Submission on the Exposure Draft of the Anti-Money Laundering and Counter-Terrorism Financing Bill 2005

General Comments

The comments in these submissions on the Exposure Draft of the Anti-Money Laundering and Counter-Terrorism Financing Bill 2005 (the ***Bill***) are those of Allens Arthur Robinson. They do not necessarily reflect the views of our clients.

Expressions of opinion or statements of interpretation in these submissions are not intended as legal advice.

These submissions are drafted on the basis of the material publicly released for comment. A great deal of the necessary detail is expected to be in Rules, Regulations or Guidelines which have not yet been publicly released. Our comments on the Bill may evolve as we receive further information and there may be areas on which we have not commented to date because of the lack of publicly-available information. We may wish to comment further on the Bill as Rules, Regulations or Guidelines are released and amendments made.

We note the Government's statement at the time of the Bill's release that "... a lawyer or an accountant who provides a financial service in direct competition with the financial sector would be subject to the proposed reforms in relation to those financial services, but not when providing other services". We support this approach as a matter of principle. However, based on the Bill, Rules and Guidelines, which have been publicly released to date, we think there are a number of examples of "traditional" legal services which are not financial services and which are not provided in direct competition with the financial sector that are regulated by the Bill. In addition to some suggestions in relation to the more general provisions of the Bill, our detailed comments below include some suggested amendments to the Bill to ensure that it conforms with the Government's statement (quoted above).

DETAILED COMMENTS

1. Part 1 Introduction

1.1 Section 5.

Account- Disregarding for the moment its definition in the Bill, "account" has several meanings, two of which are relevant in relation to some of the 'designated services' (as defined), namely designated services 2 and 3. The first and narrower meaning is simply money held in an account with a financial institution, e.g a bank account or a building society account. The second and broader meaning of 'account' in relation to money is 'a statement of pecuniary transactions or a formal record of debits and credits'. This meaning could include a bank account or an account held with any other business.

'Account' in the Bill is defined by the inclusion of three examples of facilities or arrangements that are to be caught within the definition of 'account'. This definition does not exhaust or limit what otherwise could fall within it. This definition does not provide any

assistance as to whether the broader or narrower definition is being used in designated services 2 and 3 (as discussed below at paragraph 1.2(b)).

E-currency – We submit that consideration should be given to amending the current requirement that the means of exchange be "known as" one of the things listed in paragraph (a) of the definition. As currently drafted, this will create opportunities for avoidance. For example, an entity determined to avoid regulation could offer something in the nature of e-currency but give it a name which is not mentioned in paragraph (a)(i), (ii) or (iii) of the definition.

Gambling service – Paragraph (b)(iii) should be amended to make it clear that the consideration needs to be money or moneys worth – otherwise theoretically any competition where there is an element of chance and a prize which is of value could be caught because the provision of information by the entrant (often required as a condition of entry) could constitute consideration.

Loan - "Repay" where used in paragraph (c) is probably narrower than it should be. In the context of bill financings, letters of credit and bank guarantees the borrower doesn't strictly "repay" – they provide cash cover or give an indemnity (or both). In order for the provision to achieve its desired effect, the words "or indemnify in respect of or reimburse" should be added after "repay" in paragraph (c).

We also submit that "borrower" should be separately defined, in particular to cover the issuer or drawer of a bill of exchange (see 1.2(g) below).

Stored value card – Stored value arrangements are regulated by other legislation including the *Payment Systems Regulation Act 1998* (where they constitute a "purchased payment facility" and chapter 7 of the *Corporations Act 2001* ***(the Corporations Act)*** (where they constitute a "non-cash payment facility"). We suggest that any terminology used in relation to stored value should be consistent to the extent possible with other legislation. Also, it is not clear what is meant by "device" and whether that word imports a requirement that there be some software built into the "card". Does this definition mean that a retail store gift card which has a magnetic strip or a computer chip containing data is a "stored value card", but a traditional paper retail store gift voucher is not? It should be clear just which methods of making non-cash payments are intended to be included in this definition.

Threshold transaction – The use of the word "involving" in each of paragraph (a) and (b) means that a transaction will be caught if only some part of the transaction is physical currency or e-currency but the whole transaction exceeds the $10,000 threshold – for example, a deposit to a bank account comprising $50 in cash and cheques aggregating $9,990 would be caught by this definition. We assume that in fact it is intended that the whole transaction should constitute or be made up of physical currency or e-currency (as applicable).

We also note that the second word of paragraph (d)(i) of the definition should be "regulations" rather than "transactions".

1.2 Section 6(1).

(a). Designated service 1 has the potential to apply to the trust account activities of lawyers if the wider meaning of "account" (discussed above) is adopted. To avoid this, we submit that lawyers and law firms should not be named in the AML/CTF Rules for the purposes of designated service 1.

