

AML/CTF Review Team
Financial Crime
Attorney-General's Department
4 National Circuit
BARTON ACT 2600
Via email: amlreview@ag.gov.au

30 April 2014

Dear Sir or Madam,

Statutory Review of the Anti-Money Laundering and Counter-Terrorism Financing Act (Cth) 2006

Introduction

- 1 This Submission is made by the Financial Services Committee of the Business Law Section of the Law Council of Australia ("the **Committee**"). The Committee is grateful to the AML/CTF Review Team for allowing an extension of time for this submission to be prepared.
- 2 The focus of the Committee is financial services and Committee members have significant experience in advising financial services providers and other entities that may be subject to the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (AML/CTF Act)* and associated *Anti-Money Laundering and Counter-Terrorism Financing Rules Instrument (No.1) 2007 (AML/CTF Rules)*. The Committee understands that the Law Council of Australia has prepared a separate submission, the main focus of which is whether it would be appropriate to extend the AML/CTF Act to the legal profession as part of proposals to extend coverage to 'designated non-financial businesses and professions' (**DNFBPs**).

Summary

- 3 A majority of the Committee are partners or lawyers in legal firms providing advice to financial services entities that are 'financial institutions' within the meaning of both the *'Forty Recommendations'* and the *'IX Special Recommendations'* of the Financial Action Task Force (**FATF**), which the AML/CTF Act and Rules are designed to implement but also of the February 2012 *"FATF Recommendations"* (together, **FATF Recommendations**) which replaced them.
- 4 In the context of the financial services industry in which we act, the Committee strongly supports the establishment and continuation of strong and effective controls to protect Australia and the broader global financial system from terrorism and other

criminal activity. Strong and effective anti-money laundering and counter-terrorism financing controls in the financial sector will always be a key part of such controls. The Committee is however concerned to see that such controls can be maintained in a manner consistent with the rule of law and which efficiently directs the resources of Australian financial services businesses to achieving those aims, with transaction costs minimised as far as practicable.

- 5 The Committee submits that the AML/CTF Act and Rules as currently in force contain an unacceptably high level of areas of great uncertainty for business, primarily caused by imprecision in key definitions, or overreach by the use of an unduly broad definition. The ultimate effect, it is submitted, is that:
 - a. financial institutions that should (consistent with FATF Recommendations) be covered by obligations to perform initial and ongoing KYC and report matters to AUSTRAC and that are presently doing business are put to unnecessary expense in understanding their obligations;
 - b. organisations wishing to establish businesses are put to undue expense in understanding whether they are providing designated services; and
 - c. because (in the submission of the Committee) key definitions are substantially broader than is necessary to meet FATF Recommendations, a wide range of businesses effectively depend on continued selective enforcement and non-enforcement of the AML/CTF Act in relation to activities that are not required under FATF Recommendations to be regulated.
- 6 The Committee also wishes to address some areas where it believes compliance costs and uncertainty as to the appropriate measures needed to comply with the AML/CTF Act and AML/CTF Rules could be reduced with relatively minor changes.
- 7 Finally, the Committee notes that anti-money laundering and counter terrorism financing regimes around the world fall on a spectrum of 'risk-based' approaches. The Committee is aware that a range of financial services providers and industry groups may be making submissions suggesting that the Australian regime is overly prescriptive and insufficiently risk-based. In general, the Committee believes that the efficiency and effectiveness of the Australian regime could be enhanced by moving further away from the prescriptive approach and further towards risk-based. However, as legal practitioners advising the financial services industry, these are not matters on which we are able to provide concrete observations. (We note that the main Law Council submission has observed that for some DNFBPs, adoption of the AML/CTF Act framework would not in any event be an appropriate framework for managing money laundering and terrorism financing risks (**ML/TF risk**)).

Objects of the AML/CTF Act

- 8 *To what extent are the objects of the AML/CTF Act, as expressed in section 3, appropriate and relevant?*

9 In the view of the Committee, the objects are, to a fair degree, appropriate and relevant, but incomplete (see 10 below). They are expressed primarily by reference to an offshore-focus, apparently with a view to demonstrating that the Act is within Commonwealth power under the Constitution of Australia.

10 *Are there any other objects that should be reflected in the AML/CTF Act?*

11 As for any policy, clear and specific objects are required to translate Parliament's intention into the actions necessary to achieve the aims, purpose and goals of the legislative scheme. By definition the 'objects clause' also provides the basis by which to assess whether the desired regulatory outcomes have been achieved. Without an underpinning theory or policy intent there is no logic of action that links interventions with objectives and an assessment of the effectiveness of the legislative scheme becomes impossible. As presently stated the objects merely recite a need for Australia to adhere to international obligations, addressing matters of international concern in order to affect beneficially Australia's relations with foreign countries and international organisations.

12 The articulation of clear objects for an AML/CTF regime would be difficult. However there are some helpful insights in the FATF 2013 Methodology- some of which are built upon in the following suggested objects. The objects should at the very least provide for an act that is, for example for:

The protection of the financial system in Australia and the broader economy from the threats of money laundering and the financing of terrorism, thereby strengthening financial sector integrity and the promotion of safety and security objectives'

13 The AML/CTF regime should facilitate this by

Establishing an efficiently regulated and internationally competitive financial system promoting Australia's interests in;

- a. Lessening ML and FT risks;*
- b. Detecting proceeds of crime;*
- c. Preventing proceeds of crime from entering the legitimate financial system;*
- d. Detecting and disrupting money laundering threats; and*
- e. Depriving terrorists of illicit moneys and prevention of terrorists acts.*

14 Further, the Committee suggests that the objects should also express an intention in relation to Australia supporting an efficiently regulated and internationally competitive financial services industry (and likewise, efficiently run and competitive gaming and bullion sectors), and the AML/CTF Act being administered in a manner that supports those outcomes.

