ACN 080 744 163

17 November 2006

Committee Secretary
Senate Legal and Constitutional Affairs Committee
Department of the Senate
PO Box 6100
Parliament House
CANBERRA ACT 2600

Dear Committee Secretary

Anti-Money Laundering and Counter Terrorism Financing (AML/CTF) Bill 2006

Thank you for the opportunity to comment on the Anti-Money Laundering and Counter-Terrorism Financing Bill 2006.

IFSA represents the retail and wholesale superannuation, funds management and life insurance industries and has over 135 members who are responsible for investing over $950 billion, on behalf of more than nine million Australians.

IFSA would like to acknowledge the substantial progress made by the Government and the Attorney-General's Department in addressing many of the key industry concerns as detailed in our previous submissions to Government and this Committee.

IFSA understands that with any Bill of this size and scope, it is inevitable that last minute refinements will be necessary to ensure that unintended consequences do not arise. IFSA is hopeful that the Government and this Committee share this view and remain willing to refine the legislation where there is sound reason to do so.

Based upon our reading of the Bill, we are concerned that a number of mainly technical, but still very important, issues are still to be addressed. These issues will have adverse implications for the industry if they are not appropriately dealt with.

More fundamentally, we remain concerned at the number of outstanding Rules that are required to enable IFSA members to confidently begin to design and build the necessary systems and processes required to effectively comply with the Bill.

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Our concern is that Rules may not become available until well into the legislative implementation period. Industry agreed to the details of the phased implementation approach on the basis that relevant Rules would be available well in advance of the legal obligation coming into force.

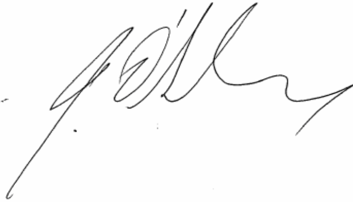
We are therefore seeking a commitment that Rules which are relevant to the commencement of AML/CTF obligations will be available before the relevant obligation becomes activated under Clause 2 of the Bill.

Alternatively, IFSA supports an approach which allows for greater flexibility around the 12 month "amnesty" period such that the Minister is able to direct AUSTRAC to provide extensions where relevant Rules have not been released in time to allow for the full intended legislative implementation period.

Once again, thank you for this opportunity to engage with you on this critical legislative reform for our industry.

If you have any questions in relation to this submission, please do not hesitate to contact me or Martin Codina on (02) 9299 3022.

Yours sincerely,



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SUBMISSION TO THE SENATE LEGAL AND CONSTITUTIONAL AFFAIRS COMMITTEE: AML/CTF BILL 2006

The following issues have been identified by IFSA as requiring further consideration and in cases amendment to the Bill as suggested.

1. Clause 2: Commencement

Rules

- IFSA is very concerned to see that the commencement period of various obligations under the Bill are not tied to the release of relevant Rules. This is compounded by the fact that several Parts of the Bill commence from the date of Royal Assent but are also operationally dependant, either in full or in part, on an underlying Rule.
- IFSA does not believe that it will be possible to implement all of the obligations required to be implemented as of Royal Assent due to a lack of relevant Rules. IFSA therefore seeks a commitment from the Government that Rules which are relevant to the commencement of obligations will be available before the relevant obligation becomes activated under Clause 2.
- At a minimum, if such an outcome is not provided, IFSA requests that the Government provide a direction to AUSTRAC to extend the "amnesty" period such that it provides the originally intended full 12 months rather than the balance of 12 months depending on when the Rule is released.
- Finally, despite the time pressure to issue Rules, IFSA believes that AUSTRAC should publicly release a defined list of Rules that it intends releasing (and by when) so that industry is better able to assess how and in what order obligations should be implemented. This information is needed so that the industry can be confident in making decisions on how to design systems and processes, safe in the knowledge that there will be some stability in the environment on which they base their implementation decisions.

Record keeping

- Items 13 and 15 of Clause 2 specify that Divisions 1, 2 and 4 of Part 10 (record keeping) are to commence from the first day after Royal Assent. This suggests that systems are already in place to capture and store the necessary information. Clearly this is not the case for a significant number of designated services.

- Even more troubling is that these provisions are tied to Rules which have not yet been released. Therefore, the benefit of any 12 month "amnesty" period from AUSTRAC may be significantly reduced depending on the time it takes AUSTRAC to release any relevant Rules.
- IFSA suggests, therefore, that items 13 and 15 be amended so that they commence 12 months from the date of Royal Assent. In the absence of any amendment, AUSTRAC needs to be aware that organisations may be in technical breach of the legislation as of day 1 and therefore the 12 month "amnesty" period will need to be observed and potentially extended depending on when the relevant Rule/s are settled and issued.