(b) Designated services 2 and 3 have the potential to apply to the trust account activities of lawyers and law firms if a broad definition of "account" is adopted.

When lawyers receive trust money they do not do so as the provider of an account in the same way that a financial institution provides a savings or loan account. They do, however, keep an 'account' of money held in trust for a client in the sense of a formal record of debits and credits and in that sense are account providers in relation to trust funds.

We submit that the following limitation in designated service 1 should be added to designated services 2 and 3, namely:

> 'where the account provider is (a) an ADI; or (b) a bank; or (c) a person specified in the AML/CTF Rules'.

If this submission is accepted, we also submit that lawyers and law firms should not be specified in the AML/CTF Rules for the purposes of designated services 2 and 3.

(c) Designated services 4 and 5 have the potential to apply to the trust account activities of lawyers and law firms.

To avoid this, we submit that lawyers and law firms should not be named in the AML/CTF Rules for the purposes of designated services 4 and 5.

(d) Designated service 6. We submit this should be restricted to those who make loans in the course of a business of lending. As presently drafted this designated service (because the definition of "loan" includes the provision of credit or any other form of financial accommodation) could be interpreted to include telecommunication companies, utilities and a broad range of others who allow their customers time to pay their bills and employers who advance funds to employees. ,

(e) Designated service 7. As for designated service 6.

(f) Designated services 14,15 and 16. We are concerned that designated services 15 and 16 overlap with designated service 14 and that for the sake of clarity designated service 14 should exclude the activities covered by designated services 15 and 16.

Also, we note that "providing" is the regulated action. "Provide" is defined in section 6 as including supply, grant or confer. We take it from this definition and from the fact that the regulated action is not "issuing" that both issuers and other persons involved in making cheque books available are intended to be regulated. For example, if an agent of a cheque book issuer has all of the contact with the account holder in relation to the application for, and delivery of, a cheque book, we interpret designated service 14 as intended to make both the agent and the issuer

reporting entities. If that is correct as a matter of principle, it would be helpful if guidelines were made available outlining the degree of involvement of the agent which renders it a reporting entity, as the factual situations will vary. We note a similar issue under the Corporations Act, which is partly addressed by the concept of work of a kind commonly done by clerks or cashiers (section 766A(3)).

(g) Designated service 17. It appears to us that the wrong party is shown as the customer for all 3 instruments.

(i) Bills of Exchange – in our view the designated service should be "accepting, endorsing, purchasing, discounting or otherwise acquiring a bill of exchange or agreeing to do any of those things". The customer should be the issuer or drawer of the bill.

(ii) Promissory notes – in our view the designated service should be "purchasing, discounting or otherwise acquiring a promissory note or agreeing to do any of those things" and the customer should again be the issuer or drawer of the promissory note.

(iii) Letters of Credit – in our view the customer should be both the person who has agreed to indemnify or reimburse the issuer of the letter of credit in respect of payments under it and the beneficiary of the letter of credit, as the beneficiary will receive funds if a payment is made under the letter of credit.

(h) Designated services 23 to 26. The reference to "selling" is not clear. For example, if Westpac Banking Corporation were to sell travellers cheques issued by American Express we assume it would be a "seller" for this purpose. American Express, as the issuer, is providing a designated service, but because the cheques are sold through another entity it won't even know the identity of the purchaser. Should both Westpac and American Express be reporting entities in relation to such sales of travellers cheques?

It is also unclear, in designated service 24, whether "the service" refers to the cashing or redeeming by an ADI or a bank of its own travellers cheque, or whether it can include cashing or redeeming a travellers cheque issued by someone else. Presumably it does not capture an entity which is not an issuer or seller of travellers cheques (for example a hotel) cashing or redeeming a travellers cheque. Similar issues arise in relation to designated services 25 and 26 and money orders and postal orders. These provisions require clarification.

We submit there should be a minimum threshold. As presently drafted the service would catch all travellers cheques, money orders or postal orders no matter how small.

(i) Designated services 27-31 deal with the transfer of funds and are drafted in wide enough terms to apply to trust accounts.

When lawyers receive instructions to:

- transfer funds to a third party's bank account or a third party's lawyer's trust account for payment to the third party;

- draw a trust cheque in favour of a third party;
- transfer trust funds to a client's bank account; or
- draw a trust cheque in favour of client

they may be doing so in the capacity of an 'originating institution'.

When lawyers receive funds into their trust account from a third party for payment to their client they may do so as a 'destination institution'.

To avoid this unintended consequence, we submit that after 'in the course of carrying on a business' in designated services 27-31 'other than an exempt legal practitioner service' be added.

(j) Designated services 32 – 33 deal with 'designated remittance arrangements'.

