August 2006

Submission in relation to the Second Exposure Draft of the Anti-Money Laundering and Counter-Terrorism Financing Bill and related Rules

MinterEllison
LAWYERS

AURORA PLACE, 88 PHILLIP STREET, SYDNEY NSW 2000, DX 117 SYDNEY
TEL: +61 2 9921 8888 FAX: +61 2 9921 8123
www.minterellison.com

Introduction

We welcome the opportunity to make a submission in relation to the Second Exposure Draft of the Anti-Money Laundering and Counter Terrorism Financing Bill 2005 (the Bill).

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

We endorse the most recent submission from IFSA (August 2006) to AUSTRAC.

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.

Issues that have been previously discussed in our submission of April 2006 have not been raised in this submission.

Background

We are concerned that the 3 week consultation period provided means that many issues will not become apparent until after the consultation period has ended. While the second exposure draft of the Bill provides a more risk based approached, there are significant gaps.

One major problem that remains is that we still do not have a full picture of the new regime. The list of missing items includes:

- **Explanatory material** – The Government has not released any explanatory material or commentary for the Bill which makes it very difficult to determine its intentions on particular points.
- **Rules** – The new version of the Bill gives AUSTRAC even wider powers to make Rules making the Bill simply a framework to be completed by AUSTRAC. However, although AUSTRAC has over 85 different rule making powers, it has only released Rules arising under 10 of them.
- **Key concepts** – Details of some key concepts are yet to be provided, 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.
- **Transition –** No information has been provided about the transition period with the Minister still publicly favouring a 1 year transition period and industry seeking 3 years. Any transition period should not commence before the full regime has been released.
- **Penalties –** The penalties for civil penalty provisions and some offences are yet to be decided.

We agree with IFSA's submission that if sufficient time is not allowed for industry and the Attorney-General's Department to continue to "work through the issues", there is a high probability that these issues will remain outstanding at the time the Bill is introduced into Parliament.

Therefore, industry appears to be in a difficult position, given that the timing for implementation may effectively mean that reporting entities must commit to the costly process of implementation, based on a Bill and Rules which are incomplete.

List of Recommendations

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 2. The position as to whether managed investment schemes are to be a regulated designated service should be clarified in the Bill.

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 5. Neither term life policies nor any other life risk policies should be regulated as a designated service under the Bill. We recommend further consultation be undertaken in relation to other life policies which may potentially have cashing restrictions.

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.

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 8. Under clause 11 of the Bill, related bodies corporate (whether or not they are a reporting entity) or any entity that chooses to opt-in to a designated business group (see Recommendation 13) should be defined as internal agents of each other.

Recommendation 9. The concept of internal agent should extend to individual trustees, any officer of a corporate trustee or administrator of the trust.

Recommendation 10. The agency concept should not be limited to three levels. The class of persons that could be appointed as agent should be left open under the Bill.

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 13. The Bill should expand the concept of designated business group, so that reporting entities and other entities can choose whether they want to 'opt-in' to a designated business group (whether or not they are related).

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. Ban on providing services

Recommendation 15. The ban on the reporting entity providing designated services if it forms a suspicion about the customer should be simplified to be limited to a ban on withdrawals, transfers, disposals etc. until they have been re-verified.

6. 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.

7. 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).

8. Enforceable undertakings

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

9. 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.

10. 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*.

Contents

Submission

1. 'Staggered' implementation

1.1 It is understood that Government's preferred approach is a staggered transition period, which may be as short as 12 months. A staggered transition would see some obligations under the Bill commence earlier than others. However, it is not clear which obligations would commence first.

1.2 We agree with industry's preferred approach that a transition period of at least 3 years is required for the reasons noted in our previous submission.

1.3 We do not believe a staggered implementation process in relation to the Bill and Rules is appropriate or necessary. A staggered approach may effectively mean that reporting entities are required to comply with parts of the *Financial Transaction Reports Act* (FTRA) and the new Bill and the Rules (as they are released). This means that reporting entities will in effect need to comply with two regulatory regimes that overlap, which would impose an undue burden on reporting entities. It also creates additional risks for reporting entities where they risk inadvertently breaching old law requirements under FTRA, in the mistaken belief that compliance with the Bill and Rules is sufficient.

> **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

Managed investment schemes

2.1 There remains uncertainty about the extent to which managed funds are caught by the AML/CTF package. While a specific item in the list of designated services (item 36 of clause 6(2)) provides that issuing interests in unitised schemes is not a designated service, managed funds could potentially be caught under other designated services.

