



Investment & Financial Services Association Ltd  
ACN 080 744 163

21 February 2006

Senator the Honourable Chris Ellison  
Minister for Justice and Customs  
Parliament House  
Canberra ACT 2600

Dear Senator *Chris*

**AML/CTF EXPOSURE DRAFT BILL AND RULES**

Thank you for the opportunity to comment on the Exposure Draft and Rules.

IFSA represents the retail and wholesale superannuation, funds management and life insurance industries and has over 125 members who are responsible for investing over \$920 billion on behalf of more than nine million Australians.

While we are continuing to review AML/CTF Rules as they are released, and will lodge a comprehensive submission prior to the end of the consultation period, we feel it is important at this time to communicate what we believe are the key AML/CTF issues going forward.

IFSA believes that the issues identified in the attached submission are the most critical to the development of a workable and effective regime – for both the financial services industry and those that interact with it.

Therefore, given the importance of these issues, IFSA would welcome the opportunity to discuss these matters with you in person as well as with members of your Office and Department.

If you have any queries regarding the contents of this submission, please do not hesitate to contact me or Martin Codina on (02) 9299 3022.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Richard Gilbert', is written over a circular stamp or seal that is partially obscured.

**Richard Gilbert**  
Chief Executive Officer

## **1. Duration of consultation period**

It is IFSA's view that the scheduled 4 month consultation period (ending on/around 16 April) will be insufficient to allow for adequate consultation to take place on the complete AML/CTF package.

While we appreciate that both the Attorney-General's Department and AUSTRAC are attempting to finalise the AML/CTF package as soon as possible, proposed timeframes for the completion of the package are insufficient to allow for adequate consultation to achieve a workable and effective regime.

Already, around half of the consultation period has passed and much of the detail around critical elements of the package such as an acceptable method for Electronic Verification; acceptable methods for determining PEPs; Risk Triggers for re-identification; Continuity of Relationship and Low Risk Designated Services are still outstanding.

In addition, the staggered release of the draft Rules, which form a fundamental part of the regime, makes it extremely difficult to undertake comprehensive analysis and provide carefully considered comments to Government.

Indeed, the range of services covered in the Bill are very broad and in order to effectively regulate those services, the relevant products themselves and the way they operate and are distributed needs to be clearly understood. For this reason, industry believes that effective consultation on the AML/CTF package needs to be iterative (i.e. submissions made by industry, considered by AUSTRAC, AUSTRAC then providing feedback or seeking further clarification from industry or both, and industry responding, etc).

Therefore, given the significant number of outstanding elements of the AML/CTF package and the need for reporting entities to have sufficient opportunity to properly consider the impacts of the proposed changes, IFSA does not believe adequate consultation on a finalised package will occur in the remaining 2 months of consultation – notwithstanding the best efforts of all the parties involved.

As a result, IFSA requests more time to consult with the Government and the Regulator on the finalised AML/CTF package (that is, once the complete package comprising the Bill, Regulations, Rules and Guidelines is finalised).

## **2. Deadlines for implementation/finalisation of AML/CTF package**

In our view, it is important to take the necessary time to develop a regime which is both practical and effective from the outset. The AML/CTF regime is one of the most significant reforms to the financial services industry in the last twenty years, and as a result, consultation with stakeholders will be critical to ensuring an effective and workable regime.

The consultation experience relating to the *Financial Services Reform Act 2001* (FSR) is a relevant example that should guide the manner in which the Government and AUSTRAC undertake to consult on the AML/CTF regime.

In the case of FSR, there was an extensive consultation period which included:

March 1999:	CLERP 6 Consultation Paper released
February 2000:	Draft FSR Bill released
September 2001:	Bill receives the Royal Assent
March 2002:	Legislation commences with 2 year transition period
March 2004:	End of transition period

Importantly, despite the extensive consultation outlined above, industry and Government are still attempting to overcome a number of practical difficulties with the FSR regime. Indeed, while many of the ongoing difficulties were largely unintentional, IFSA nevertheless believes that the industry's and the Regulator's experience would have been far worse had there not been extensive consultation from the outset.

Therefore, IFSA believes that an extended consultation and transition period is essential to limit unforeseen consequences/outcomes.