Lawyers are constantly involved in designated remittance arrangements (as defined) without in any way competing with providers of financial services. For example, at the settlement of a simple conveyance the lawyers involved (typically one for the purchaser, one for the vendor, one for the outgoing mortgagee and one for the incoming mortgagee) will be handing over and receiving cheques, certificates of title and transfer documents. It appears that all four lawyers would be providing either designated service 32 or 33.

We submit the following words should be added:

(i) "in the course of carrying on business of providing a designated remittance arrangement" after the words "arrangement" in both items; or, in the alternative

(ii) 'or an exempt legal practitioner service' after 'building society' in s9(1)(a) and (b).

(k) Designated services 36 and 37. As presently drafted these services would be provided by companies who issue, redeem, buy back or cancel shares in themselves. Similarly, these services would be provided by a person who issues, sells or cancels a single derivative if that person also carries on a business of any type. If this is not the intention, we suggest that the designated services be amended to cover:

(i) in the case of designated service 36, the issuer or seller of a security or derivative where the issue or sale is in the course of carrying on a business of issuing or selling securities or derivatives; and

(ii) in the case of designated service 37, the issuer or seller of a security or derivative where the redemption, buy back or cancellation is in the course of carrying on a business of redeeming, buying back, or cancelling securities or derivatives.

(l) Designated services 44 and 45. The Bill contains no definition of the terms 'pension' or 'annuity'. We are concerned that without a precise definition of the terms, organisations that make payments to retired personnel may be providing a designated service.

The definitions of 'pension' and 'annuity' used in the *Superannuation Industry (Supervision) Act 1993* (Cth) for example, if replicated in the Bill, would make it clear that designated services 44 and 45 are aimed at organisations that provide pension or annuity financial products for sale to customers.

(m) Designated service 54, which deals with the provision of a custodial or depository service, has the potential to apply to lawyers unless they are exempted by the AML/CTF Rules. Lawyers have traditionally provided safe custody facilities for clients and will often hold

- deeds;
- wills; and
- certificates of title

on behalf of clients. The items held for safe custody will generally be documentation, rather than goods or assets and will also usually relate to the work done on behalf of client. For example, if a lawyer drafts a will for a client, the lawyer will often retain the original for safe keeping. We submit lawyers should be exempted from designated service 54 or in the alternative should be exempt when they hold property other than negotiable instruments.

Also we repeat our comments in respect of designated services 14,15 and 16 to the extent they relate to the term "providing".

(n) Designated services 56 and 57. As presently drafted designated service 56 would make a natural person who provides any guarantee a reporting entity if that natural person happens to carry on a business (for example, as a plumber or shopkeeper). Designated service 57 would operate to the same effect. We submit that the effect of these designated services should be restricted to guarantees provided and payments made under guarantees where the guarantees were provided in the course of carrying on a business of providing guarantees.

1.3 Section 10.

Section 10 defines a "control test" in relation to an unlisted company or a trust by reference to sections 1207Q and 1207V of the *Social Security Act 1991*. Relevantly paragraph 2(i) of the Draft AML/CTF Rules on customer identification applies this test as the minimum customer identification requirement for unlisted companies.

We submit that the application of the *Social Security Act* test in this context is inappropriate. The test is complicated (and not generally used in the financial services sector) and requires the collection of information on individuals and more importantly, their associates (who are very widely defined), which the customer may not have and which the reporting entity may not be able to obtain.

We consider that the use of this prescriptive and complicated test, which requires the collection of information, but does not require any analysis or understanding of that information, detracts from the underlying Financial Action Task Force (***FATF***) requirement that financial institutions should take reasonable measures to understand the ownership and control of their customers.

Other jurisdictions appear to adopt a much simpler approach. In the United Kingdom, Guidance[1] published by the Joint Money Laundering Steering Group (***JMLSG***), suggests that regulated firms should obtain the names of individual beneficial owners holding (directly or indirectly) 25% or more of an unlisted company. The equivalent guidance in Hong Kong, (the Hong Kong Monetary Authority Guidelines)[2] requires identification of shareholders holding more than 10% of the voting capital.

We accept that reporting entities may find it useful to apply this control test in some circumstances (for example where no other method of assessing ownership/control of an unlisted company is available). However, we submit that its use should not be prescriptive. Rather it should be one method by which a reporting entity can assess who owns or controls their customer. Other methods used in other jurisdictions may also be suitable, if the assessment can be justified.

1.4 Section 12.

The effect of section 12(2)(c) is that external agents (third party intermediaries) who are instructed by a reporting entity to conduct a customer/agent identification procedure can only disclose the information obtained to the reporting entity. There is no provision whereby the external agent can disclose that information to a related entity of the reporting entity, (for example an intermediary who is instructed to carry out a customer identification procedure by the retail banking member of a corporate group cannot pass that information to the managed funds member of the group).

We submit the section should be amended to permit disclosure not only to the reporting entity but also to affiliates/related bodies of the reporting entity if authorised by the reporting entity.

The same comments apply to section 12(3)(c).