2.2 It is not clear whether the Government intends managed investment schemes to be regulated, particularly given the way that item 36 of clause 6(2) is drafted. What is clear is that under the current draft of the Bill there is scope for managed investment schemes to be directly regulated if AUSTRAC decides to list trusts in the AML/CTF Rules. It seems inconsistent from a public policy perspective to give AUSTRAC such power, particularly given that section 6(5) of the Bill reserves the ability to prescribe new designated services to the regulations (and not the AML/CTF Rules).

> **Recommendation 2**. The position as to whether managed investment schemes are to be a regulated designated service should be clarified in the Bill.

Investor Directed Portfolio Services (IDPSs) and Managed Discretionary Accounts (MDAs)

2.3 The uncertainty for managed investment schemes also applies to IDPSs and MDAs. IDPSs and MDSs may be caught through the regulation of custodians and agents acquiring securities and derivatives. The problem with this outcome is that it is probably more appropriate for

IDPS and MDA operators to be regulated rather than custodians who do not have any direct relationship with the client.

2.4 Therefore, the Bill should specifically list an IDPS as a designated service and regulate only the operator of the IDPS. If a definition of IDPS is required, it would need to be consistent with (although not necessarily identical to) the definition provided by ASIC in Class Order 02/294.

2.5 MDAs should also be listed as a separate designated service under the Bill. A similar approach could be taken to defining MDAs having regard to ASIC Policy Statement 179 and associated Class Orders (CO 04/191, CO 04/192 and CO 04/193 and CO 04/194). Similarly, only MDA operators should be regulated under the Bill.

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.

Superannuation

2.6 While the concessions for superannuation are welcome, they still pose challenges. For example, it is not clear why any identification should be required for transfers and rollovers to another superannuation fund.

2.7 We submit that transfers and rollovers between reporting entities should not be regulated, regardless of whether the transfer is made before or after preservation age. This is because it is only when the product is cashed-out to the customer that an ML or TF risk may arise. Therefore, it makes sense not to regulate transfers between reporting entities.

2.8 We also support the approach proposed by IFSA in its submission in relation to the regulation of superannuation products, given the low-risk nature of superannuation.

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

Life insurance

2.9 'Life policy' is now defined to include only a term life policy in the Bill. This change appears to have the opposite outcome to that intended by the Government as it excludes life policies with an investment component or surrender value.

Recommendation 5. Neither term life policies nor any other life risk policies should be regulated as a designated service under the Bill. We recommend further consultation be undertaken in relation to other life policies which may potentially have cashing restrictions.

Bills of exchange, promissory notes or letters of credit

2.10 Issuing bills of exchange, promissory notes or letters of credit by a bank or person prescribed in the AML/CTF Rules (none are currently specified) will be a designated service under the Bill.

2.11 It is commercial practice for entities within a corporate group to provide credit or a promissory notes or the like to another entity within a group as a legitimate method of managing cash flows within the corporate group. To ensure that such entities are not regulated, we recommend that Item 17 of clause 6(2) in the financial services table include a rider that issuing bills of exchange, promissory notes or letters of credit by a bank will be a designated service only when issued in the ordinary course of that business.

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.

Travellers cheques

2.12 Travellers cheques should have a $1,000 regulatory threshold, which currently applies to other non-cash payment facilities under the Bill, including money orders, postal orders and stored value cards.

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

3.1 The Bill distinguishes between internal agents and external agents of a reporting entity. The distinction has significant implications for agent appointment obligations, where external agents must be appointed and authorised in writing in certain circumstances (clauses 12(1) and 34).

Related entities

3.2 While related reporting entities could fall within a 'designated business group' under the Bill and therefore rely on the same AML/CTF program, they would not be internal agents of each other and would have to be appointed in writing to perform identification for one another.

3.3 This means that if entities in a designated business group wanted to centralise customer identification with one entity, each of the other entities would need to have agreements in place to authorise the relevant group entity as a primary external agent. Such an obligation seems inappropriate and unduly burdensome, as related entities in a designated business group each rely upon the same AML/CTF program.

Recommendation 8. Under clause 11 of the Bill, related bodies corporate (whether or not they are a reporting entity) or any entity that chooses to opt-in to a designated business group (see Recommendation 13) should be defined as internal agents of each other.

Trusts

3.4 Managers and employees of trusts are internal agents. As 'trust' is defined to include both the trustee or the trust as appropriate, it would seem that 'managers' means a third party manager rather than an employee manager. However, 'manager' is not defined so it unclear whether administrators would be internal agents. It is also not clear why employees are internal agents but not officers such as directors of the trustee.

