behalf, they are highly vulnerable to criminal misuse. Most of the reported misuse has been due to a lack of AML/CTF training and inadequate risk assessment processes, but other factors can also come into play (FATF, 2019).

In the report *Money Laundering Using Trust and Company Service Providers*, FATF reports that multiple ML/TF acts have been facilitated due to the presence of an employee willing to help criminals (FATF, 2010).

“Tranche 2 will bring HVDs into accountability and significantly increase their responsibility to conduct customer due diligence, report transactions to AUSTRAC, and implement an in-depth internal controls system to monitor risk at all times.”

According to the same report, some common ways TCSPs remain vulnerable include:

### Creation of Complex Corporate Structures

TCSPs can be misused to facilitate money laundering with the creation of complex corporate structures with low clarity on the ultimate beneficial owner. This can allow criminals to legitimize their illegal funds and store their wealth in a stable economy without alerting the legal system.

### Internal Risk Factor

According to research by FATF, many money laundering investigations have uncovered internal criminal activity as the main precursor. An inability to adequately monitor employee behavior and conduct employee due diligence can expose TCSPs to a higher risk of ML/TF.

### Layering Facilitation

Layering is the most advanced stage of money laundering and gives criminals an opportunity to conceal the original source of their funds. By acting as nominee directors, setting up untraceable corporate structures, and operating in multiple jurisdictions, TCSPs can wittingly or unwittingly help criminals remain out of legal sight.

### Hindering Investigations

FATF noticed that ML/TF criminals are well aware of the fact that conducting investigations and prosecution becomes more difficult when multiple jurisdictions are involved. When financial data and other criminal behavior are spread across multiple jurisdictions, compiling enough evidence becomes more challenging. A TCSP can be used to create corporations and conduct fragments of operations in different jurisdictions, thereby avoiding legal grip.

### International Standards for TCSPs

Not all of the 49 FATF recommendations are applicable to TCSPs. The most important recommendations TCSPs need to prepare for include the following:

- Implementation of Internal Controls program for AML/CTF for high-risk activities.
- Conduct Enhanced Due Diligence for High-risk countries and PEPs.
- Reporting all suspicious activities without engaging in tipping-off (FATF, 2019).

## Customer Due Diligence

Customer Due Diligence (CDD) makes the Recommendation 22. Being reliant on a risk-based approach only, FATF expects TCSPs to only engage in CDD when they conduct the following activities:

- Providing accommodation, a business address, or a registered office for a company/individual/ partnership.
- Providing an administrative address for a company/ individual/partnership.
- Taking the role of a company formation agent for legal persons

A CDD will also be due if a TCSP takes (or arranges another person to take) the role of:

- Director, secretary, partner, or other equivalent position for another legal person/entity.
- A trustee or equivalent position for an express trust or any other legal arrangement.
- A nominee shareholder for another individual (FATF, 2022).

## Everyday Compliance Functions

With a heavy reliance on high-level clients, TCSPs will be expected to engage in continual customer due diligence programs. While the obligation is clear, there are still tactical steps TCSPs must take to satisfy the quality standards of an adequate CDD program. These steps are included in recommendations 10-15 and 17. At a glance, these will require TCSPs to:

- Undertake ongoing, in-depth Customer and transaction recordkeeping for select high-risk clients.
- Have an adequate risk management system that allows for the detection and handling of PEPs and any associated individuals.
- Identify the ultimate source of wealth when dealing with PEPs.
- Conduct a risk assessment, review the existing AML controls, and research the reputation of a correspondent bank before engaging in any business relationship.
- Conduct a risk assessment and effectively mitigate any risks arising from the introduction of new technology, service, product, or delivery method.
- Conduct due diligence when working with a third party and ensure they have proper AML controls in place.

- Ensure that third-party services conduct CDD of TCSP's clients and collect data that is readily available when needed (FATF, 2019).

## Other Compliance Functions

### Ongoing Customer Due Diligence (OCDD)

Ongoing Customer Due Diligence is required to ensure adequate risk control throughout the span of a business relationship. It's possible that the key details and corporate situation of existing customers may change over time. OCDD helps TCSPs detect and account for the changing risk levels (FATF, 2019).

### Enhanced Due Diligence (EDD)

The Enhanced Due Diligence program plays a pivotal role in detecting and reporting high-risk customers and transactions. TCSPs may be expected to implement an EDD when they suspect money laundering or terrorist financing activity. Some of the red flags can include:

- The ultimate customer is a foreign PEP.
- Suspicious, unusual activity by a customer.
- Transactions that involve entities from a prescribed foreign country (FATF, 2019).

### Reporting Obligations for HVDs and TCSPs

According to current AUSTRAC requirements, there are three primary reporting obligations under the AML/CTF regime:

#### Threshold (Cash) Transaction Reporting

HVDs will be the most impacted profession when it comes to cash-related regulations. The threshold transaction reporting is mandatory for all high-value, cash-based transactions due to their frequent involvement in ML/TF activities. Under this change, HVDs will be required to report their client if they make a purchase of over AUD10,000 through/from them.