1.5 Section 13(2)and (3)

See our submissions on the use of the "control test" (at paragraph 1.3 above). Additionally it may well be very difficult to apply the test to companies/trusts/individuals in another country where for example a different test of "beneficial ownership" may apply or where the information on individuals (and more importantly their 'associates") may not be readily available or may be subject to confidentiality constraints.

1.6 Section 13(4)

We are concerned that a partnership that operates entirely in a foreign jurisdiction will be required to comply with the Bill just because one partner of the partnership is a resident of Australia. This appears to be the effect of section 6(4)(b). For example, a partnership that operates solely in a foreign country may have all but one partner resident in that foreign country and one partner resident in Australia. Under section 13(4), the partnership would be a resident of Australia and under section 6(4)(b) its activities in the foreign country could

[1] The JMLSG Guidance for the UK Financial Sector PART 1. paragraph 5.4.67

[2] Supplement to the Hong Kong Monetary Authority Guideline On Prevention of Money Laundering paragraph 4.5 and Interpretive Notes paragraph 13.

be designated services as they are provided at or through a permanent establishment of the partnership in that foreign country. We submit that, in these circumstances, it is not appropriate to subject all of the activities of the partnership to regulation by the Bill. Alternative approaches could be to have only the activities of the Australian resident partner or the designated services provided in Australia or to Australian residents regulated by the Bill.

1.7 Section 17

The last line of this provision refers to translating a currency to Australian currency at "the exchange rate applicable at the relevant time". There is no one exchange rate – rates are offered by a whole range of organisations and they are offered for buy and sell transactions. It would be prudent to specify which exchange rate should be used.

2. Part 2. Identification procedures.

2.1 Groups

As a general point we are concerned that, unlike other jurisdictions, there is no allowance in the Bill for simplified customer due diligence or sharing of information by entities within the same group. In particular:

- Reporting entities within the same group who provide designated services to each other, such as Treasury operations, (including the provision of loan or guarantee facilities) will be required to carry out customer identification on each other.
- Reporting entities will **each** have to carry out customer identification/verification. Customers of one reporting entity in the group may not be "an existing customer" of another member of the group. If the customer is "new" for one member, that member as a reporting entity will have an obligation to identify it. This will apply even if the customer is "existing" for another member of the group.
- Reporting entities within the same group will **each** have to put in place an AML/CTF program and therefore, the Board and senior management of each reporting entity will be responsible for compliance with the program of their entity. Each program will need to be tailored for the particular circumstances of the individual reporting entities.
- Reporting entities will **each** have to risk classify both new and existing customers. There is no provision where by a reporting entity can rely on a risk classification carried out by another member of its group.

The UK takes a more practical approach. Guidance issued by the JLMSG suggests that, where a customer is introduced by one part of a financial sector group to another, it is not necessary for the customer's identity to be re-verified or for the identification records to be duplicated, provided that;

- the identity has been verified by the introducing part of the group in line with AML/CTF standards; and
- a group introduction confirmation is obtained and held with the customer's records, (although this confirmation is not necessary where firms have day to day access to

all group customer information and the identity of the customer has been previously verified to AML/CTF standards).[3]

We submit that;

- Reporting entities within a group should not be required to carry out customer identification procedures on a member of the same group;
- Reporting entities within a group should be able to share relevant Know Your Customer **(KYC)** information held by other members of the same group (subject to privacy constraints);
- Reporting entities within a group should be able to rely (using a risk based approach) on customer identification procedures carried out by, or on behalf of, other members of the same group;
- Reporting entities within a group should be exempt from the third party requirements of the AML/CTF Program Rules so far as they apply to members of the same group; and
- Reporting entities within a group should be exempt from the tipping off offence so far as it relates to disclosing information to members of the same group (see below at paragraph 5.1).

Furthermore, we submit that the concept of a group needs to be broader than just encompassing related bodies corporate as defined in the Corporations Act. For example, partnerships with common partners and bodies corporate controlled by partners in a partnership should also be considered for inclusion as members of a group.

2.2 Section 27.

Persons who were customers before the commencement of the legislation but who do not receive any designated services after commencement are not customers (existing or otherwise) and not subject to KYC procedures. They do however seem to be customers for the purposes of some of the Draft Rules (for example, Rule 17[4] (risk classification), Rule 11[5] (minimum or additional KYC information), and Rule 13 [6] (updating KYC information) of the AML/CTF draft program which require a degree of KYC information for such customers). This conclusion is supported by paragraphs (f) and (g) of s74(1). If this is not the intention, we suggest that this is made clear (either in the Bill or in the Rules).

We look forward to the provision of detailed guidance on what constitutes a "continuous relationship". This concept has significant practical consequences for reporting entities.