The risk-based approach and better regulation

15 *Is the scope of the AML/CTF regime and the obligations appropriately risk-based?*

- 16 Although the Committee considers that the AML/CTF regime and obligations under it are inappropriately weighted towards minimum prescriptive requirements and is insufficiently risk-based, the Committee considers that these are matters that are better responded to by financial services providers.
- 17 *Are the requirements for an AML/CTF program adequate to assist reporting entities to mitigate and manage ML/TF risks?*
- 18 The Committee believes that in most cases (at least in the context of the financial services industry in which we practice) the requirements for an AML/CTF Program appear adequate to assist reporting entities to mitigate and manage ML/TF risks on the basis that a 'risk-based approach' is generally required to be sufficient having regard to the risks faced by a particular business.
- 19 However, the Committee believes that in comparison with some regimes that are widely thought to be able to achieve substantial compliance with international standards (such as that which applies to the financial services industry in the United Kingdom), the 'minimum standards' applicable in Australia to objectively minimal risk products and situations may be too high. While certain services are entirely excluded (for example, low-value, non-reloadable gift cards are generally thought to be exempt), once something qualifies as a designated service there is a high minimum standard for up-front applicable customer identification procedures.
- 20 The Committee submits that reporting entities should be given greater leeway to determine how information may be collected and verified where ML/TF risk is low or would not be exacerbated by the method.

21 **Recommendation: Risk-based disclosure certificates** The AML/CTF Rules impose strict restrictions on matters for which disclosure certificates may, and may not, be used. In relation to customer types for which reliable information may not be readily available (such as trusts, unincorporated associations and foreign entities) it should be open for a reporting entity to determine (using a risk-based approach) which matters a certificate may be relied on to establish, and also whose certificate ought to be accepted. For example, in the case of a trust, its auditor may be best placed to certify matters about the beneficiaries and the beneficial owner. For a school parents and citizens association, the school principal may be best able to identify office-bearers. It should not be assumed that officers of a reporting entity are best placed to provide certification. In the Committee's experience, many countries have no formal equivalent of a 'company secretary', and directors of large companies in many cases cannot be prevailed on to certify matters even where they have personal knowledge.

- 22 *Are there barriers to the implementation of the risk-based approach and if so, what are they?*
- 23 In the experience of the Committee, smaller entities (such as single person bookmaking operations) have struggled to implement a risk-based approach. Even a fully off-the-shelf AML/CTF program which was suitable (if such a thing existed) would in many cases be unlikely to be obtained at a price that such a business is able to pay.

- 24 *Does the AML/CTF regime promote both an effective and proportionate response and approach to combating ML/TF risks?*
- 25 In the view of the Committee, yes in relation to higher risks and substantial service providers, but no in relation to lower risks or entities that provide designated services only tangentially, as the 'lower bound' of obligations is not 'scalable'.
- 26 In the view of the Committee, a particular flaw of the AML/CTF Act in this regard flows from its reliance, in seeking to achieve the ends of the FATF Recommendations, on concepts defined for different purposes in the Corporations Act, and which in the Corporations Act apply more broadly than is needed to satisfy FATF Recommendations. As one key example, the issue of an interest in a managed investment scheme is a designated service under Item 35. The Corporations Act definition of 'managed investment scheme' is notoriously extremely broad, so that any manner of scheme which was in substance offered to the public as an investment could be brought under the scheme of regulation (that is, even if its substance is very dissimilar to traditional investments).
- 27 This breadth may be appropriate in a consumer protection statute where regulatory powers would only be exercised in the case of consumer harm. However, its breadth as drafted runs far beyond the activities of a financial institution mentioned in the FATF Recommendations. The Committee submits that such a definition is not appropriate when used to define a group with automatic and material compliance obligations.
- 28 It has been judicially recognised that the Corporations Act definition of 'managed investment scheme' takes in arrangements that would clearly not be 'financial institution' activities under the FATF recommendations, such as the operation of class action lawsuits.
- 29 Further, the Committee notes, that while the definition of 'managed investment scheme' in the Corporations Act is extremely broad, under the Corporations Act, merely satisfying that definition does not automatically generate the serious regulatory burden that does arise under the AML/CTF Act. For example, a managed investment scheme (including virtually any arrangement involving the pooling of resources with some possibility of a benefit) is not required to be registered under Chapter 5C of the Corporations Act if it has 20 or fewer members and has not been 'promoted' by a person whose business is to promote managed investment schemes (section 601ED(1)). A wide variety of other circumstances will also (under the Corporations Act and Regulations) relieve an arrangement that technically is a managed investment scheme from any substantial compliance obligations.
- 30 The AML/CTF Act, in selecting the extremely broad Corporations Act section 9 definition of 'managed investment scheme' (but failing to account for other provisions which effectively restrict its impact to products issued by true financial institutions), on its face applies to a wide range of commercial arrangements including partnerships, joint ventures and class action lawsuits which are not required, under the FATF Recommendations, to be regulated as financial institution activities.

- 31 Entities faced with these issues must rely on technical arguments that they are not 'in the course of a business' of issuing managed investment scheme interests which would directly contradict the expressed view of AUSTRAC as to the proper construction of 'business' in this regard (see 66 below).
- 32 The Corporations Act definition of 'derivative' also mentioned in Items 33 and 35, is likewise defined so as to contemplate a wide range of instruments, transactions and relationships that need not be issued by a FATF financial institution. (Similar observations can be made of the very broad Corporations Act definition of 'security', also used in Items 33 and 35.)

33 **Recommendation: Corporations Act definitions to be qualified by all Corporations Act effective qualifications** The Committee submits that for each key definition based on a Corporations Act definition, its application be limited to the extent that provisions of the Corporations Act, its regulations, or class orders of general application effectively exempt that definition from material consequences. Only Corporations Act definitions of classes of financial activity that are *substantively* regulated under the Corporations Act should be of consequence in AML/CTF Act definitions.