#### Suspicious Matter Reporting

A Suspicious Matter Report is mandatory in cases of any transactions or interested clients that exhibit signs of high risk. Besides ML/TF, any activity that can be related to a serious offense such as tax evasions and proceeds from criminal activity should also trigger a reporting. These reports must be submitted within three days or 24 hours in case of terrorist financing risk.

## Chapter 7: The Impact Of Regulatory Burden on Small Business; Lessons Learned from A&A Case Study

According to TIA, the most prominent case against Tranche 2 is the negative impact it will have on small businesses and sole operators (Transparency International Australia, 2021).

In the recent Senate Committee regarding the AML regime, the Legal, Financial, and Real Estate participants were highly vocal about the increased regulatory burden on small businesses. The ANU Law Reform and Social Justice (ANU LRSJ) stated that nearly 80 percent of businesses within the DNFBPs industries are small businesses or sole operators.

Chartered Accountants Australia and New Zealand (CA ANZ) provided expected compliance costs based on the results from the experiences of small and sole practitioners in New Zealand. According to it, the complex CDD requirements caused New Zealand services to outsource their compliance operations which cost them between \$50-\$500 per client.

“According to TIA, the most prominent case against Tranche 2 is the negative impact it will have on small businesses and sole operators (Transparency International Australia, 2021).”

Because the compliance processes are not easy to fulfill and require expert knowledge of the legal, compliance, and risk assessment domain, businesses will not be able to fulfill their responsibilities internally. The Real Estate Institute Australia (REIA) stated that *“sophisticated international compliance activity is a specialist skill set.”*

It also explained that such a regulation would force real estate agents to hire an AML/CTF compliance officer, outsource some tasks to a risk firm, spend time on documenting and assessing risks, and much more. It is estimated that all these processes will amount to nearly \$50,000 per agency.

Similar problems were estimated by the Law Council as well. It is estimated that setting up new compliance operations can cost approximately:

- \$119,000 for small operators
- \$523,000 for medium businesses
- \$748,000 for large businesses.

The figures were derived from a 2017 survey of legal professionals undertaken by the Queensland Law Society.

With respect to these figures, it was further argued that the annual gross revenue of most of the small firms is between \$300,000 and \$600,000. It thereby emphasized that the additional compliance costs will damage the sustainability of businesses (Legal and Constitutional Affairs References Committee, 2022).

The high-value dealers and arts and antiques is another sector that remains prone to a significant compliance burden. The experience of HVDs and A&A businesses can be estimated from the experience the UK and US HVDs had when a similar AML regulation was implemented. Most commonly, the early concerns included:

- The high administrative costs and operation costs of galleries.
- The negative impact the intrusive inquiries may have on existing commercial relationships.
- Adverse Effects of CDD requirements on art transactions which are usually closed very quickly (Foley, 2022).

“With respect to these figures, it was further argued that the annual gross revenue of most of the small firms is between \$300,000 and \$600,000. It thereby emphasized that the additional compliance costs will damage the sustainability of businesses (Legal and Constitutional Affairs References Committee, 2022).”



## Chapter 8: Understanding Apprehensions Toward New Regulation

On 30 March 2022, the Senator Committee's report on the Australian AML/CTF regime provided insights into the resistance received by the DNFBP sector. It stated, *"Evidence to the inquiry suggested that there is resistance to reform from within DNFBP sectors"* The report mentions multiple forms of resistance which varied from minimal support to serious opposition. Most of the resistance came from the legal, accountancy, and real estate representatives. Some key arguments made in specific DNFBPs sectors are included below.

### Legal Sector

Lack of evidence for the need for such a comprehensive change and extension in scope was a common pushback from the legal sector. There was a call for making decisions based on actual evidence and risk-based decisions rather than due to a probable or theoretical risk.

The Law Council stated, *"And where you consider there is a risk, ask, does the weight of evidence show that it is high? Is it moderate? Is it low?"*. It further argued that there is a lack of credible evidence that can support the belief that legal professionals pose a serious or moderate ML/TF threat. The adequate strength and efficacy of existing regulations governing the legal sector were also brought up.

The next opposition came in the form of questions regarding the compatibility of the risks posed, and the remedial AML/CTF regulations suggested. The Law Council questioned if the specific risks posed by the legal sector could be mitigated or addressed with the AML/CTF regulations. In simpler terms, it doubted that the nature of existing risks is actually addressable or related to the contents of AML regulations.

### Accountancy

The primary concern in the Accountancy sector was the duplication of obligations and the unnecessary additional burden of compliance. The existence of similar regulations was put forth by multiple bodies, including the APES, CPD, and IIFAC. CPA Australia stated that its members are already subject to stringent regulations that mirror the international AML standards put forth by FATF.

It told the committee that all members already comply with the professional and ethical standards established by the APESB. Regarding the reporting requirements, CPA Australia told the committee that its members are part of the International Federation of Accountants (IIFAC). This makes them obliged to report against its Statement of Membership Obligations (SMO).