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[3] The JMLSG Guidance for the UK Financial Sector PART 1 paragraphs 5.5.22- 5.5.25

[4] A reporting entity must assign each existing customer with a risk classification as soon as is practicable but no later than (still to be defined) months from commencement

[5] A reporting entity must determine, as soon as is practicable after commencement, whether any minimum or additional KYC information is required for each existing customer (as defined by section 27(1) of the Act)

[6] A reporting entity must update its KYC information on each customer (including existing customers) at appropriate intervals and on a risk basis.

2.3 Section 28.

We understand the exemption for low risk products and services from the customer identification requirements is still under consideration. FATF recognises that in low risk situations or, where information on a customer is publicly available or where adequate checks and controls exist elsewhere, simplified customer due diligence can apply, including where:

- the customer is itself a supervised financial institution that is required to have an AML/CTF program; or
- a publicly listed company; or
- the product is a life insurance policy with an annual premium of no more that USD/EUR 1000 or a single premium of no more that USD/EUR 2500; or
- a life insurance policy with no surrender value which cannot be used as collateral; or
- a pension or superannuation scheme that provides retirement benefits to employees where contributions are made by deduction from wages and members' interests cannot be assigned.

These examples of low risk products and customers have been adopted by other jurisdictions. For example, in the UK publicly listed companies are recognised as low risk and only minimum identification is required. The *UK Money Laundering Regulations 2003*[7] provide three broad categories of exemption from the obligation to verify customer identity. These include;

- where the customer, whether as principal or agent for others, is another regulated firm;
- certain one-off transactions, including where the transaction is for less than £15,000;
- long term insurance contracts with no surrender or collateral value that are associated with pension schemes and taken out by virtue of a person's employment or that have a single premium of less than £2500 or an annual premium of less than £1,000.

The European Union's Third Money Laundering Directive[8] takes a similar approach to low risk products. The US Bank Secrecy Act and its implementing regulations exempt regulated financial institutions and publicly listed companies from customer verification.

We submit that exemptions which reflect FATF and overseas best practice should be provided.

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[7] UK Money laundering Regulations 2003 Article 5

[8] European Union's Third Money Laundering Directive Article 11.2 and 11.5

2.4 Section 31.

It is accepted that as a general rule customer identification and verification should be carried out prior to the designated service. The exceptions to that rule as set out in section 30(b) reflect the Interpretive Note to FATF Recommendation 5.

Section 31 provides that where the exemptions apply the reporting entity can only provide the designated service for a period of business 5 days.

We submit this time limit does not permit a risk based approach to be taken and does not reflect commercial realities (in particular where there are bulk identification requirements or the reporting entity is depending on a third party intermediary to carry out the customer identification procedure).

Prescriptive time limits are not a FATF requirement or best practice overseas. FATF suggests[9] financial institutions can be allowed to complete the verification process as soon as is reasonably practicable following the establishment of the relationship (where the money laundering risks are effectively managed). This is reflected in the JMLSG Guidance[10]. The US adopts a similar approach where banks must collect customer identification before opening an account but must carry out verification within a reasonable period of time (thereby providing the banks with the flexibility to use a risk based approach to determine how soon identity must be verified)[11].

We submit that the 5 business day time limit should be replaced by a requirement to verifiy 'as soon as is practical" provided that the reporting entity has measures in place to ensure suitable risk based controls over the account (or any funds) until verification is complete.

Additionally with specific reference to the exception in section 30(1)(b)(iii) we submit that the 5 business day limit goes beyond the FATF requirement. FATF suggests that, in the case of life insurance business, verification can take place after the business relationship has been established but must be done before payout or the beneficiary exercises any rights under the policy[12].

2.5 Section 32.

Generally, for the reasons mentioned above (at paragraph 2.4), we consider the 5 business day time limit is impractical particularly as the relevant trigger event may impact numerous customers, including existing customers (who will never have been verified).

Specifically, section 32(1)(b)(iii) contemplates a "risk trigger" may occur when a "period" ascertained in accordance with the AML/CTF Rules ends. No further guidance has been issued on this point. We are unaware of any corresponding provision in comparable overseas legislation, the FATF Recommendations or the Basle Principles which suggests the passage of time per se is a risk trigger.

We submit that the application of this subsection goes beyond the FATF requirements.

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[9] FATF Recommendation 5

[10] The JMLSG Guidance for the UK Financial Sector PART 1 paragraphs 5.4.6 and 5.4.7

[11] Title 31. Part 103.121(b)(2)(ii) Code of Federal Regulations

2.6 Section 34.

Section 34 facilitates the use of intermediaries by reporting entities and is therefore welcome.