Recommendation 9. The concept of internal agent should extend to individual trustees, any officer of a corporate trustee or administrator of the trust.

Sub–sub-agent

3.5 Given the administrative nature of the tasks performed which could forseeably constitute activity requiring the appointment of agents under the Bill, it may be that three levels of appointment for agents is insufficient. Much depends on the distribution and administration structures used by reporting entities.

3.6 Therefore, the class of persons that could be appointed as agent should be left open under the Bill, given that limiting the agency concept to three levels may unduly restrict distribution structures. The Bill should work within existing distribution and administration arrangements (rather than determine them).

Recommendation 10. The agency concept should not be limited to three levels. The class of persons that could be appointed as agent should be left open under the Bill.

Upwards reporting only

3.7 Primary, sub and sub-sub-agents can report suspicions up the chain to the reporting entity. However, the reporting entity and higher level agents cannot discuss suspicions down the chain. This seems likely to cause difficulties when a reporting entity wants to alert agents to be aware of the activities of a particular customer. There is also a technical problem in that sub-sub-agents can disclose information to the sub-agent and the reporting entity but not the primary agent.

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).

Agency reporting

3.8 Agents can report suspicions directly to AUSTRAC. However, where they report to the reporting entity, the timing for the report to AUSTRAC does not start from the time the reporting entity is told. It starts from the time the agent formed the suspicion. As reporting entities only have 24 hours to report certain suspicions, this is likely to cause significant compliance difficulties and risks for reporting entities.

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

4.1 While the ability to develop a single program for the entire group is welcome, there are still problems for conglomerates.

Unrelated entities

4.2 There may be circumstances where a group that wishes to rely on a single program will comprise entities that are not related. Examples may include joint-venturers, companies with common shareholdings but no holding company, trusts and stapled structures.

Tipping off

4.3 There is an exception from the tipping off offence for designated business groups. However, it will only apply to disclosures between reporting entities if they have adopted a common AML/CTF program and only for the purpose of informing the other about the risks of dealing with a particular customer. This will cause artificial barriers within the group and is likely to cause problems where other entities (whether within or outside the group) perform an administration, compliance, monitoring or risk management function. It will also cause corporate governance issues where the holding company is not a reporting entity.

'Opt-in' approach to designated business group

4.4 Government should expand the concept of designated business group beyond entities that are closely associated. In particular, reporting entities should be able to choose whether they want to 'opt-in' to a designated business group (whether or not they are related). It makes practical sense to allow financial services providers to work together where that is commercially feasible.

4.5 Shared experiences and processes across similar products means more effective programs for detecting and stopping ML and TF. An opt-in approach also has the advantage of improving efficiencies for compliance and monitoring programs for particular products or services.

Recommendation 13. The Bill should expand the concept of designated business group, so that reporting entities and other entities can choose whether they want to 'opt-in' to a designated business group (whether or not they are related).

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. Ban on providing services

A reporting entity must cease to provide designated services where a suspicion arises until the customer's (or their agent's) identity has been re-verified. This requirement is impractical for some services. For example, it would seem to require a custodian to divest itself of the assets it holds as custodian for the customer. This would seem to be the opposite of the intended outcome of preventing the customer from accessing their account.

Recommendation 15. The ban on the reporting entity providing designated services if it forms a suspicion about the customer should be simplified to be limited to a ban on withdrawals, transfers, disposals etc. until they have been re-verified.

6. Tipping off

6.1 Apart from the issues mentioned above, there still seems to be a problem with the interplay between the tipping-off offence and other offences. Difficulties seem likely to arise in relation to the following requirements:

(a) a reporting entity must cease to provide further services if a suspicion arises until the customer's (or their agent's) identity is re-verified (or verified for the first time for pre-commencement customers) – subject to the Rules (which may require the reporting entity to do something other than verifying identity), there seems to be a real risk of tipping off in these circumstances;

(b) the obligation to report suspicions has been extended to include a suspicion that a person is not who they say they are – it will be very difficult to seek additional identity information without indicating this suspicion;

(c) the AML/CTF program must have a primary purpose of identifying, mitigating and managing the risk of money laundering and terrorist financing through the reporting entity's services – although there is no requirement to materially mitigate the risk any more, the program must still have the purpose of mitigating, ie reducing, the risk and it is an offence to fail comply with the program. It may be difficult to mitigate the risk without stopping a service and this must give rise to a risk of tipping off;

(d) reporting entities must also monitor the provision of services with a view to identifying, mitigating and managing the risk of money laundering or terrorist financing and similar considerations apply to this obligation.