- 34 *Do stakeholders support the rule-based (prescriptive regulation) approach compared with the risk-based approach?*
- 35 The Committee believes that strict rules-based prescriptive regulation tends to lead to higher costs and sub-optimal outcomes. Many of the difficulties that may be experienced in practice with the Australian regime, in the view of the Committee, arise because of an over-reliance on strict rules for minimum standards. Difficulties with the regime inappropriately regulating particular matters 'at the edges' (discussed below where we comment at length about issues with the scope of designated services) would be of lesser concern if minimal steps could be taken in cases where ML/TF risk is demonstrably low to minimal. (However, having regard to both the compliance burden of establishing an AML/CTF Program and the cost recovery regime, uncertainty as to coverage should in the view of the Committee be addressed as a matter of urgency.)
- 36 *Are there particular obligations under the AML/CTF regime which stakeholders would benefit from increased prescription?*
- 37 Not in the view of the Committee.

Modifications and exemptions

- 38 *What other options may be considered to minimise or reduce regulatory burden on reporting entities in meeting their obligations under the AML/CTF Act? What are the potential benefits and limitations of the proposed measures?*
- 39 In our experience, AUSTRAC, operating within the envelope provided by its responsibilities and its resources, is not able to devote sufficient resources to be able to respond appropriately and in a timely fashion to requests to minimise or reduce regulatory burden. Client confidentiality obligations prevent examples being given by name, but it is not uncommon for matters to remain outstanding for

between 6 months and several years, in many cases without any indication of when, if at all, an appropriate solution might be reached.

- 40 AUSTRAC should be given resources dedicated to considering regulatory relief applications, with an express bias towards providing relief that would not be likely to increase ML/TF risk.
- 41 Similarly, in cases where the application of the section 6 designated services to particular fact situations is unclear, and action in the nature of no-action relief is requested, extreme delays are the norm. AUSTRAC should dedicate a team to responding promptly to cases where the application of the AML/CTF Act is unclear, with a view to providing clear exemptions in cases where to do so would not materially increase the ML/TF risks to the Australian economy.
- 42 *In what circumstances would the inclusion of greater flexibility in the current AML/CTF regime's provisions for reliance assist reporting entities to undertake CDD measures in a cost effective way?*
- 43 See our comment as to risk-based disclosure certificates at 8 above.
- 44 See our comments in relation to 'signatories' and 'agents' at 93 to 98 below
- 45 The technical distinction between 'collection' and 'verification' can complicate processes without (in the submission of the Committee) materially enhancing protections. If a customer identifies themselves as a particular listed company and produces sufficient evidence to show that they do represent that company, it should not matter whether information is collected from the customer and verified from public records, or collected and verified from public records. The changes to customer due diligence that are expected to commence on 1 June require collection and verification of obscure information as to settlors of any trust, for example. As the information will in most cases be verified from the trust deed, separate collection from the trustee seems to add inconvenience and expense without delivering any benefit.
- 46 In the case of foreign customers, reporting entities should be given a general discretion to form a risk-based assessment as to whether they will accept evidence of a kind that is customarily accepted in the relevant country by prudent entities regulated by an equivalent law.
- 47 *To what extent do reporting entities currently use simplified due diligence measures? What options may be considered to extend the use of simplified due diligence measures?*
- 48 In the experience of the Committee, to the extent that a simplified due diligence process is available (such as for Australian listed companies or ASIC regulated entities), it is widely used.

Minimising regulatory burden on reporting entities

- 49 *Are there areas where exemptions or modifications have been granted that could be incorporated into the AML/CTF Act or AML/CTF Rules?*

50 A number of relief instruments have been issued to reduce regulatory burden for economic groupings that fail to qualify as 'related bodies corporate', including for the dual-listed BHP Billiton, and for various Babcock & Brown entities that are not 'related bodies corporate' due to intervening trusts and management arrangements.

51 **Recommendation:** In the Committee's view, treatment of true economic units as 'related' regardless of whether they satisfy the Corporations Act 'related body corporate' definition should apply generally, both in relation to customers and also when assessing which entities can or cannot be part of a designated business group. 'Related body corporate' should not be the only, or even the primary, criterion for determining whether entities are or may be 'grouped' for the purposes of the AML/CTF Act.

52 *To what extent have exemptions or modifications that have been granted by the AUSTRAC CEO reduced the compliance burden? (Information that measures, quantifies or demonstrates the benefit in some form would be particularly useful in helping the Review assess the efficiency and effectiveness of this part of the AML/CTF framework.)*

53 Some industries (such as insurance premium funding) have received substantial benefits as a result of a determination that the product is sufficiently low risk that applicable customer identification procedures are not required.

Designated services, industry sectors, and offshore service providers

54 *Does the AML/CTF regime provide a framework to respond to new and emerging services and risks, such as offshore service providers?*

55 The Committee notes that the discussion paper invites discussion on the jurisdictional test in section 6(6). The Committee does not support material change to the jurisdictional test in the AML/CTF Act, particularly in (but not limited to) the usual case where a foreign based provider of services will be based in and supervised by a financial intelligence unit (FIU) in a country with an ML/TF risk management regime meeting FATF standards.

56 Before any step is taken to amend section 6(6) it is, in the view of the Committee, essential that the existing list of designated services be thoroughly reviewed to ensure that they are not drafted in such a way as to capture matters outside of their intended scope.

57 The AML/CTF Act (and the broad capacity for designated services to be amended or introduced by regulation: section 6(7)) already provides mechanisms that are able to be used to ensure that new and emerging services are appropriately covered.

58 *If not, how could the framework be enhanced?*

59 There is no need to enhance the current framework.

60 *Is the current range of designated services appropriate and is there scope for revision or enhancement?*