The title to section 34 ("When applicable customer identification procedures may be carried out by another person") appears somewhat misleading in that it implies that the section will apply to methods by which someone other than the reporting entity will carry out the appropriate procedure. However section 34 includes (at subsection (1)(a)) a provision whereby the procedures can be carried out by "internal agents" of the reporting entity. As internal agents are defined in section 11 as employees, secretaries or directors of the reporting entity, in practice the reporting entity will itself be carrying out the customer identification procedure. The requirement in section 34(1) that written authorisation is required before the customer identification procedure can be carried out obliges a reporting entity to provide written authorisation to its own employees before they can carry out a customer identification procedure. The application of this section to the reporting entity itself seems superfluous and unnecessarily complicated.

Section 34 also authorises external agents to carry out customer identification procedures but, because of section 12, they are effectively prohibited from providing information obtained by that procedure to any other reporting entity. In order to facilitate the sharing of information between related entities in a group (and thereby reducing costs) we suggest external agents should be able to provide customer identification information to (at least) related entities of the reporting entity if so authorised by the reporting entity.

We have concerns that the way the section is drafted permits reporting entities to direct third parties (including other reporting entities) to carry out customer identification procedures (i.e. in the future) but does not provide for the situation where the customer identification procedure has already been carried out by the third party perhaps for another or a related reporting entity.

As an example, a financial service provider providing a service to a customer who has been introduced by a financial planner and who has already been identified some months earlier by the financial planner (perhaps for the purposes of another investment) cannot rely on that identification procedure (unless the financial planner was authorised by the financial service provider under section 34 prior to that identification occurring) and the customer will have to be re-identified to allow the financial service provider to provide a designated serve to the customer.

Similarly, a lawyer providing a designated service to a client referred by a bank cannot rely on the customer identification procedure already carried out by that bank (unless it has previously authorised the bank under section 34, which is unlikely, and will have to re-identify the customer.

We submit the Bill should be amended to allow reporting entities to rely on customer identification procedures already carried out, particularly if carried out by reporting entities or accredited persons.

[12] FATF Interpretative Note to Recommendation 5.

2.7 Non-standard customers

One of the lessons learned in the UK was that customers must not be excluded from the financial services sector because they cannot provide standard evidence of identity. Such customers could include low income customers in rented accommodation, or with a legal, mental or physical inability to manage their affairs, prisoners, dependent spouses, students, refugees and others. The recent Guidance published by the JMLSG[13] suggests that in some circumstances confirmatory letters could be accepted. We submit that the Bill/Rules should provide for a similar discretion (which is not currently the case).

2.8 Privacy

We submit that business should not become subject to another set of privacy rules which are inconsistent with current privacy regulation. From a policy perspective we believe that any reporting entity which is not currently regulated by the *Privacy Act 1988* (because it has the benefit of the small business exemption) should comply with the Privacy Act in relation to personal information it collects, uses and discloses as required by the Bill.

In our view, the most efficient way to achieve this would be to bring small businesses (and their relevant acts and practices) within the Privacy Act where they are a reporting entity for the purposes of the Bill. The Government has nominated consistent regulation as key principle in its policy principles for *Anti-money Laundering Reform* document. [14] In our view it is important that the rules be consistent across all reporting entities, and consistent with current privacy law.

Depending on the final outcome of procedures for customer identification and customer due diligence, it is likely that the *Commonwealth Electoral Act 1918* will require amendment so that the electoral roll can be used for customer due diligence purposes. To do that would be consistent with recent changes made to the *Commonwealth Electoral Act 1918* to enable the electoral roll to be used for the purposes of the *Financial Transaction Reports Act 1988* ***(the FTRA)***.

3. Part 3 Reporting obligations.

3.1 Section 39(1) and section 39(2)

There is an inconsistency between the scope of the obligation in section 39(1) and the reporting obligation in section 39(2) which appears to undermine the effect of the section 39(2).

Sections 39(1)(d), (e), and (f) apply if a reporting entity has "reasonable grounds to suspect", that is, an objective test applies. In contrast section 39(2) requires a reporting entity to make a report to AUSTRAC within 3 business days (or 24 hours) after the day on which the reporting entity ***formed the relevant suspicion***. "Relevant suspicion" is not defined. The obligation to report (under section 39(2)) therefore only applies when a

[13] The JMLSG Guidance for the UK Financial Sector PART 1 paragraph 5.4.49

[14] Policy Principles for Anti-money Laundering Reform issued June 2004

suspicion is formed, not when there are reasonable grounds to suspect but no suspicion is actually formed.

This section is drafted in similar terms to the existing reporting obligation under section 16 of the FTRA.

The inconsistency could be cured if section 39(2) was amended so that the obligation to report arose within 3 business days or 24 hours of either forming the suspicion or having reasonable grounds to have done so. Alternatively, the drafting in section 39(2) could be amended to reflect the language of section 311 of the Corporations Act, (where an auditor is required to report within 28 days of becoming aware of circumstances that he has reasonable grounds to suspect amount to a contravention).