### **3. Transition period**

Given the statements made above and the high-level nature of the Bill, industry is concerned to ensure that any transition period should be set by reference to the entire AML/CTF package rather than just the passage of the Bill. The obligations imposed by the Bill and Rules are extensive and cover matters ranging from employee training, to monitoring and reporting requirements, which will require the development of complex systems to ensure compliance.

Furthermore, it is important to recognise that not all sectors of the financial services industry have previously been subject to regulation by AUSTRAC under the *Financial Transaction Reporting Act 1988* (FTR Act).

As a consequence, industry considers a minimum implementation period of 2 to 3 years is required – commencing from the later of the passing of the legislation or the development of the full set of Rules and Guidelines.

Therefore, in light of the arguments above, IFSA believes it is inappropriate for parts of the Bill to become operational “as soon as practicable after the date of commencement of the Bill”.

### **4. Impact on/of other laws**

Our industry is heavily regulated by other legislation whose obligations may be inconsistent with AML/CTF obligations. For instance, under the Corporations Act, responsible entities of registered schemes are required to

comply with scheme constitutions. Constitutions typically provide for timeframes for issuing or redeeming investments. Under the AML/CTF regime, responsible entities (as Reporting Entities) may be required to delay the issue or redemption of units because of a lack of appropriate verification.

Importantly, it has not been possible to carry out a comprehensive AML/CTF legislative impact analysis due to the incomplete nature of the package at this time. However, this is a critical issue that reinforces our request for more time to consider the Bill.

## **5. AUSTRAC Resourcing**

A well resourced Regulator will be critical to the effective implementation and ongoing administration of the AML/CTF regime. IFSA does not believe that, at the present time, AUSTRAC is directing sufficient resources towards this project to enable it to release the necessary and critical Rules/Guidelines with sufficient time to engage with industry on their practical application prior to the end of the consultation period.

We request that the Government consider whether AUSTRAC is adequately resourced to effectively carry out its obligations in relation to its Rule making function under the AML/CTF Bill.

## **6. Legislative model/Industry versus AUSTRAC Guidelines**

IFSA is also concerned that if the present practice of AUSTRAC-issued Guidelines continues, the guidance provided will not meet industry needs, as it will not adequately take into account industry expertise and commercial practice. This legislative design aspect should not be understated as it has been one of the critical learnings from the UK AML implementation experience.

Indeed, in the UK, the FSA is now going through a major exercise in removing “the existing detailed rules on anti-money laundering controls in their entirety, replacing them with high-level requirements for firms to have their own risk-based controls on money laundering.”<sup>1</sup> This would be a costly and wasteful exercise that neither the industry nor the Regulator (AUSTRAC) would want to go through.

Instead, the Guidance published by the Joint Money Laundering Steering Group (which comprises the leading UK trade associations in the financial services industry) now represents best practice in the UK. The FSA Rules recognise this by requiring the FSA to take account of the JMLSG Guidance in considering whether a breach of the AML Rules has occurred.

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<sup>1</sup> Financial Services Authority – Reviewing our Money Laundering regime: Feedback on Chapter 2 of CP05/10 and made text. Link to Paper:  
<http://www.fsa.gov.uk/pages/Library/Communication/PR/2006/008.shtml>

The UK experience indicates that it is industry, rather than the Regulator, that is best placed to prepare practical level Guidelines. IFSA once again emphasises that the Government should follow the example of the UK in this regard.

By omission, the Bill appears to allow for the Guidelines to be drafted by industry. However, in order to remove any doubt of the legislature's intention that industry (rather than AUSTRAC) be responsible for preparing these Guidelines, we suggest that this should be clearly outlined in the Bill so that a formal steering committee structure/process can be established.

IFSA believes that this model is the most likely to achieve the Government's aims without imposing undue costs on industry or exposing consumers to unnecessary inconvenience.

#### **7. Certain superannuation and life insurance products to be treated as low risk designated services**

Superannuation (excluding Self Managed Super Funds – SMSFs) and certain life insurance products should be categorised as low risk designated services. These products contain a number of important features that ensure they are neither suitable nor likely to be used by individuals seeking to launder money or finance terrorism.

Importantly, however, it should be noted that most (if not all) designated services carry with them some risk that they will be used for money laundering or terrorist financing. Therefore, AUSTRAC should not restrict a "low risk" categorisation to designated services that have "no risk" or "minimal risk".

