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Submission to the Senate Standing Committee on Legal and Constitutional Affairs

Reference: Anti-Money Laundering and Counter Terrorism Financing Bill 2006

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Introduction

We welcome the opportunity to make a submission in relation to the Anti-Money Laundering and Counter Terrorism Financing Bill 2006 (**Bill**).

While we have considered the position of our clients in the banking and financial services industries in relation to the matters raised in this submission, the views expressed are ours alone.

In addition, we make the Recommendations set out in the Executive Summary.

Terms defined in the Bill are used in that sense in this submission. Clause references are to the current draft of the Bill.

In this submission, AML means anti-money laundering, ML means money laundering, CTF means Counter Terrorism Financing, TF means terrorism or terrorist financing.

We have identified in the Schedule to this submission the recommendations that that we made in our submission of August 2006. The comments we made in relation to these recommendations in that submission remain relevant unless otherwise indicated in this submission.

Background

This submission follows the oral submissions made by Richard Batten and George Spiteri on the Bill made to the Senate Standing Committee on Legal and Constitutional Affairs on 14 November 2006.

We acknowledge that the Bill tabled in Parliament is a significant improvement on the previous draft and that some of the issues raised previously have been addressed. However, we believe that there are changes that should be made to the Bill before it becomes law.

It is difficult to respond fully on all aspects of the Bill as we have not yet seen a complete set of the AML/CTF Rules. The new version of the Bill gives AUSTRAC even wider powers to make Rules which reinforces the framework nature of the Bill. However, although AUSTRAC has over 85 different rule making powers, it has only released Rules arising under 10 of them. Similarly, some key concepts still remain unclear, including for example, the circumstances in which one reporting entity can rely on customer identification procedures carried out by another reporting entity; the nature and timing for compliance reporting; and the role and requirements for appointing a compliance officer.

List of New Recommendations

The following recommendations are in addition to the recommendations we have made in previous submissions to the Attorney-General's Department. We have listed in the Schedule to this submission the recommendations made in our previous submission which remain outstanding.

Recommendation 1. The Bill should contain all of the substantive obligations that apply to Reporting Entities. AUSTRAC's rule making powers should be restricted to technical matters and should not extend to setting regulatory policy.

AUSTRAC's other powers should be limited to providing exemptions from unintended or inappropriate consequences of the Bill.

Recommendation 2. AUSTRAC should be subject to appropriate Parliamentary oversight of the exercise of its powers.

Recommendation 3. The obligations which are subject to civil penalties should be reviewed and that most if not all of them should be removed. We submit that they should be legal obligations which can be enforced by AUSTRAC directing the Reporting Entity to comply with the obligation. A Reporting Entity should only be liable to prosecution if it fails to comply with such a direction.

Recommendation 4. If civil penalties are retained they should be reduced to a level consistent with the *Corporations Act 2001*.

Recommendation 5. Reporting Entities who do not have direct customer contact should be able to rely on the information received from any Reporting Entity who does have that contact about the identity of the customer.

Recommendation 6. The Bill should be reviewed so that the customer identification requirements of the first and second reporting entities are appropriately aligned.

Recommendation 7. The Bill should allow AFSL holders who are only caught by item 54 to opt into either the joint AML/CTF program adopted by any designated business group an AML/CTF program of which they are a member (to the extent relevant to the AFSL holder) an AML/CTF program that covers more than one AFSL holder.

Recommendation 8. The Bill should be reviewed to determine whether there are any other categories of businesses in a similar position to AFSL holders who should be treated as providing a designated service for the limited purpose of identifying customers.

Recommendation 9. An appropriate transition period should be implemented for record keeping obligations and Government should consult with industry for this purpose.

Recommendation 10. The exemption for companies issuing its own securities should be extended to other entities, in particular listed trusts and stapled structures.

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1. AUSTRAC powers

1.1 We are concerned about the breadth of AUSTRAC's powers. AUSTRAC's rule making power together with its modification power mean that AUSTRAC can effectively rewrite the law in this area. While the exercise of AUSTRAC's powers (and relevantly those of the Minister under clauses 228 and 229(3)) are subject to requirements to consult under the Bill (clause 212(2) and the Legislative Instruments Act 2003 (although those obligations are more limited under that Act), we are not convinced they need to be as wide-ranging as is proposed in the Bill.