3.2 Section 39(6)

There is an inconsistency between:

(a) the prescriptive obligations imposed by section 39(6) and paragraph 1 of the Draft Rules on Suspicious Matters (to take into account a list of 24 matters set out in that paragraph); and

(b) the Statement in paragraph 10 of the Draft Guidelines on Suspicious Matter Reporting.

The prescriptive nature of the obligations is reinforced by the language of paragraph 9 of the Draft Guidelines.[15]

In contrast, paragraph 10 of the Guidelines implies that a reporting entity need only take into account such of the 24 matters as are relevant to the individual circumstances of each case. This approach is consistent with the view, which we understand to have been expressed by AUSTRAC's representatives, that the list in paragraph 1 is not prescriptive.

If the matters listed in paragraph 1 of the Rules are for guidance only (as is the case in comparable jurisdictions) we submit this should be made clear in the Bill and the Rules.

Of concern also is the timing requirement. Suspicious matter reports must be made within 3 business days (or 24 hours for terrorist financing). There is no overseas equivalent to this. The United Kingdom and Hong Kong reporting regimes adopt a more pragmatic approach by requiring reports to be made "as soon as is practicable"[16]. The US allows a period of 30 days[17]. Relevantly the FTRA requires reports to be made "as soon as is practicable"[18]. We submit this approach is more practical especially in light of the complexity of the matters to be taken into consideration in determining whether a report should be made.

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[15] it refers to the Rules as "prescribing matters that a reporting entity must take into account"

[16] The UK Proceeds of Crime Act 2002 sections 330(4), 331(4) and 332(4)

The Hong Kong Drug Trafficking (Recovery of Proceeds) Ordinance (Cap 405) section 25A and the Organised and Serious Crimes Ordinance (Cap 455) Section 25A

[17] Title 31. Part 103.18 Code of Federal Regulations (for banks)

[18] Section 16 FTRA

3.3 Section 40(3)

We are concerned that this section is unworkable in practice and goes beyond the requirements of the relevant FATF Recommendation[19].

The section extends the reporting obligation in section 39(1)(d)(i) to information relevant to the investigation of an evasion, or attempted evasion of a law of a foreign country or part of a country that deals with taxation. The foreign tax evasion does not have to correspond to any Australian taxation law, neither does it have to constitute an offence in Australia or in the foreign jurisdiction.

This presupposes that the reporting entity is in a position to know what may be relevant to an investigation into the evasion or attempted evasion of every foreign taxation law, whether that law has any similarity to an Australian tax law or not.

FATF Recommendation 13 requires financial institutions to report funds that are the proceeds of "criminal activity". The Interpretive Note to the Recommendation refers to criminal activity as:

(a) all criminal acts that would constitute a predicate offence for money laundering in the jurisdiction; or

(b) at a minimum offences that would constitute a predicate offence as required by Recommendation 1 (that is all serious offences).

Section 40(3) goes beyond the requirements of the Recommendation as the conduct to be reported, i.e. the evasion or attempted evasion of a foreign tax law, does not need to constitute a predicate offence for the purposes of the Recommendation. There is reference in the Interpretive Note to Recommendation 13 to the effect that suspicious transactions should be reported regardless of whether they involve tax matters. Section 40(3) goes beyond this.

3.4 Section 40(5)

Similar issues arise under section 40(5) as those which arise under section 40(3).

Section 40(5) extends the reporting obligations in section 39(1)(d)(ii) to information relevant to the investigation of an offence that is an offence against the law of a foreign country and that corresponds to an Australian offence. In practical terms, this requires the reporting entity to consider (and therefore by implication have full knowledge of) offences in all foreign jurisdictions.

Although FATF Recommendation 1 makes it clear that predicate offences should include conduct that occurs in another country that constitutes an offence in that country and which would constitute a predicate offence if it occurred domestically (this is the format followed by section 40(4)), it also suggests a simpler approach, that is, that countries may provide that the only prerequisite for a predicate offence is that the conduct would have constituted a predicate offence domestically. This simpler approach has been adopted by other jurisdictions (section 326(1)(b) of the UK Proceeds of Crime Act is an example).

[19] FATF Recommendations 13 and 1 and Interpretative Note to Recommendation 13

We suggest that section 40(5) should adopt the simpler (and more practical) approach and provide that only information relevant to conduct overseas which, if committed in Australia would be an offence against an Australian law, should be reported. This approach complies with Recommendation 1 but obviates the need for a reporting entity to consider offences under the laws of overseas jurisdictions.

3.5 Section 40(7)

We submit this is impractical in that it presupposes a reporting entity will have full knowledge of the proceeds of crime law in all other jurisdictions. This is not a FATF requirement.

3.6 Section 46(1)

This section provides protection to any person in relation to any action taken in good faith and without negligence in fulfilment of any requirements under sections 39, 41, 42 or 45 or in the mistaken belief that action was required under those sections.