- 61 In broad scope, the range of designated services that is intended to be covered (and that is actually treated as covered by AUSTRAC) is in the submission of the Committee, appropriate. However, the Committee strongly feels that the **expression** of those definitions is seriously inadequate, causing significant uncertainty and increased costs to the regulated and the unregulated financial services community.
- 62 The Committee understands that for a regulator such as AUSTRAC, a broad definition is of use when the regulator wishes to suggest to a recalcitrant organisation that they should take specified action. However, overly broad definitions are harmful when the written definition encompasses activity that is not in the contemplation of the regulator and was not in the contemplation of the legislators when the legislation was proposed. The Committee has a number of general and specific points to raise in this regard.
- 63 ***'in the course of business' are words of limitation*** Committee members were involved in the development of the AML/CTF Act during late 2005 and early 2006. That development took place between the Attorney-General's Department and industry organisations, through the circulation of a series of exposure draft bills, in the course of which material changes were made, before the final draft bill was introduced to Parliament and passed in a substantially unamended form.
- 64 The original exposure draft dated 12 December 2005¹ included a financial services table in paragraph 6(6) which is easily recognisable as a predecessor of the current section 6(6). One point that is immediately noticeable is that many designated services are expressed as activities carried on 'in the course of a business'. For example, Item 6 would define a service of *'making a loan, where the loan is made in the course of carrying on a business'*. Given the extremely broad definition of 'business' (which remains in the Act unamended from the first draft), industry groups sought for this to be qualified, on the basis that FATF Recommendations do not treat an entity as a financial institution simply because (for example) it makes a single loan in the course of a business that is not otherwise a financial services business. When the Bill was introduced to the House of Representatives in October 2006², in response to consistent comments from industry, references to 'carrying on a business' had been amended (only in the final draft) to references to carrying on *the relevant kind* of business. See for example, the submission of the then Allens Arthur Robinson dated 7 August 2006 at 1.2(j):

As presently drafted designated service 56 would make a natural person who provides any guarantee a reporting entity if that natural person happens to carry on a business (for example, as a plumber or shopkeeper). Designated service 57 would operate to the same effect. We submit that the effect of these designated services should be restricted to guarantees provided and payments made under

¹ Accessed on 2 April 2014 at [http://pandora.nla.gov.au/pan/37952/20070206-0000/www.ag.gov.au/www/agd/rwpattach.nsf/VAP/\(CFD7369FCAE9B8F32F341DBE097801FF\) ttBill2006.pdf/\\$file/ttBill2006.pdf](http://pandora.nla.gov.au/pan/37952/20070206-0000/www.ag.gov.au/www/agd/rwpattach.nsf/VAP/(CFD7369FCAE9B8F32F341DBE097801FF) ttBill2006.pdf/$file/ttBill2006.pdf)

² See press release from the then Minister for Justice and Customs of 27 October 2006 at http://pandora.nla.gov.au/pan/39423/20070416-0000/www.ag.gov.au/agd/www/Justiceministerhome.nsf/Page/Media_Releases_2006_4th_Quarter_27_October_2006_-_Anti-Money_Laundering_and_Counter-Terrorism_Financing_Reforms-2.html

*guarantees where the guarantees were provided in the course of carrying on a business of providing guarantees.*³

- 65 That is, the Attorney-General's department in developing section 6 intended 'in the course of [specify] business' to operate as words of limitation. However as only the final Bill was introduced to the Parliament, traditional methods of statutory construction will not allow it to be construed in that way.
- 66 AUSTRAC's public legal interpretation (No. 4)⁴ notes (at 15) that 'business' is very broadly defined, then (in reliance on the *Acts Interpretation Act*) notes that the broad definition of 'business' in the Act contradicts clear statements in the Replacement Explanatory Memorandum that the defined business types are intended to confine reporting entity status to businesses with a 'core' function involving the designated service. AUSTRAC notes that this inconsistency means that the statements in the Replacement Explanatory Memorandum are unable to be used in construing the effect of the contradictory provisions of the legislation. The legal result will therefore (on traditional analyses) be clearly opposed to the effect that was intended by the legislature.
- 67 **Recommendation:** The Committee submits that the Act should be amended to specifically reflect the original intention that a reference in section 6 to a particular kind of business is intended to limit the broad scope of the defined term 'business' so that it only applies when the specified business is a core function of the relevant entity.
- 68 **'Remittance' services are defined far too broadly** The Committee suggests that material uncertainty and increased costs are occasioned to entities considering establishing a business as a result of unacceptably imprecise drafting in relation to 'designated remittance services'. The Committee notes that AUSTRAC in general enforces these provisions as though they were limited in effect to the money services businesses that (under paragraph 4 of the definition of 'Financial Institutions' in the FATF 40 Recommendations (October 2003 version)) they are intended to capture, but observes that the plain meaning of the words permits AUSTRAC to regulate a far greater range of persons.
- 69 As drafted, a person commits a serious criminal offence (if not on the register of providers of designated remittance services), if the person - *whether or not in the course of any business* - accepts an instruction or gives value in connection with 'an arrangement' (defined extremely broadly) that is 'for' the 'transfer' (which has an extended meaning) of money or property (that is, a remittance service). If the person is not an ADI, the remittance service is likely to be a designated remittance service. (The word 'for' is effectively the only limiting factor within the definition.)
- 70 Given that property in chattels passes by delivery, it is difficult to confidently state that most commercial and non-commercial activities of any kind would not at least arguably be caught by this definition. Each market, each registry, and each retail shop is primarily concerned with changes of ownership of money or property, and it

³ [http://pandora.nla.gov.au/pan/37952/20070206-0000/www.ag.gov.au/www/agd/rwpattach.nsf/vap/\(756edfd270ad704ef00c15cf396d6111\)_revised-draft-aml-ctf-bill-submission-aar.pdf/\\$file/revised-draft-aml-ctf-bill-submission-aar.pdf](http://pandora.nla.gov.au/pan/37952/20070206-0000/www.ag.gov.au/www/agd/rwpattach.nsf/vap/(756edfd270ad704ef00c15cf396d6111)_revised-draft-aml-ctf-bill-submission-aar.pdf/$file/revised-draft-aml-ctf-bill-submission-aar.pdf)

⁴ http://www.austrac.gov.au/files/pli_4_reporting_entity.pdf

is difficult to see from the Act why they are not 'arrangements' 'for' those 'transfers'⁵. These matters should not be uncertain or vague. That they are demonstrates, in the submission of the Committee, that the relevant definitions are not fit for the purpose for which they are being used.

71 **Recommendation:** The designated remittance service definitions need to be entirely redrafted so that they are directed to money services businesses of the kind that are intended to be regulated under the FATF Recommendations. It should be made clear whether sale and purchase of goods or real property, drawdown on loans, repayment of loans are captured. Registry services and stock markets should be expressly excluded, with a formal regime for 'ruling out' defined activities and market participants. The key definition should be limited so that it applies only when engaged in by a person whose business is substantively a money services business.