1.2 We do recognise the need for flexibility in regimes which impose major new regulatory burdens on business. By way of parallel, there is no doubt that the Australian Securities and Investments Commission (**ASIC**) requires wide powers to make exemptions under Chapter 7 of the *Corporations Act 2001* (**FSR**) and some might argue that those powers should be extended where they do not currently exist, for example in relation to Part 7.1 of that Act. However, we submit that modification powers should be limited to providing exemptions (whether conditionally or otherwise) to deal with inappropriate application of the legislation.

1.3 In terms of the Rule making powers, we submit that they should be limited to dealing with technical matters which AUSTRAC would be better able to deal with than Parliament. An example of this power would be to specify precise customer identification requirements, within the context of the principles for customer identification which should be set out in the Bill. The regime should be principles-based which means that regulated entities should be able to identify and assess the impact of their substantive obligations without referring to or waiting for the Rules. That is not the case under the Bill – for example, there is no description of the requirements for compliance reports.

1.4 While similar concerns could be raised in relation to the regulation making power, there have generally been less concerns about the exercise of that power under FSR. Whether that would be the case under the Bill given different ministerial and departmental responsibilities is a matter for conjecture.

> **Recommendation 1**. The Bill should contain all of the substantive obligations that apply to Reporting Entities. AUSTRAC's rule making powers should be restricted to technical matters and should not extend to setting regulatory policy.
>
> AUSTRAC's other powers should be limited to providing exemptions from unintended or inappropriate consequences of the Bill.

1.5 Given the wide ambit of AUSTRAC's power, we believe that it should be subject to the scrutiny of and accountable to a Parliamentary Committee. We also believe that it should be required to consult with other regulators of the financial services industry (such as ASIC and the Australian Prudential Regulation Authority), in addition to the industry itself, when making Rules or modifications to ensure that the impact of its proposals are fully considered and understood and to limit any regulatory overlap. If this is done, we do not believe that it should be necessary at this stage to require AUSTRAC to obtain the approval of these regulators before exercising its powers. However, the exercise of AUSTRAC's powers does need to be kept under review.

Recommendation 2. AUSTRAC should be subject to appropriate Parliamentary oversight of the exercise of its powers.

2. Civil penalty provisions

2.1 The imposition of civil penalties requires a lower burden of proof than criminal penalties. While regulated entities would obviously prefer not to be subject to criminal prosecution, the lower burden of proof is a matter for significant concern. Financial institutions are particularly risk averse when it comes to regulatory matters. We therefore believe that a lower burden of proof is not required to ensure compliance. However, if a lower burden of proof means that financial institutions are more likely to be prosecuted, it will significantly affect their ability to make appropriate judgments about the best means to comply with the Bill.

2.2 A significant objective of the Bill is to enable financial institution to assess the risk of ML or TF offences occurring and to determine the appropriate measures to reduce this risk. If the regulatory environment is prosecute first and ask questions later, then financial institutions are likely to take the lowest risk option for themselves. This may lead to very cautious business decisions with consequential implications for the success of the industry and the Australian economy.

2.3 We submit that most if not all of the obligations imposed on Reporting Entities should not directly give rise to civil penalties or criminal offences. We submit that they should be legal obligations which can be enforced by AUSTRAC directing the Reporting Entity to comply with the obligation. A Reporting Entity should only be liable to prosecution if it fails to comply with such a direction. We believe that this would give AUSTRAC sufficient enforcement powers while still permitting Reporting Entities to make sensible decisions about how to comply with their obligations. An example of a similar approach can be found in Division 3 of Part 7.6 of the *Corporations Act 2001*.