We consider that this protection should also include any actions taken to comply with the Rules and Guidelines. An example of where such protection might be required is where enhanced due diligence (with the attendant risk of tipping off) is carried out as required by paragraph 21(g) of the Draft Rules on AML/CTF programs.

3.7 Safe harbour defence

The Bill applies the objective test, that is "reasonable grounds for suspicion". That test is also found in the FTRA, the UK Proceeds of Crime Act 2002 and the UK Terrorism Act 2000. However, the UK legislation provides reporting entities with a protection that is not included in the Bill, by providing a specific defence whereby UK courts are required to take account of industry guidance in considering whether an nominated officer has committed an offence by failing to report. [20] We submit a similar safe harbour defence should apply to the Australian reporting regime.

4. Part 7. The AML/CTF program

4.1 Section 75

The requirement in section 75 that every AML/CTF program requires the reporting entity to monitor against the risk of foreign AML/CTF offences requires the reporting entity to have full knowledge of AML/CTF regimes and money laundering and terrorist financing risks in every other jurisdiction.

This is not qualified in any way (for example to jurisdictions that are FATF members or NCCT countries) but applies to every jurisdiction.

We accept that the global nature of money laundering/ terrorist financing requires an effective AML/CTF regime to guard against reporting entities being used to facilitate offences being committed overseas. However, we consider that a more risk based

[20] Proceeds of Crime Act sections 330(8) and 331(7) and Terrorism Act section 21A(6)

approach should be adopted and that section 75 should be amended to reflect this by, for example, applying only to the laws of the foreign jurisdictions in which the reporting entity provides designated services at or through a permanent establishment.

4.2 Safe harbour defence

Unlike the UK there is no safe harbour provision in the Bill for contraventions of the AML/CTF program requirements. The UK Money Laundering Regulations 2003, in addition to the general defence of taking all reasonable steps and exercising all due diligence [21], provide a safe harbour defence by requiring a UK court to have regard to whether a person charged with committing an offence under the Regulations followed any relevant guidance issued by a supervisory or industry body[22]. The FSA Handbook[23] has recently been amended to provide that the FSA, in considering whether any breach of its rules on AML systems has occurred, will have regard to whether the firm in question followed the Guidance issued by the JMLSG.

The due diligence defence is already available for breaches of the customer identification procedures. We submit that both this defence and the safe harbour defence should be extended to the AML/CTF program requirements in the Bill.

We are unaware of any such defences in the Criminal Code.

5. Part 11 Secrecy and access

5.1 Section 95

Section 95(1) (the tipping off offence) prohibits disclosing specified information.

In our view, there should be an exemption whereby a reporting entity can disclose the fact of its suspicion, or a report it has made, to an external legal advisor for the purpose of obtaining legal advice.

Additionally, where the reporting entity is part of a group we suggest that the reporting entity should be able to make the same disclosure to another member of the group, so long as that disclosure is not likely to prejudice an investigation which might be conducted following the report.

As a matter of sound business practice and risk management, if one member of a group has information relevant to an offence or attempted offence it should be able to advise other members of the group of that suspicion, for example, to minimise the likelihood of offences being perpetrated across the group or another member of the group unwittingly facilitating a money laundering or terrorist financing offence.

We understand that this is accepted as best practice overseas. In the United Kingdom and Hong Kong a regulated entity cannot make a disclosure likely to prejudice an investigation but is not otherwise prevented from advising other members in the same corporate group

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[21] Article 3(5)

[22] Article 3(3)

[23] Rule 3.2.6E

of such matters[24]. In the United States, FINCEN has recently issued Guidance (20 January 2006) to the effect that some financial institutions may share suspicious activity reports with domestic and foreign parent entities for the purpose of enabling the parent entity to discharge its oversight responsibilities or with respect to enterprise wide risk management and compliance with applicable laws and regulations.

5.2 Section 97.

As indicated above (at paragraph 1.4) we consider third party intermediaries should be able to provide information to related entities of the reporting entity that authorised the report.

6. Part 12. Offences

6.1 Section 110.

We suggest section 110(b)(i) should be amended as follows: "commences to provide a designated service to a customer who it has reasonable grounds to suspect is using a false customer name; or ".

6.2 Section 111.

We repeat our submission as it applies to section 110.

7. Part 15. Enforcement

7.1 Section 155(1)

We submit that AUSTRAC should also be required to monitor and report on compliance with the Rules.

7.2 Section 170.

We submit there should be an exemption whereby a reporting entity who receives a notice under section 164(2) which specifies that information about the notice must not be disclosed, can disclose the information about the notice to a parent entity or to an external lawyer for the purposes of obtaining legal advice.

[24] UK Proceeds of Crime Act 2002 section 333(1)(b) and

Hong Kong Drug Trafficking (Recovery of Proceeds) Ordinance (Cap 405) section 25A and the Organised and Serious Crimes Ordinance (Cap 455) Section 25A