72 **Electronic funds transfer instructions and defining the end points** The key definitions in relation to 'electronic funds transfer instructions' are intended to work in concert with domestic and international intra-bank and inter-bank payment systems and to manage data transfer through those systems. However in the practical application, they raise considerable doubts because it is unclear whether the point at which data is first entered to such a system is truly the end point of the funds transfer chain. If the endpoint (that is, the originating institution or beneficiary institution) is not the entity actually encoding the message to the system, it becomes a legal requirement to transcribe the data that ultimately is to be added to that system and pass it through informal and unstructured channels.

73 **Recommendation:** Key definitions relating to electronic funds transfer instructions should be reviewed to ensure they actually align with the way in which electronic funds transfer instructions operate.

74 **Stored value cards and other payment instruments** Grave uncertainty surrounds low value payment instruments, because there are strong arguments that the key definition 'stored value card' does not define any facilities that actually are in the market. Prepaid card products that are in the market either (arguably) fall outside of being regulated at all, or (if issued by an entity other than a 'non-financier') arguably fall within categories which may attract more strict requirements, creating inefficient and discriminatory market conditions.

75 'Stored value card' is defined to exclude 'debit cards' and 'credit cards', but to include portable devices that are 'capable of storing monetary value in a form other than physical currency' or 'being used to access' monetary value in such a form, **and** are of a kind specified in the regulations. As there has **never** been a relevant regulation, the set of things that satisfies this definition is empty. Further, gift cards and stored value cards available in the Australian market (other than some public transport tokens which do not represent monetary value) do not generally 'store' anything in the nature of monetary value on the portable device.

⁵ As an aside we note that the reference to 'transfer' having an extended meaning is not appropriate for most remittance arrangements and serves to mislead. We submit that 'transfer' is only given an extended meaning because as a matter of banking law 'transfers' between bank accounts do not operate in the way that they are commonly thought to operate, as a bank deposit is not in fact a pool of money that can be transferred, but is rather an indebtedness.

- 76 They are typically an authentication token that verifies the holder's right to access monetary value held on a central server that is not portable. (Indeed, it seems likely that devices such as mobile phones will increasingly be used as a 'token' authenticating the holder's right to access funds managed at a central server, and any definition should be broad enough to capture this likely development.)
- 77 As a whole, then a stored value card 'includes' a thing of a kind that has never been widely issued in Australia, and that in any event does not exist (due to the absence of regulations). Despite this, a view is generally taken that prepaid card products (whether 'closed loop' and proprietary to one retailer or group, or 'open loop' and able to be used widely) must be 'stored value cards', as no other designated service describes them, where a non-financier is the issuer.
- 78 In the case of entities that are not non-financiers, however (such as an ADI), the absence of an appropriate definition of 'stored value card' potentially suggests that they are instead an 'account' issued by the ADI. If that view were correct, this would have the effect that it would be unlawful for an ADI to issue the products on an anonymous basis, and that their use as gift card products would be curtailed. The Committee submits that there is no basis in principle for permitting non-ADIs to issue anonymous low value payment products but forbidding ADIs from issuing the same product.
- 79 There is a related issue for an ADI which is a provider of a 'purchased payment facility' under the Banking Act 1959, as any purchased payment facility that it issues will, because of the reason that it has ADI status, likely be construed as ADI 'accounts'. To put this in context, such an ADI may have ADI 'accounts', properly so called, for which signatories are to have their identity verified, and other instruments (including but not limited to 'stored value cards') which are intended to have the benefit of some exemption from identity verification. In the absence of a clear statement within the AML/CTF Act, such an entity faces uncertainty whether any facility it offers (under an exemption or otherwise) will be treated as an ADI 'account'. For example, a prepaid gift card which is able to be used to add value to a formally identified customer account might itself be regarded under the AML/CTF Act as an ADI 'account'. This issue raises regulatory burdens to competition, as the issue is not faced by any of the many issuer of purchased payment facilities which APRA has not (under the Payment Systems (Regulation) Act and Banking Regulations) declared to be 'banking business'.

80	Recommendation: The definition of 'stored value card' should be replaced with a definition that includes the products that actually are in the market. Further, it should be specified that a stored value card with the specified characteristics is taken not to be an 'account' for the purposes of Item 1 or a 'debit card' even where issued by an ADI, including where it has a balance below or greater than the thresholds provided for such facilities under Items 21 through 24.
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- 81 **Credit card / debit card** The Committee submits that the definitions of 'credit card' and 'debit card' are inappropriate. Both definitions refer to section 39 of the Australian Consumer Law. However, the relevant part of the Australian Consumer Law does not apply to any credit cards or debit cards in connection with facilities that are ASIC Act financial products: *Competition and Consumer Act 2010*, section 131A(2)(d). An equivalent exclusion applied under the then Trade Practices Act. In

construing these important terms, reporting entities and their advisors have to selectively ignore parts of the definitions.

82 **Recommendation:** 'Credit card' and 'debit card' should be defined by reference to the definition in section 12DL of the ASIC Act.

83 **Control test** The 'control test' should be removed or based on an entirely different statutory regime. The 'control test' mentioned in section 11 is substantially used to establish the jurisdiction of residence of non-natural persons, and is mostly of interest in determining the residence of reporting entities. If countermeasures were implemented under Part 9, the 'control test' also would be of relevance in determining to whom the countermeasures were applicable.

84 The Committee submits that the Social Security Act based test is inappropriate. An individual is taken to 'control' a company if the individual or any associate of the individual is in a position to control the company. 'Associate' is too broadly defined, as it includes any second cousin of the individual. The Committee submits that most people will be unaware of the identities of each second cousin (a person who shares any great grandparent, or a spouse or child of such person), and there is a substantial chance that most individuals will have second cousins, unbeknownst to them, in multiple jurisdictions.

