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Discussion Paper – Cost Recovery
Australian Transaction Reports and Analysis Centre
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AFMA submission in relation to cost recovery for AUSTRAC's regulatory functions

The Australian Financial Markets Association (AFMA) is the leading industry association promoting efficiency, integrity and professionalism in Australia's financial markets and provides leadership in advancing the interests of all market participants. These markets are an integral feature of the economy and perform the vital function of facilitating the efficient use of capital and management of risk.

AFMA represents over 130 members including Australian and international banks, leading brokers, securities companies, State Government treasury corporations, fund managers, traders in electricity, remittance service providers, and other specialised markets and industry service providers.

We make the following submissions in response to the discussion paper.

1. Cost burden remains unevenly allocated

AFMA wrote to the Hon. Brendan O'Connor MP, Minister for Home Affairs, in May 2010 following the announcement in the May 2010 Budget that the Federal Government intended to recover some of the costs of AUSTRAC's regulatory activities. A copy of that letter was provided to AUSTRAC CEO John Schmidt.

In the letter, we noted it is clear that the objects and purpose of the AML/CTF Act and AUSTRAC's regulatory activities are to provide a public and social good to the Australian people by combating money laundering and the financing of terrorism. Accordingly, as the benefit of Australia's AML/CTF regime accrues to all Australians, the costs of AUSTRAC's regulatory activities should not be borne solely by regulated entities.

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The Replacement Explanatory Memorandum to the AML/CTF Bill, presented to the House in 2006 by the then Minister for Justice and Customs, states on page 20 that "..*as with other law enforcement measures, it is certainly not necessary that AML/CTF regulation be self-funding*."

The cost recovery proposal as it stands is contrary to the justification presented to Parliament for the introduction of the legislation – that the AML/CTF Bill was necessary for Australia to comply with its international obligations, but that it was not necessary for it to be self-funding.

However, we acknowledge the Government has now made AUSTRAC cost recovery a budget measure.

AFMA members accept that they will bear their fair share of the costs of AUSTRAC's regulatory activities. However, the costs should be allocated between regulated entities, consolidated revenue, and the users of the financial intelligence produced by AUSTRAC. Industry already contributes to this process by providing the reports AUSTRAC needs to form financial intelligence and fulfil its statutory obligations.

2. Tranche 2

Real progress needs to be made on the introduction of Tranche 2 of the AML/CTF regime. It is proposed that Tranche 2 will include a number of additional business activities, some of which pose a real AML/CTF risk. These entities should be made subject to the AML/CTF regime and cost recovery in the same way as other entities that are deemed to pose a risk are currently regulated.

3. Large entity component

The revised cost recovery model now includes the base component, "large entity" component, and the transaction reporting component.

The base and transaction reporting components are relatively straightforward to calculate. However, the large entity component is unclear and is causing confusion within industry.

The businesses of AFMA members (and particularly those who are part of a global operation) are structured in different ways. It might be the case that the entity that is the reporting entity for the purposes of the AML/CTF Act has very few full time equivalents (FTE), and the majority of FTEs are employed by a related service company. In other cases, a reporting entity might have a number less than 150 FTEs here in Australia but other FTEs located offshore in a related entity that has no other presence in Australia.

These structures are affected by employment, taxation, and company registration laws amongst other things, so it is not simply a case of being able to say there are a particular number of FTEs for purposes of AUSTRAC cost recovery, and not have regard to the reasons why these arrangements are structured as they are. There may be significant consequences for an entity if AUSTRAC was to take a unilateral view about the number of FTEs that was not consistent with the entity's own view.

In addition, some AFMA members, who may have for example 600 FTEs in Australia, actually have only a very small number of FTEs involved in the provision of a designated

service. The majority of their FTE count is engaged in some other activity that is unrelated to the provision of a designated service and not regulated by AUSTRAC.

We submit that in calculating the number of FTEs for the large entity component, the following factors should apply:

(a) Only FTEs physically located in Australia should be counted;
(b) Only FTEs directly involved in the provision of a designated service as their main day to day function (ie. more than half their time) should be counted;
(c) Only FTEs directly involved in the provision of a designated service during the period to which a cost recovery invoice applies should be counted;
(d) FTEs involved in other business activity that is unrelated to the provision of a designated service and not regulated by AUSTRAC should not be counted;
(e) FTEs in offshore related entities should not be counted as these entities are subject to regulation in their home jurisdiction and AUSTRAC has no supervisory responsibility for them.

It is not clear how AUSTRAC will know how many FTEs an entity has taking into account (a)-(e) above. AUSTRAC should determine a process for calculating the large entity component and consult with industry about this. The most feasible approach appears to be self assessment by regulated entities according to a formula. However, an entity should not be subject to penalty if it makes a reasonable and legitimate assessment of its FTEs which AUSTRAC subsequently does not agree with.

This approach would satisfy the principles of efficiency and fairness in allocating cost burden within a given framework.

4. Exemption of certain types of transactions relating to the over the counter derivatives market

A number of AFMA members have the benefit of the exemption in Chapter 22 of the AML/CTF Rules relating to certain types of transactions in the over the counter (OTC) derivatives market. They are primarily energy market participants who undertake OTC transactions to manage their exposures to NEM pool price movements, and other derivatives to manage their exposures to environmental products.

In granting the exemption, AUSTRAC accepted that the electricity industry is low risk for money laundering and terrorism financing. The vast bulk of derivatives transactions that occur are between organisations that meet the exemption requirements. In most cases, only a few FTEs of energy market participants are involved in the provision of a designated service – the rest are engaged in the production, supply and sale of energy products which is an essential service to the public. Derivatives trading is a secondary, risk management activity.

The energy industry is an otherwise highly regulated sector and participants bear the compliance costs of that regulation. The supervision burden for AUSTRAC is negligible, and virtually no supervision resources are expended on the sector.

Accordingly, AFMA requests confirmation that entities that have the benefit of the exemption in Chapter 22 of the AML/CTF Rules will not be subject to cost recovery.

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Please contact me on or if you would like to discuss any of these comments.

Yours sincerely

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