6.2 Therefore, a reporting entity is placed in a very difficult position of having to find a way to explain a request for identification information and disruption to existing services to the customer without disclosing any information from which the customer could reasonably be expected to infer that the reporting entity has formed a suspicion or reported the matter to AUSTRAC – which is a tipping-off offence. There is a much higher risk that a reporting entity will inadvertently tip-off a customer in such circumstances.

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.

7. AML/CTF program

Compliance Report

7.1 The Bill creates an obligation to provide AUSTRAC with compliance reports on a periodic basis. This obligation seems inconsistent with the approach taken in other jurisdictions. Relevantly, in the United Kingdom (**UK**) there is no requirement to file an AML/CTF compliance report with the UK regulator. Instead, the UK approach only requires an internal compliance report to be prepared by the Compliance Officer on an annual basis in accordance with the UK Financial Services Authority (**FSA**) Rules regulating AML/CTF (see FSA Handbook, ML 7.2.2).

7.2 We submit that given that AUSTRAC already has extensive audit powers under the Bill and international experience in the UK, the imposition of a Compliance Reporting obligation to AUSTRAC is not appropriate. Instead, the Bill should only require an internal report to be produced which assesses the reporting entity's compliance with AML/CTF Rules.

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.

Penalty provisions

7.3 The Bill continues to provide an automatic offence where a reporting entity does not comply with its AML/CTF program. There is a reasonable precautions/due diligence defence to this offence (as with all other offences). Nevertheless, the fact that the program becomes in effect law seems inconsistent with the nature of the program.

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.

7.4 In addition, a separate offence has now been created where the reporting entity fails to undertake appropriate ongoing customer due-diligence. The similar wording for these requirements under clauses 33A and 74(2) seems to run a risk that the same conduct could give rise to two different offences, namely clauses 33A(2) and 73(2).

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

8. Enforceable undertakings

8.1 AUSTRAC is empowered to accept enforceable undertakings which it may publish on its Internet site. There are no restrictions on this power equivalent to those applying to ASIC under section 93A of the ASIC Act which requires ASIC to exclude from any copy made available to a member of the public information that:

(a) is commercial in confidence;

(b) should not be disclosed because it would be against the public interest to do so; or

(c) consists of personal details of an individual.

8.2 Given industry's experience with enforceable undertakings, it may be more appropriate to require AUSTRAC to keep the details secret and only publish a summary of the issues and undertakings without naming names. There are grounds for thinking that the prospect of reputational damage is such a concern that industry participants will do anything to avoid any risk of it occurring which reduces efficiency and increases cost and does not always produce the intended outcome.

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

9. Infringement notices

9.1 The power to issue infringement notices should be subject to certain thresholds and procedural fairness requirements, which are imposed upon other regulators (ie ASIC). For example, in determining whether an infringement notice can be issued, the Corporations Act requires ASIC to (sections 1317DAC and 1317DAD):

(a) have regard to certain matters in determining if an infringement notice should be issued (eg guidelines);

(b) provide a statement which sets out the reasons for believing the entity has contravened the *Corporations Act*; and

(c) give representatives of the alleged contravener the opportunity to appear at a private hearing before ASIC, give evidence to ASIC and make submissions to ASIC in relation to the alleged contravention. There are also limitations on ASIC's use of such information as evidence in proceedings.

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.

10. Terminology – Reporting Entity

10.1 The AML/CTF Bill and Rules refers to a regulated person as a 'reporting entity'. The acronym for that term is RE, which is unfortunate and likely to create confusion, given that the term RE is commonly used in the financial services sector for a person that is a 'responsible entity' regulated under Chapter 5C of the Corporations Act.

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*.

Contacts

Please contact any of our team at the address below if you have any queries about the matters dealt with in this submission.

Richard Batten, Partner
Direct phone: +61 2 9921 4712
richard.batten@minterellison.com

James Beaton, Partner
Direct phone: +61 2 9921 4063
james.beaton@minterellison.com

Ross Freeman, Partner
Direct phone: +61 3 8608 2648
ross.freeman@minterellison.com

Ian Lockhart, Senior Associate
Direct phone: +61 7 3119 6210
ian.lockhart@minterellison.com

George Spiteri, Senior Lawyer
Direct phone: +61 2 9921 4575
george.spiteri@minterellison.com