85 It follows from this use of the control test, that for each company, once the person who actually is in a position to control the company is identified, the company is taken to be resident in each jurisdiction where that person has a second cousin, whether or not the person or company is aware of the connection or has ever been in contact. The Committee notes that the connection is actually broader, as it is extended by reference to any trust capacities of any of those second cousins and other matters. The Committee respectfully submits that this is absurd and is not fit for purpose. It is pointless for the Act to prescribe that (for example) US based firms with no business in Australia are Australian residents because the CEO has a distant relative that lives in Australia. It is absurd that Australian based entities are taken to reside in multiple jurisdictions where they have no business because of the jurisdictions of residence of relatives of the controlling individuals.

86 **Recommendation:** The 'control test' should be removed and replaced with a simpler and more direct test. The FATF beneficial owner test may be a more appropriate starting point.

87 **Finance / operating leases** The provision of finance leases is intended to be regulated as a designated service but the provision of operating leases is not. The Act does not provide a definition.

88 **Recommendation:** The Act should include a clear definition of 'finance lease', potentially one that is based on accounting standards, to provide certainty.

89 **The Item 33 service and stockbroking** At a meeting between representatives of AUSTRAC, representatives of the Attorney-General's Department, and the then Investment and Financial Services Association on 1 May 2007, the Attorney-General's representative stated that Item 33 was intended to apply to stockbrokers, but was also intended to apply to persons who in the capacity as agent of a person,

acquire or dispose of securities or derivatives on behalf of the person, in the course of a business of that kind.

90 The Committee submits that in many cases, the section as drafted may not extend to the activities of a stockbroker, as the stockbroker will in the ordinary course **not** 'acquire' or 'dispose of' any securities, but rather arranges for, or causes, the customer to do so. If Item 33 is construed so as to include the activities of a stockbroker, it becomes necessary to also construe it as including the activities of other persons who may cause or arrange for a principal to gain or lose ownership of financial assets. In particular, it is difficult to separate the activity of an investment manager operating under a mandate (who will have authority to determine that a client should hold a particular asset, and instruct a stockbroker to cause the client to acquire the asset) from the activity of the stockbroker.

91 It is submitted that this is an undue regulatory burden on the investment manager, having regard to the fact that a stockbroker acting for the ultimate client will have obligations to carry out an applicable customer identification procedure in relation to the client (and may be obliged to verify that the investment manager has been appropriately authorised by the client).

92 Recommendation: The Item 33 service should be redrafted to ensure that it transparently captures stockbroker-type activities of the kind it is intended to cover and does not inadvertently capture other entities. Further, where in a transaction a person provides the 'stockbroker' designated service, persons giving instructions to the stockbroker should be regarded not as other reporting entities, but as customers of the stockbroker or agents of such customers.

93 **Signatories and ADI accounts** In relation to ADI accounts, the notion of a 'signatory' presents significant practical difficulties. It is submitted that it is drawn too broadly. The *Financial Transaction Reports Act* incorporated a formal 'identification officer' regime, so that in the case of a large corporate customer, a financial institution could implement a procedure for indirectly having verified that specified individuals had authority as agent to instruct the financial institution (including in relation to corporate credit card facilities and bank accounts).

94 The 'signatory' definition can be shown to be inappropriately wide by considering the example of a department store. The store has (say) 40 separate cash registers, each of which has EFTPOS facilities. Each payment received through a cash register may be seen as a 'transaction' on the bank/ADI account of the store owner, and therefore each cashier a person on behalf of whom the financial institution 'customarily' conducts transactions. Perhaps mere receipt of a payment may be construed as not being a transaction performed on the authority of the store owner (incidentally, the Act would be improved by appropriately specifying what is and is not 'authorising' a 'transaction' for this purpose).

95 Even if 'transaction' is considered as excluding **receipt** of a payment, we note that it is not uncommon for a purchase transaction to be reversed, which in the ordinary course involves a withdrawal from the bank/ADI account of the shop owner and a balancing payment to the source account of the customer. It is difficult (and there is no basis in the relevant definition) to distinguish this from any other withdrawal performed by a true 'signatory'.

96 It is submitted that the key definition of 'signatory' is drawn too broadly. The 'verifying officer' provisions in Part 4.11 of Rule 4 of the AML/CTF Rules have not proven to be an effective substitute for the identifying officer provisions of the Financial Transaction Reports Act, and in any event there is uncertainty as to whether they are able to be used in relation to relation to signatories of a non-natural person customer (despite some indications from AUSTRAC in approximately 2009 that this was under consideration).

97 It is submitted that in the department store example above, there is no compelling public interest and no ML/TF risk to be managed that are served by treating the operators of cash registers as account signatories whose identity should be formally verified, and likewise there is in many cases no benefit for the identity of 'in house employees' being verified by external parties when they perform their roles on behalf of an organisation.

98 **Recommendation:** The Committee suggests that the key definition of 'signatory' should be redefined so that it applies more narrowly, perhaps by reference to persons with authority to authorise payment transactions beyond a certain threshold. The 'verifying officer' provisions under the AML/CTF Rules should be redrafted and expanded to the extent that reliance on them would not materially increase ML/TF risk.

99 **Use of FATF Recommendation drafting in Australian laws** The Committee notes with concern that material changes currently being proposed to the AML/CTF Rules in relation to customer identification procedures have in key areas chosen to appropriate language from the FATF recommendations, with a view to clearly complying with international standards.

100 The Committee observes that the FATF recommendations are the outcome of a consensus based committee approach, involving representatives of countries with widely differing legal systems, and are often prepared by persons who are not legal practitioners. The language used will in many cases, it is submitted, be too imprecise to be the foundation of legislative instruments that are backed by criminal penalties and by extremely high levels of civil penalty provisions. Legislative provisions need to be precise and capable of interpretation according to principles of statutory interpretation.

101 **Recommendation:** FATF terminology should not, in our submission, be adopted in primary or subordinate legislation unless it has been shown to be precise and clear and should not be used where use of different terminology could achieve both clarity and compliance with the substance of the relevant FATF requirement.