In particular, the specific APES requirement that mirrors the AML reporting requirements was put forth. It argued that APES 110 already requires professionals to report acts of suspected or proven non-compliance with the laws and regulations even if there is no legal requirement to do so. These acts include specifically:

- Fraud, corruption, and bribery.
- ML/TF or proceeds from crime.

Coming to the CDD requirements, the sector put forth the pre-existence of such requirement, stating that it is already provided as a guideline by the ATO and Tax Practitioner's Board. However, the opposition from the sector was still minimal. There was prominent support for the need for higher enforcement across the sector.



The head of Public Practice and Small and Medium Enterprises, Mrs. Waller, stated that the current obligations *“only apply to qualified accountants, as opposed to those who may call themselves accountants but who are not members of a professional accounting body.”*

## Real Estate Agents

Duplication of obligation was also mentioned by the Real Estate Sector. The Real Estate Institute of Australia (REIA) stated that real estate agents are already subject to a code of conduct managed by the state and relevant real estate institutes.

Another duplication was found in the area of the identity verification process. The REIA told the committee that such verification processes are already conducted for the purchaser, and a high amount of technology is used to perform these processes. However, the concern accompanied only a slight opposition as it believed the pre-existence would help it play its part in AML regulation more effectively.

The key pushback came from the misinformed definition of the role of real Estate agents. It stated that *“the role of the real estate agent is not to transfer money,” and therefore, the belief that they are “somehow complicit in criminal activity is an incorrect assumption.”*

Another key concern was related to the limitation of an agent’s role and the inability to intercept criminal activity. The CEO of REIA, Anna Neeagama, stated:

*“We don’t have access to bank accounts, for example. The legal transfer of property is undertaken by state-based registries”.*

She further questioned the ability and scope of real estate agents in uncovering any data that can point to criminal activity:

*“Real estate agents do not offer any new visibility data... That could provide any additional surveillance to detect criminal activities”.*

The impact on small businesses was again a key concern. The REIA argued that a large part of real estate agencies is small businesses that do not possess the ability to fulfill such onerous regulatory functions and maintain oversight. Its submission also warned that:

*“The costs associated with replicating the responsibilities and reporting that first tranche companies are undertaking would be prohibitive for the real estate sector and would most likely see the cost imposts leading to closures.”* (Legal and Constitutional Affairs References Committee, 2022)



## Chapter 9: A One-Stop Compliance Solution

With immense pressure building up, Australia is bound to raise its regulatory scope and make DNFBPs more accountable. Irrespective of size, nature of business, and level of risk, all professions that fall within the DNFBPs category will be immediately made responsible.

This highlights a serious need for investing time and money in training employees, learning about new laws, appointing compliance staff, and setting aside resources for continual assessment and reporting.

There is no doubt that small businesses and individual professionals do not hold the financial resources, network, and time to fulfill these responsibilities. Australian Institute of Criminology (AIC) has already established that such compliance responsibilities have a huge impact on both business profitability and overall performance (Australian Institute of Criminology, 2012).

There are lower-level, tactical tasks that need to be conducted in order to fulfill the wider obligations of CDD, Risk Assessment, Reporting, and Creating internal controls.

Going through the recruitment process, hiring a compliant AML manager, or training a new employee can put a strain on both time and financial resources. After all, is done, businesses still run the risk of not succeeding due to the significant learning curve accompanying the transition.

### How Contingent Workforce Can Help

A contingent workforce is increasingly being recognized as the perfect, all-rounder relief to new compliance burdens and a more sophisticated regulatory landscape. With it, businesses are able to minimize their costs, ensure high-quality standards, cut the training time, and complete their compliance requirements without going through a frustrating learning curve.

Businesses can hire AML-compliant officers, onboard temporary staff to conduct CDD, and delegate risk assessment and reporting processes to minimise annual overhead costs.

### Our World-Class AML/CFT Services

Momenta Solutions has provided a reliable workforce to both large and small businesses for 30 years. We provide accredited industry specialists that hold intimate knowledge about the constantly evolving demands of different industries.

Businesses can quickly access experienced individuals with the relevant skills and knowledge needed to fulfill all compliance demands and meet their strict deadlines.

With our support, you can hire a team of professionals whenever there is a change in the market risk, effortlessly conduct risk assessments, implement a new program, create a control system, and simply downscale later. Our offshore capabilities allow us to deliver the highest quality of services to all businesses regardless of their location.

With the arrival of Tranche 2, our goal is to help DNFBPs fill their skills gap, understand the new landscape, and build excellence in compliance processes without needing to give up their current business stability.

Because AML compliance requires a range of skills and responsibilities, our easily scalable and retractable workforce from financial, legal, tech, training, and arts and antique professionals can help you economically meet all compliance needs as soon as they occur.

At Momenta Solutions, we understand that all companies are different and feature their own unique culture, priorities, management style, and customer base. Keeping this understanding in mind, we ensure that every professional hired through us is able to quickly learn and respect the key needs and priorities of your particular business.

“A contingent workforce is increasingly being recognized as the perfect, all-rounder relief to new compliance burdens and a more sophisticated regulatory landscape.”



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