2.4 In particular, we believe that failure to comply with the AML/CTF program should not give rise to a civil penalty unless the Reporting Entity has failed to comply with an AUSTRAC direction to that effect. The AML/CTF program contains both the standards for managing ML and TF risks set by a Reporting Entity based on its risk assessment and its plan for complying with those standards and the Bill generally. It is not appropriate to make the Reporting Entity subject to prosecution for breach of the program. This will have a significant impact on the way the Reporting Entity documents its standards and procedures for managing ML and CT risks. It will give Reporting Entities a strong incentive to make the program as general as possible to avoid or limit the risk of breach. We submit that this would not be an appropriate outcome. It is also not consistent with the approach taken in relation to similar obligations in other legislation, for example FSR training and compliance obligations in section 912A and compliance plan obligations for responsible entities in Chapter 5C of the *Corporations Act 2001*.

Recommendation 3. The obligations which are subject to civil penalties should be reviewed and that most if not all of them should be removed. We submit that they should be legal obligations which can be enforced by AUSTRAC directing the Reporting Entity to comply with the obligation. A Reporting Entity should only be liable to prosecution if it fails to comply with such a direction.

2.5 We also note that the maximum civil penalties under the Bill are very high. FSR does not contain any civil penalties. However, civil penalties relating to other provisions of the *Corporations Act 2001* are only 10% of the penalties in the Bill. We submit that if civil

penalties are retained they should be reduced to a level consistent with the *Corporations Act 2001*.

Recommendation 4. If civil penalties are retained they should be reduced to a level consistent with the *Corporations Act 2001*.

3. Sharing information

3.1 We note that despite the extension of the concept of designated business group, information can only be disclosed between Reporting Entities. Consequently, our concerns regarding disclosure between related entities within a corporate group remain.

3.2 The tipping offence also still precludes the disclosure of information to agents. Consequently our concerns regarding the sharing of information between Reporting Entities and agents also remain.

4. Relying on another Reporting Entity

4.1 We welcome the exemption from the requirement to conduct customer identification and verification procedures where the applicable procedures have been carried out by another Reporting Entity (clause 38). However, we note that the exemption only appears to apply if the other Reporting Entity does in fact and presumably correctly carry out the applicable procedures. This suggests that the second Reporting Entity could only rely on the first if the second Reporting Entity is satisfied that the first Reporting Entity has undertaken those procedures correctly. Furthermore, the second Reporting Entity can only rely on the first Reporting Entity to the extent that the identification and verification procedures of each are identical. These outcomes would significantly limit the usefulness of clause 38.

Recommendation 5. Reporting Entities who do not have direct customer contact should be able to rely on the information received from any Reporting Entity who does have that contact about the identity of the customer.

4.2 The introduction of item 54 of clause 6 raises some interesting issues. While we are still working through the implication of item 54, we note that there are particular difficulties for relying on holders of an Australian financial services licence (**AFSL**) to conduct customer due diligence where the customer is an existing customer or a pre-commencement customer. If the customer is an existing customer of the AFSL holder, then presumably the AFSL holder will not need to conduct any customer due diligence. This would cause a problem for a product issuer (such as a responsible entity of a managed investment scheme) if the customer is not an existing customer of the product issuer. As the AFSL would not have conducted appropriate identification procedures, the product issuer would have to do so. As the product issuer may not have any direct contact with the customer this may cause difficulties and may delay the customer's investment.

4.3 The opposite problem arises when a customer obtains a product for which customer identification procedures do not apply, for example superannuation. In this case, if the customer is not an existing customer of the AFSL arranger, it would seem that the AFSL arranger would have to identify the customer even if the customer does not need to be identified for the product.

Recommendation 6. The Bill should be reviewed so that the customer identification requirements of the first and second reporting entities are appropriately aligned.

5. AFSL arrangers

5.1 Another problem for AFSL holders is that they cannot participate in a joint AML/CTF program. Many financial planning groups form part of financial conglomerates and it would be normal for such corporate groups to have a single compliance and risk management program that applies to all parts of the group, with appropriate tailoring for particular operations. There does not seem to be any particular reason why AFSL holders could not opt into the group's joint AML/CTF program to the extent that it relates to their AML/CTF program requirements with appropriate recognition of the particular role they perform.