102 The Committee notes that the AML/CTF Act was prepared under a tight deadline, and at the time that it was passed, industry associations had hundreds of issues where the drafting caused grave concern. Because of international undertakings, passage of the Bill became urgent. As it was only ever possible to negotiate the most critical issues with a particular version, many issues regarded as mistaken drafting were passed into law without clear consideration.

103 The Committee suggests that at this juncture, the key issues lists of industry organisations in 2006 should be considered in detail to determine whether the

issues raised have been substantial issues or have not, and to resolve those that were.

- 104 The Committee notes however that financial services organisations have invested material resources in implementing compliance frameworks for the current regimes (however unsatisfactory they may be in parts), or upon interpretations of key provisions that are widely accepted in industry and by the regulator (whether or not they bear any close resemblance to the express words of the Act).

105 Recommendation: In making any changes, the Committee stresses that it will be important to have a significant consultation period, and asks that government officers considering industry concerns endeavour to engage fully with them and understand the basis of concerns, so that the result will resolve ambiguities without creating new and equally or more serious ambiguities.
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- 106 *How should DNFBPs be regulated under the AML/CTF Regime?*

107 The Committee offers no view on this topic. The Committee notes that the broader Law Council of Australia has provided a submission that offers specific views on this topic as it relates to the legal profession.

Harnessing technology to improve regulatory effectiveness

- 108 *How might the development of online identity verification systems be harnessed to streamline and strengthen compliance with customer due diligence obligations under the AML/CTF Act?*

109 The Committee notes that there has been significant growth in online commerce since 2006 and that online systems potentially offer an identification mechanism that is as robust as, or more robust than reliance on hard-copy materials. The Committee suggests however that any change should be designed to be facilitative rather than prescriptive.

- 110 *What are the advantages and disadvantages of online identity verification, and how might the disadvantages and risks of this approach be addressed?*

111 As legal practitioners, these are not matters on which we are able to provide concrete observations.

- 112 *In what other ways can technology be used to support the objectives of the AML/CTF regime or reduce the compliance burden on business?*

113 As legal practitioners, these are not matters on which we are able to provide concrete observations.

Industry monitoring and supervision

- 114 *Does the supervisory framework support an effective, risk-based AML/CTF regime and compliance with the AML/CTF framework?*

115 Broadly, the Committee considers that it does.

- 116 *Is AUSTRAC's monitoring of compliance targeted, proportionate and risk-based?*
- 117 As legal practitioners, these are not matters on which we are able to provide concrete observations. Based on anecdotal feedback from reporting entities for which Committee members act from time to time, and experience of in-house members, AUSTRAC's actual practice of monitoring generally proceeds as though the material overreach and material drawbacks of the legislative regime that the Committee considers exists, largely do not exist. To that extent, AUSTRAC's monitoring of compliance is broadly speaking targeted, proportionate and risk-based.
- 118 The caveat that the Committee would offer is that for entities that are (and are treated as) reporting entities, AUSTRAC strictly applies identification standards that may not in themselves be appropriately risk-based or proportionate.
- 119 *How effectively does AUSTRAC communicate with reporting entities and industry associations to ensure they have a sound understanding of their legal obligations under the AML/CTF regime?*
- 120 In the experience of the Committee, AUSTRAC is somewhat open about its regulatory priorities and plans. However (largely because the legal obligations are excessively complex), the Committee believes that AUSTRAC has not been able broadly to provide this assistance to reporting entities.
- 121 Committee members are involved with certain industry associations in relation to their interaction with AUSTRAC and welcome the open way in which AUSTRAC will engage with industry organisations in developing improvements to the regime.
- 122 *To what extent does the current DBG approach work to help reporting entities to engage with AUSTRAC and comply in an efficient way that reduces the compliance burden?*
- 123 For economic entities that are eligible to form designated business groups, the Committee suggests that the DBG concept is effective at limiting regulatory burden.
- 124 However, the Committee notes that a wide range of economic groupings (even if under common actual control) are not eligible to form DBGs because of the presence of an intervening trust⁶ within the economic group, or the presence of some other entity that is not a company (such as a limited partnership).. In some cases, it could be appropriate for a group of individuals to establish a DBG.

125	<p>Recommendation: The Committee suggests that the criteria for formation of a DBG should be liberalised so that any legal person (or unincorporated association, if applicable) can form a DBG with any other legal person, if there is a material and non-short term economic relationship between them, and none is a member of any other designated business group. 'Related body corporate' status under the Corporations Act should not be a requirement. In any event, legal persons under</p>
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⁶ Corporations Act section 48(2) and 50AA(4) may have the effect that entities under common control and ownership cannot be regarded as 'related bodies corporate' if shares in one of the entities is held on trust, even if ultimately held on trust for the shareholders of the ultimate parent as is common in many 'stapled security' structures.

common ownership, management, or control (whether or not all are reporting entities) should be permitted to form a DBG even if they are not all Corporations Act 'related bodies corporate'.

- 126 *Are changes required to promote better regulation at the corporate group level?*
- 127 The Committee believes that facilitative guidance may be a more appropriate approach than any mandatory changes, to allow DBGs and economic groups to manage ML/TF obligations in a way that effectively manages those obligations in a manner that is efficient for the organisations. For larger reporting entities, it may be most appropriate for AML/CTF compliance to be monitored by a risk sub-committee of the Board, for other entities AML/CTF compliance may be a matter appropriately considered by the Board as a whole.
- 128 *Are there other approaches AUSTRAC can employ to assist reporting entities to improve compliance?*
- 129 For smaller entities that fall within the definition of reporting entity and do not have the benefit of an exemption, the Committee suggests that a range of simple explanatory materials and pro-forma policies and procedures should be developed and made freely available to assist compliance.