2. Clause 5: Definition of Life Policy

- Our interpretation of the definition of Life Policy (in conjunction with the Life Insurance Actuarial Standard 4.02) is that Life Policies, not otherwise caught by the legislation, but with "cash-back" features may be caught.
- The cash-back feature typically provides the policy holder a refund of a percentage of the premiums paid back (in the form of a cheque) based on the length of time that the policy has been held and on the basis of there not being a claim against the policy.
- We do not believe that these products were intended to be caught by the legislation, but the current wording of the Bill make this unclear. Therefore we seek clarification that such products are excluded.

3. Clause 6: Items 6, 7 and 35 – application to sale of securities and investment in debt instruments

Items 6 and 7

- It appears as though activities such as investing in fixed interest securities and other debt instruments (such as corporate bonds, short term notes and debentures) will result in fund managers being caught under items 6 & 7. This is because these transactions can arguably be classified as "transactions which in substance effect a loan of money".
- This would seriously impact fund managers and similar investors (such as corporate treasury operations) by requiring them to identify the issuer of these debt instruments – as they would technically be taken to be making a loan to the issuer of the instrument in the course of carrying on a loans business.

Item 35

- Considerable uncertainty remains as to the correct interpretation of paragraph 35(b) which excludes an issue by a company of a security of the company or of an option to acquire a security of the company. Security is defined in section 5 of the Bill by reference to sections 92(1) and (2) of the Corporations Act, which defines securities, when used in relation to a body, to include shares in the body, debentures of the body, and interests in a managed investment scheme made available by the body. Therefore, the exclusion seems to cover any issue of any shares, debentures or managed investment schemes (or options to acquire them) by a company.

- This means that item 35 only covers the issue of securities or options if the issuer is not a company. Is this the intention? If not, what is the intention of the exclusion?
- In addition, IFSA believes that item 35 has the unintended consequence of requiring fund managers (and other similar investors) who sell securities on an exchange to identify the person to whom they sell such securities. This will capture many thousands of daily transactions and seriously limit the speed with which such transactions take place.
- It is our understanding that fund managers are caught under the Bill by item 35 because they sell securities in the course of carrying on a business of selling securities. However, while this is appropriate where a fund manager issues a security to a new member, it also inappropriately covers the sale of securities through a stock exchange to a party that the fund manager never meets due to the way in which the stock market operates – with brokers acting as the agents of share owners and with the ASX operating the necessary clearing systems.
- IFSA is seeking confirmation that these wholesale investment activities, and any other activities of this nature, are not intended to be captured under the Bill and that therefore appropriate exemptions will be provided.
- Importantly, we note that item 33 makes disposing of or acquiring securities as agent (such as a sharebroker acting for a client in an on-market transaction) a designated service, thus requiring brokers to identify their clients. The existence of item 33 removes the need for customer ID obligations being imposed on fund managers in this area.
- Without the suggested exemptions in place, the funds management industry could become unworkable due to the sale of securities or purchases of debt instruments triggering AML/CTF obligations. These AML/CTF requirements would impact heavily on the ability for fund managers to make time critical investment transactions and therefore result in an undue burden being imposed on the investment industry.

4. Clause 6: Item 54 "arrangers"

A number of technical issues have been identified with the drafting of item 54 of clause 6.

Alignment of customer ID triggers between the first and second reporting entity

- At present, there is a mismatch under the Bill between the circumstances where the first reporting entity is required to conduct a customer ID procedure and the circumstances when the second reporting entity is required to conduct a customer ID procedure.
- Under item 54, an AFSL holder (licensee) provides a designated service where it makes arrangements for a person to receive designated services from another reporting entity. The licensee must, in these circumstances, identify the customer.
- Clause 39(6) is an example of where the Bill aligns the customer ID obligations between the first and second reporting entities. In this case, the

licensee is exempted from the identification obligations where the designated service arranged is the acceptance of payments to superannuation, annuities or RSAs, as in these cases the second reporting entity is itself exempt.