5.2 Furthermore, AFSL holders should be able to opt into a special AML/CTF program that covers more than one AFSL holder. At the moment the AML/CTF program requirements only appear to permit an AFSL holder to have their own program.

Recommendation 7. The Bill should allow AFSL holders who are only caught by item 54 to opt into either the joint AML/CTF program adopted by any designated business group an AML/CTF program of which they are a member (to the extent relevant to the AFSL holder) an AML/CTF program that covers more than one AFSL holder.

5.3 We also note that there are businesses that may arrange for designated services to be provided to customers who do not hold an AFSL. For example, mortgage brokers may not hold an AFSL. While we recognise that there is some controversy about the appropriateness of imposing customer identification requirements on AFSL holders, we submit that similar industry structures should be treated similarly.

Recommendation 8. The Bill should be reviewed to determine whether there are any other categories of businesses in a similar position to AFSL holders who should be treated as providing a designated service for the limited purpose of identifying customers.

6. Record keeping requirements

6.1 We are concerned about the 'day-one' implications of the transaction record-keeping requirements.

6.2 We note that in the absence of any Rules (and no such Rules have been released as yet) businesses will only be required to keep any records they make or received from a customer relating to the provision of a designated service. While this may seem innocuous, the difficulty will be for businesses to determine to what extent they currently keep all such records, to train staff to retain all such documents and to implement appropriate systems to ensure all such records are retained on 'day-one' of the regime. The shorter the period between the Bill passing through Parliament and the date of royal assent, the more onerous this obligation will be. While we note that no prosecution periods are proposed, we do not believe that it is appropriate to introduce new obligations without giving business any reasonable opportunity to comply.

Recommendation 9. An appropriate transition period should be implemented for record keeping obligations and Government should consult with industry for this purpose.

7. Listed trusts

We note that there is an exemption for companies issuing shares in themselves (item 35(b)). However, while item 35 relates to issuing securities and derivitives, this exemption is specifically limited to companies. It does not extend to other entities. For example, it does not extend to listed trusts. This means that a responsible entity of a listed trust will be caught by the Bill. This will produce particularly anomalous results in a stapled structure where a unit in a trust is stapled to a company share. The company will not be regulated but the trust will be.

Recommendation 10. The exemption for companies issuing its own securities should be extended to other entities, in particular listed trusts and stapled structures.

8. Matters arising from oral submissions

8.1 We provide the following responses to the questions we took on notice at the hearing on 14 November 2006.

8.2 **Question 1**: Which of the 22 recommendations from the Minter Ellison August 2006 submission on the AML/CTF Bill have been addressed in the new Bill?

Response: The new Bill has addressed the following issues raised in our August 2006 submission:

- The Bill now regulates managed investment schemes, this was previously unclear.
- Term life policies and life risk policies are not regulated as designated services under the Bill.
- Expansion of the Designated Business Group concept so that reporting entities could opt in to a group whether or not they are related.
- The removal of the concepts of internal and external agents has addressed on these points.
- The Bill no longer contains a ban on providing services if a suspicion is formed about the customer – Reporting Entities will need to comply with the Rules in these circumstances.

The outstanding recommendations are listed in the Schedule to this submission.

8.3 **Question 2**: Is the AML/CTF penalty regime comparable to that of ASIC or company law?

Response: Our response to this question is set out in paragraph 0 of this submission.

8.4 **Question 3**: Should any legislative instruments made by AUSTRAC be required to be approved by a relevant financial services regulator before they apply to financial institutions or service providers? How can any regulatory overlap be minimised? How is the UK experience relevant?

Response: Our response to this question is set out in section 1 of this submission.

In the limited time available to us, it has not been possible for us to undertake a detailed comparison of the approach in the UK and the approach proposed in the Bill. We note that the UK does appear to have taken a significantly different approach to AML regulation in recent years, at least in relation to the organisation of regulatory authorities responsible for implementation and enforcement of the regime. This approach is quite different to the

proposed Australian approach of a single regulator with responsibility for all aspects of AML regulation. While we recognise that this is a response to experience of implementing a more rigourous AML regime than that which currently exists in Australia, we do not believe that it is possible to comment on the appropriateness of the UK approach versus that proposed in Australia without a detailed and time consuming study taking place.