Enforcement

- 130 *How effective and proportionate is the enforcement regime, particularly in promoting compliance?*
- 131 The Committee believes that reporting entities are aware of AUSTRAC's supervisory approach and believes that AUSTRAC's current stance is leading to compliant behaviours.
- 132 *What additional or alternative powers would encourage compliance and /or facilitate enforcement? By way of example, is there scope to increase the use and application of infringement notices?*
- 133 A key focus of the Law Council of Australia is the rule of law and the Council does not support any increase in the use of non-judicial enforcement processes. The use of such processes is considered particularly inappropriate where the underlying regulatory regime is uncertain or definitions are overly broad (as is definitely the case for the AML/CTF Act), as in this case an unfettered regulatory discretion becomes the main determinant of whether a penalty will or will not be levied.
- 134 *How effectively does AUSTRAC use its enforcement powers?*
- 135 The Committee believes that AUSTRAC uses its regulatory powers relatively effectively, but that investigations are in many cases extremely slow to reach a resolution.

Reporting obligations

- 136 *To what extent are the existing transaction reporting obligations appropriate in achieving the objectives of the AML/CTF regime?*

- 137 As legal practitioners, these are not matters on which we are able to provide concrete observations.
- 138 *How can the reporting regime be strengthened or enhanced?*
- 139 As legal practitioners, these are not matters on which we are able to provide concrete observations. The reporting obligations should not be extended beyond what is required under FATF Recommendations or provided for under regimes of Australia's key trading partners.
- 140 *What are the issues, constraints and limitations of the transaction reporting obligations?*
- 141 As legal practitioners, these are not matters on which we are able to provide concrete observations.
- 142 *Is there scope to vary or impose further thresholds and, if so, what is the evidence to support variation?*
- 143 As legal practitioners, these are not matters on which we are able to provide concrete observations.
- 144 *Are the cross-border movement reporting obligations appropriate and how can they be strengthened or enhanced?*
- 145 As legal practitioners, these are not matters on which we are able to provide concrete observations.
- 146 *Do reporting entities receive appropriate feedback from AUSTRAC and its partner agencies on the benefits, value and purpose of transaction reporting? How could feedback be improved?*
- 147 As legal practitioners, these are not matters on which we are able to provide concrete observations.
- 148 *Does this feedback and other information assist reporting entities to detect high risks and assist in meeting their AML/CTF obligations?*
- 149 As legal practitioners, these are not matters on which we are able to provide concrete observations.

Secrecy and access

- 150 *Do the current secrecy and access arrangements strike the right balance between protecting sensitive AUSTRAC information and allowing the use of AUSTRAC information to achieve AML/CTF and other government objectives?*
- 151 Subject to our comments on the tipping off provision below, the Committee believes the measures are appropriate.
- 152 *Has the tipping off offence worked as intended? If not, what improvements can be made?*

- 153 The Committee submits that the tipping off provision is overly restrictive and as currently implemented is more likely to increase, rather than mitigate, ML/TF risk.
- 154 The Committee accepts and supports the proposition that there should not be external communication of the fact that (following the submission of a suspicious matter report (**SMR**)), AUSTRAC or a law enforcement agency has sought additional information, nor the nature of any such information.
- 155 The Committee accepts and supports the intention of the tipping off provision of ensuring that a person involved with a matter that has been the subject of a SMR does not become aware that the SMR has been made so as to change their behaviour and perhaps interfere with an investigation.
- 156 However, the Committee is concerned that there is no real benefit in restricting the Australian branch of a foreign controlled financial services provider from supplying information through internal channels to either regional management or the head office, which may be of use in enhancing the global ML/TF risk management and may be a requirement under laws binding the foreign parent. Such supply of information, if it is submitted, would not ordinarily increase the risk that a person might learn that an SMR had been lodged about them.
- 157 Similarly, the Committee believes that ML/TF risks may be better managed if information as to the formation of a suspicion may be actually or implicitly disclosed as part of an internal investigation, of the matters surrounding the SMR or in improving relevant systems.
- 158 For example, if a reporting entity relies on a service provider to carry out its applicable customer identification procedure, and forms a suspicion as to the procedure, it would support ML/TF risk management if the risk team of the reporting entity could provide specifics of their concern to the risk team of the service provider, to ascertain whether the service provider's risk systems had identified the risk and assist them doing so in future. Legally enforceable non-disclosure obligations (ie 'tipping-off' offences) could be imposed on the service provider in receipt of information as to a suspicion having been formed. Similarly, the service provider (if it is a reporting entity) should be free to disclose to the 'upstream' reporting entity the substance of any suspicion.

159 Recommendation: The Committee submits that the tipping off rule should be substantially amended so that disclosures may be made where the discloser reasonably believes that the disclosure will not lead to any material risk that a person connected with the suspicious matter will become aware that the suspicion has been formed.
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Privacy and record keeping

- 160 *Does the current AML/CTF framework provide adequate provisions for safeguarding personal information?*
- 161 In the view of the Committee, the measures are appropriate, although the Committee notes that any requirement under the AML/CTF Act automatically ceases to raise 'safeguarding' of personal information issues.

- 162 *Can technological solutions assist with the collection, verification and storing of personal information and what are the privacy implications?*
- 163 The Committee notes that these issues have been discussed at length in the 2006 Australian Law Reform Committee Report that has formed the basis for recent privacy reforms.
- 164 *Are the record-keeping obligations sufficient and proportionate for AML/CTF purposes?*
- 165 The Committee submits that the record keeping provisions may be of assistance if they were drafted with more precision and less generality. The fact that it is arguable that all CCTV footage of a bank branch must be retained for 7 years under the Act as currently in force tends to indicate that the obligations have not been articulated with appropriate specificity to ensure that they only require collection of information that is necessary to meet the purpose of the Act.

International cooperation

- 166 *Do Australia's arrangements under the AML/CTF regime provide an adequate framework to enhance international cooperation?*
- 167 As legal practitioners, these are not matters on which we are able to provide concrete observations.
- 168 *Are there areas where the framework could be enhanced or expanded to strengthen international cooperation on AML/CTF?*
- 169 As legal practitioners, these are not matters on which we are able to provide concrete observations.

Contact details

- 170 If you have any questions regarding this submission, in the first instance please contact the Committee Chair, James Moore, by phone on 02-9334 2686 or via email: jmoore@hwle.com.au . The Committee would welcome the opportunity to present in person or be involved in further consultation as the review proceeds.

Yours faithfully,



John Keeves
Chairman, Business Law Section