The purpose of categorising designated services as "low risk" is to ensure that the AML/CTF obligations imposed on financial institutions is not disproportionate to the risk posed by that designated service. Further, even if a designated service is classed as "low risk" by AUSTRAC, reporting entities will still need to consider the risks posed by individual products and circumstances in formulating their AML programs.

In other words, in deciding whether to categorise a designated service as "low risk", AUSTRAC should not focus on unusual circumstances or on the possibility of unusual product features or situations where the risk of money laundering is increased – these will be captured by each reporting entity's AML program.

Instead, IFSA believes that AUSTRAC should focus on ensuring that the AML measures required are proportionate to the risk posed in the majority of cases.

However, in relation to SMSFs, we believe that there are potentially significant implementation issues that require separate consideration.

A comprehensive submission on low risk products/designated services will be lodged prior to the end of the consultation period in addition to ongoing work

being undertaken by the Risk Principles Working Group which IFSA Co-Chairs.

## **8. Risk-based approach**

At the core of the AML/CTF regime is the notion of a 'risk based approach' to identify and mitigate AML/CTF risks. However, to date there has been very little guidance about what a risk-based approach entails.

For example, it is still not clear what a risk based approach means and how to go about developing a program that will reflect that approach. As an example, it is unclear how the risk assessment of products (or services) and the risk assessment of customers will interact.

Other issues include whether classification as low-risk for ID purposes translates into similar treatment for all or elements of that reporting entity's AML Program or reporting obligations.

In addition, the level of prescription in AML/CTF Rules does not appear consistent with the risk-based approach supported at earlier Ministerial Roundtables. The Rules that have been released are considered too prescriptive in nature and in certain cases do not allow industry sufficient flexibility.

Again, the AML implementation experience in the UK should be carefully considered given the potential for the same errors to be committed here.

## **9. Electronic Verification (EV)**

While the AML/CTF Bill and Rules are technology neutral, they do not outline an acceptable EV process. This issue is critical to the financial services sector which predominantly interacts with existing customers and potential customers on a non face-to-face basis.

We also note that the Bill, as currently drafted, will possibly require multiple verifications of the same customer due to interactions with a number of Reporting Entities in relation to the same transaction chain. As customers may obtain products from multiple issuers, it is necessary that the Rules provide for an EV process that balances regulatory and customer experience outcomes.

IFSA has previously provided the Government with a proposal for Electronic Verification for superannuation and life insurance products based on the Tax File Number. We are still awaiting feedback on that proposal and believe that it is a priority for industry and the Government to work in partnership to develop an effective and efficient solution on this front.

Finally, we would like to commend the Government for the work it has recently undertaken in relation to the release of its document verification system for use by certain government agencies. IFSA again calls for a whole of

Government approach to ensure that electronic verification is available to industry from the commencement of the AML/CTF Act. In this regard, we support the establishment of a taskforce including industry and Government representatives to further develop an electronic verification system.

## **10. Third party authorisation and due diligence**

Most of the financial products issued by our members are distributed through licensed financial advisers that the AML/CTF Bill treats as third parties. Regardless of this, members (themselves reporting entities) will be required to authorise advisers (who may also be reporting entities) in writing and take reasonable precautions and exercise due diligence to assure themselves that the advisers have not contravened their AML/CTF obligations.

These requirements are impractical given the size of the advice industry, the way financial planners interact with product issuers (as independent stakeholders), and their ownership of the primary relationship with the customer.

Indeed, IFSA questions why the responsible entities are effectively required to monitor each other as this introduces added unnecessary costs to the regime and is at odds with a risk based approach.

## **11. Conglomerate issues**

On a related note, a number of IFSA members are part of conglomerates that do business on a group basis. We are concerned about provisions (such as the requirements to authorise internal agents in writing, and for each reporting entity to have its own AML program and Board oversight) that derogate from the way conglomerates operate. As indicated above, if these provisions are not amended, the industry will incur unnecessary expense as a result.

In addition, restrictions on conglomerates acting on a group wide basis will also affect the experience of customers who deal with related reporting entities and also AUSTRAC in terms of the possibility of duplicate reporting of the same suspicious matters.

These undesirable outcomes could be avoided by the legislation more explicitly recognising and allowing grouping for AML/CTF purposes.