8.5 **Question 4**: Under the AML/CTF regime, is the ability to delegate one's reporting responsibility sufficiently secured? Can small reporting entities delegate their reporting upwards and fulfil their obligations under the law, or should they be able to?

Response: There is no ability to delegate responsibility for reporting to another entity. It is possible to appoint agents to undertake this activity, but the Reporting Entity will remain responsible for ensuring that the regime is complied with.

However, we note that AFSL holders who are only caught by item 54 will not be required to report suspicions. They will only be required to do so if they are in fact agents of another Reporting Entity in which case it will be that Reporting Entity which is responsible for reporting suspiscions.

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Schedule

The recommendations which we made in our submission in August 2006 which have not been addressed are set out below.

1. 'Staggered' implementation

Recommendation 1. The transition period for implementation of any of the obligations under the AML/CTF Bill and Rules should be 3 years. We do not believe a staggered implementation process in relation to the Bill and Rules is appropriate or necessary.

2. Designated services

Recommendation 3. The provision of services by an operator of managed discretionary accounts and investor directed portfolio services should be specifically listed as a designated service in Bill and custodians should not be regulated in relation to these products.

Recommendation 4. Superannuation transfers and rollovers by members or reporting entities to another reporting entity should not constitute a designated service.

Recommendation 6. Item 17 of clause 6(2) of the Bill should be amended to make it clear that issuing a bill of exchange, promissory note or letter of credit will only be a designated service when issued in the ordinary course of that business. (Note that while this change has not been made, our comments at paragraph **Error! Reference source not found.** are relevant to this recommendation.)

Recommendation 7. Items 23 and 24 of clause 6(2) of the Bill should be amended to so as to only apply where the minimum value is not less than $1,000.

3. Agents

Recommendation 11. The Bill should be amended to remove any restrictions on the sharing of information relating to suspicious matters between reporting entities and their agents (upwards or downwards reporting).

Recommendation 12. In relation to suspicious matter reports received from agents, the time when a reporting entity is required to report a suspicious matter to AUSTRAC should only start when the suspicion is reported to the reporting entity by an agent (and not when the agent forms the suspicion).

4. Designated business groups

Recommendation 14. The exception to the tipping off offence for designated business groups should be broadened so that it applies to any related entity (whether or not they are a reporting entity) or any entity that chooses to opt-in to a designated business group and is not limited to identification of risks in dealing with a customer.

5. Tipping off

Recommendation 16. The Bill should include a specific defence to tipping-off if a reporting entity, acting in good faith, inadvertently tips off a person while fulfilling obligations under clauses 27A, 27B, 28A, 28B, 31, 32 or 33.

6. AML/CTF program

Recommendation 17. The obligation to produce an external Compliance Report to be lodged with AUSTRAC should be removed. Instead, the reporting entity's AML/CTF Compliance Officer should be required to report annually to the board of the reporting entity or other relevant governing body of the reporting entity or designated business group in relation to the reporting entity's compliance with AML/CTF Rules.

Recommendation 18. The obligation to have and comply with a compliance programme should be similar to the obligation that applies to AFSL holders under section 912A of the Corporations Act, in that a breach of the obligation is a breach of the law but is not a criminal offence.

Recommendation 19. The Bill should make it clear that the same conduct will not constitute an offence under both clauses 33A and 73(2).

7. Enforceable undertakings

Recommendation 20. The Bill should be amended so that enforceable undertakings issued by AUSTRAC must be kept confidential.

8. Infringement notices

Recommendation 21. The Bill should be amended so that the power to issue infringement notices is made subject to certain thresholds and procedural fairness requirements which apply to other regulators.

9. Terminology – Reporting Entity

Recommendation 22. The term 'reporting entity' should be changed to 'designated services provider' (**DSP**), given that the use of the acronym 'RE', is likely to create confusion with another commonly used financial industry term 'responsible entity' under Chapter 5C of the *Corporations Act*.