- However, there are other circumstances in which the second reporting entity will, or may, not be required to identify the customer. These include:
    - pre-commencement customers of the second reporting entity;
    - low-risk designated services exempt under the Rules;
    - where other exemptions allowed by AUSTRAC apply;
    - customers that have already been identified by the second reporting entity.
- In principle, it should not be necessary for the licensee to identify the customer in these cases. On current drafting, however, the identification requirement nevertheless applies.
- IFSA accepts that there are difficulties with fully aligning these obligations because the first reporting entity will not always know whether a customer ID procedure is required to be conducted by the second reporting entity.
- Accordingly, customer ID obligations could be restricted so that if the first reporting entity is aware of whether the customer would not otherwise be required to be identified by the second reporting entity no customer ID obligation would arise for the first reporting entity.
- Alternatively, a more pragmatic approach could be adopted such that the first reporting entity is required to conduct a customer ID procedure in all circumstances except where the second designated service is exempted, or partially exempted, from customer ID obligations (as is the case with superannuation).
- A significant issue also arises in respect of the converse arrangements. That is, where the customer is an existing customer (or pre-commencement customer) of the first reporting entity, they will not be required to conduct a customer ID procedure under the Bill. This raises practical difficulties for the second reporting entity which would otherwise have sought to rely (under clause 38) on the customer ID procedure conducted by the first reporting entity in respect of the same customer.
- IFSA seeks an assurance that these issues will be addressed to ensure that there is appropriate alignment between the identification obligations of the first and second reporting entity.

Suspicious matter reporting

- Sub-clause 42(6) excludes 'item 54 arrangers' from the requirement of having to provide a suspicious matter report to AUSTRAC. This exclusion presents a number of issues:
    1. It exposes 'item 54 arrangers' to penalties under the Criminal Code by virtue of not being protected by clause 51 of the AML/CTF Bill. That is, as 'item 54 arrangers' are unable to lodge a suspicious matter report, they are also unable to access the defence provided by clause 51, and therefore being taken not to have been in possession of offending information.

2. Where an 'item 54 arranger' decides that the customer they are dealing with raises a suspicion of a kind that would ordinarily result in a suspicious matter report being lodged, they will be unable from communicating this to the second reporting entity without exposing themselves to legal liability. This is because the defence provided under clause 235 of the Bill would not appear to apply as they will not have acted in purported fulfilment or compliance with the Act.
3. There are also tipping off implications from such an action which IFSA believes need to be addressed. There is sound rationale for information sharing between these two reporting entities in respect of the same customer.
4. Because there is no obligation on 'item 54 arrangers' to lodge a suspicious matter report with AUSTRAC, there is also no way of informing the second reporting entity that there may be something suspicious about the customer which only the first reporting entity would know of.

- Therefore, IFSA believes that it is both appropriate and desirable from an AML/CTF perspective, as well as from an operational perspective, that 'item 54 arrangers' be subject to Division 2 of Part 3 of the Bill.
- The Bill should be further amended to ensure that where a suspicious matter report is provided to AUSTRAC, that a copy of the report is also required to be provided to the second reporting entity to ensure that they are able to appropriately assess the risk posed by the customer.

Designated business group limitations

- Sub-clause 85(6) prohibits 'item 54 arrangers' from joining a DBG. This will seriously affect the arrangements that diversified financial services businesses were anticipating implementing. That is, a diversified financial services business that owns or has a legal relationship with an 'item 54 arranger' will now be unable to include them in their DBG. IFSA strongly suggests that this limitation be removed.
- Similarly, there does not appear to be any rationale as to why a number of 'item 54 arrangers' cannot themselves form a "special" DBG. There is no provision that would currently allow for this to occur.

Scope of the designated service

- The designated service as presently drafted arguably covers matters beyond the activities of financial advisers. This may include mortgage broking activity where the AFSL holder is a bank and the bank has agents that are mortgage brokers.
- IFSA therefore recommends that the designated service refer to "arranging* for the provision of a financial service* that is a designated service". 'Financial service' would be defined by reference to section 766A of the Corporations Act and 'arranging' by section 766C(2). This would ensure the designated service was not broader than the potential activities for which an AFS license can be granted.

Liability as between the AFSL holder and their "authorised representative/s"

- It is not clear from the Bill that an Authorised Representative (as per the Corporations Act) of the Licensee is also an agent of the Licensee under the AML/CTF Bill.
- Consequently, if they are seen to be agents of the Licensee, Licensees will be technically liable for any AML/CTF breaches/contraventions involving the actions or omissions of their Authorised Representatives.
- Moreover, it is also uncertain whether section 236 of the Bill (defence of taking reasonable precautions, and exercising due diligence, to avoid a contravention) will be available to a Licensee in circumstances where their Authorised Representative has acted outside of the 'special AML/CTF Program' established by the AFS Licensee.
- IFSA therefore seeks explicit clarification, either in the Bill or EM, that an AFS Licensee will not be held responsible where an Authorised Representative has failed to conduct a customer ID procedure in accordance with the Licensee's 'special AML/CTF Program' as a consequence of either deliberate action/omission, recklessness, or negligence on the Authorised Representative's part.

Arranging by an Authorised Representative

- As it is not clear from the Bill that an Authorised Representative of the Licensee is also an agent of the Licensee under the AML/CTF Bill, it follows that where the arranging service is provided by a financial planner who is an Authorised Representative of a Licensee, then technically there has been no designated service provided by the AFSL holder. Accordingly, it would appear as though the second reporting entity will not be able to rely on the customer identification procedure conducted by the Authorised Representative.
- Given the large number of Authorised Representatives within the financial services industry, the impact of not including the acts of Authorised Representatives within Item 54 would be significant. Accordingly, the Bill should be amended to clarify that the action of an Authorised Representative for the purpose of the Bill is taken to be the action of the Licensee.
- IFSA notes that this is not intended to suggest that Authorised Representatives should themselves be treated as separate reporting entities under the Bill. Rather, that they should be deemed agents of the Licensee in order to avoid any gaps or uncertainty in the application of this designated service in practice.

5. Clause 37: Customer ID may be carried out by an Agent of the RE

- This provision appears superfluous and also raises questions about whether similar "enabling" provisions are required elsewhere in the Bill to allow a reporting entity to authorise an agent to carry out an AML/CTF legislative function on behalf of the reporting entity.

- IFSA therefore believes that a provision permitting the appointment of agents more generally for the execution of any AML/CTF obligation under the Bill should be inserted.

6. Clause 38: Customer ID procedure deemed to have been carried out by a reporting entity

- IFSA believes that the current wording requires amendment to ensure that reliance by the second reporting entity is not predicated upon the second reporting entity knowing what the "applicable customer ID procedure" of the first reporting entity is and whether that procedure is the one that has actually been conducted.
- That is, if the Bill and relevant Rule will require the second reporting entity to have an understanding of the first reporting entity's customer ID program and procedures and then to conduct an assessment of the actual procedure conducted against this – the usefulness of clause 38 will be seriously diminished.
- It is also unclear what the implications could be where for example, the first reporting entity has carried out "a" customer ID procedure but not necessarily "the applicable" customer ID procedure. In this regard, an amendment to the Bill that inserted the words "or purported to carry out" after the words "(a) a reporting entity carried out, or purported to carry out, the applicable…", with a similar amendment to paragraph (b), would be useful to avoid doubt.
- Alternatively, we suggest replacing the opening six words of clause 38(a) with "a reporting entity was required to carry out an", and deleting section 38(b).
- As previously indicated, it is important that the EM or relevant Rule put beyond doubt that where an Authorised Representative of an AFS Licensee was the relevant person doing the "arranging", that reliance on their actions is permitted.
- If these issues are not addressed/clarified, clause 38 and the accompanying draft Rule could be very onerous and practically of little/no benefit to the second reporting entity. This is contrary to our understanding of the rationale behind clause 38 (previously clause 34A) which provided for streamlined arrangements on the basis that these are dealings between AML/CTF regulated reporting entities and hence each entity was liable for its own conduct under the Bill.
- In this regard, a more useful approach would be for the second reporting entity to only be required to receive "sign-off" from the first reporting entity that the relevant procedure was conducted.

7. Record keeping: clause 114

- Consistent with prior requests, where the first reporting entity is an 'item 54 arranger', IFSA seeks the flexibility to allow the second reporting entity to not be required to physically keep a record of the procedure.

- This is consistent with existing practice under the Corporations Act. It is also consistent with the general concept that in outsourcing the customer identification procedure to the first reporting entity, the two parties should be allowed to reach an agreement as to how relevant records will be managed.

- This could be achieved by amending clause 114 by inserting a new sub-clause (8) that provides an exception to the general rule where "under an agreement in place for the management of identification or other records, the second reporting entity has access to the relevant records, or a copy of the relevant records, on request but no later than 5 days".

8. Endorsement of other financial sector industry body submissions

- IFSA also wishes to endorse the submissions prepared by the Australian Bankers Association (ABA), Australian Financial Markets Association (AFMA) and Association of Superannuation Funds of Australia (ASFA).

- IFSA has been involved in the preparation of the ABA submission and wishes to explicitly support the comments made in relation to:

    - Status of Rules vis-à-vis commencement of obligations under the Bill; and

    - AUSTRAC accountability mechanisms such as:

        - An enforcement policy which is subject to a consultation process before implementation.

        - Specified consultation processes for the Rules including public draft and notice periods.

        - No action letters and appeals.

        - A mechanism such as an advisory council for consultation on Rules, Guidelines and for other purposes.