

Australian Friendly  **Societies Association**

8 March 2006

Committee Secretary
Senate Legal and Constitutional Committee
Department of the Senate
Parliament House
Canberra ACT 2600

By email: legcon.sen@aph.gov.au

Dear Sir/Madam,

AFSA Submission: Inquiry into the Exposure Draft of the Anti-Money Laundering and Counter-Terrorism Financing Bill 2005

The Australian Friendly Societies Association ("AFSA") is the peak industry body representing friendly societies across Australia. On behalf of AFSA, I would like to express our appreciation for the opportunity to comment in respect of the Senate Legal and Constitutional Committee's Inquiry into the Exposure Draft of the *Anti-Money Laundering and Counter-Terrorism Financing Bill 2005*.

As you know, a public consultation period in respect of the Exposure Draft of the Anti-Money Laundering and Counter-Terrorism Financing Bill 2005 and the accompanying documents (referred to as the **AML/CTF package**) closes on 13 April 2006. We are currently preparing a detailed submission for that purpose, and due to the need to examine the many complex issues very carefully, we are not therefore able to provide a comprehensive submission to the Senate Legal and Constitutional Committee at this point in time. However, we will forward to you a copy of our comprehensive submission once completed on or before 13 April 2006 and do hope that there will be further opportunity to present our specific concerns to the Committee.

For the purposes of this submission, we set out in general terms a number of concerns identified to date for your consideration.

1. Concerns of a general nature

1.1 Timing and Process for the Consultation.

As you know, the AML/CTF package was issued on 16 December 2005, just prior to the Christmas and New Year holiday season, therefore not allowing full use of the 4 month consultation period due to the number of staff on annual leave at that time. Furthermore, much of the detail of the package will be contained in the Rules, which are not all yet available for consideration.

We would submit that there is neither adequate time nor an adequate process, in the absence of much of the Rules, for industry to properly consider and comment on the full impact of the AML/CTF package during this consultation period. The reality is that the whole package of reforms, including the details to be contained in the Rules, should be subject to an adequate consultation period. We would suggest that at least a 2 month period for review of the complete package would be necessary to allow adequate assessment and comment.

1.2 Support for ABA submission

In respect of the AML/CTF package, we wish to express our overall support for the submission of the Australian Bankers' Association (ABA), and the many complex issues raised by the ABA that are equally applicable to the friendly society sector. We have participated as a member of the ABA industry consultative groups and working party and are aware of the contents of that submission.

In particular, the ABA has raised the concern that the intended risk-based approach derived from the FATF Recommendations has not been properly facilitated in the package, given the prescriptive requirements that are evidenced in the AML/CTF package. We would be strongly supportive of a more appropriate legislative reflection of the risk-based approach as formulated by the FATF Recommendations¹ and agreed in the industry roundtable meetings.

We also strongly support the ABA's submission that greater account be taken of the international experience, particularly that of the UK, in further developing the AML/CTF package.

1.3 An adequate transition period

AFSA urges the Senate Legal and Constitutional Committee to ensure that an adequate transition period is provided. This would allow for properly planned systems and procedures to be introduced. Many friendly societies use account based computer systems so it is currently not feasible to obtain a "whole of customer" view across all of a society's products and services. In addition, many societies are fairly small operations (see further background information at section 2 below) that have not previously been subject to existing customer identification requirements under the *Financial Transactions Reporting Act 1988 (Cth)*.

The AML/CTF package will involve major changes to systems and procedures, potentially requiring new systems, as well as workforce training requirements, which will create significant demands and resourcing issues from both a costs and personnel perspective. Therefore, serious consideration must be given to ensuring that a transition period of as long as possible a duration is provided – we would be suggesting at minimum a 2 year transition period from the date of Royal Assent of the AML/CTF package.

1.4 Product Disclosure Statements and Privacy Statements

We are concerned about the implications for Product Disclosure Statements ("PDS") under the *Corporations Act 2001*. Existing customers who have invested in products pursuant to information contained in a PDS will not have been warned of the requirements of the AML/CTF package. This is particularly an issue if a claim or withdrawal from a product is subsequently delayed (or even refused) due to the organisation carrying out customer identification prior to paying the claim or withdrawal.

In addition, the updating of PDS documents is an expensive and time-consuming process and an appropriate transition period should be allowed to enable AML/CTF information to be included at the next rollover of PDSs.

Furthermore, there is legal commentary to suggest that Privacy Statements will need to be amended to indicate that identifying information is collected from customers (including potential customers) as required under the AML/CTF package and that a transaction or application may not proceed without provision of all the required information. Organisations will therefore need appropriate time to amend Privacy Statements. More

¹ Financial Action Task Force on Money Laundering (FATF), *The Forty Recommendations*, 20 June 2003 (incorporating the amendments of 22 October 2004)

importantly, privacy issues arise where there is a need to re-visit existing customers for AML/CTF purposes and the obligation under Privacy legislation to notify the customer that the information is required for AML/CTF obligations. This gives rise to a concern regarding how this privacy obligation might sit with the obligation to not “tip off” the customer under AML/CTF package.

1.5 Legal implications of rejecting a potential customer

Concerns have been raised about the legal implications of an organisation rejecting a potential customer on the basis of their AML/CTF program and customer due diligence, particularly where there could be allegations of discrimination on the grounds of race, given the collection of information about country of birth and citizenship. We would query whether consideration has been given to what protections there might be for financial institutions that reject a potential customer and are later subject to legal suit?

2. **Concerns specific to friendly societies and friendly society products and services**

We take this opportunity to highlight in general terms a number of issues identified to date that are specific to friendly societies that offer financial products to members of the public (see paragraphs 2.1 to 2.8). However, because friendly societies may not be well understood by all stakeholders, we also provide the following brief background information.

There are currently 27 friendly societies in Australia which are regulated by APRA under the *Life Insurance Act 1995* and that offer financial products to members of the public. These friendly societies are also regulated under the *Corporations Act 2001*. Friendly societies encompass a range of institutions including –

- (a) demutualised listed companies (the IOOF Group and OFM Funds Management), as well as large mutual organisations (Australian Unity, Lifeplan Funds Management and Australian Scholarships Group), each managing close to \$1 billion on behalf of their clients;
- (b) 6 medium sized mutual societies managing between \$50 million and \$500 million on behalf of their clients;
- (c) the smaller end of the market, including 16 mutual societies managing less than \$50 million in assets.

In total, the friendly society sector manages close to \$7 billion on behalf of in excess of 1 million Australian customers.

Friendly societies commenced in Australia with the arrival of the first settlers to the colony, bringing with them a history of mutual self-help within their communities. Friendly societies provided a cooperative means for individuals to join together to provide support services for one another, in an era when governments did not provide such needed benefits. In exchange for a regular small contribution, friendly society members would receive assistance for themselves and their families in times of sickness, accident, loss of employment or death. If a member fell upon hard times, they or their families received financial assistance, medical care and the supply of medicines, but if not, generally they would not expect to receive any financial return. Friendly societies were also a venue for fraternal, social, sporting and community building activities within the communities in which they operated, primarily amongst working class families.

Friendly societies thrived for over a century until the Federal Government introduced welfare through the social security system in the late 1940s, necessitating a change of direction. Friendly societies continued to adapt and expand their operations to address other important areas of need for products and services within the community that are appropriately accessed through cooperative means. This included the development of the tax advantaged insurance bond during the 1980s, which provided an important long term savings vehicle for Australians. Its attractiveness resulted in a further boom period for friendly societies (then numbering over 60 friendly societies across Australia) until the sector was faced with the significant costs of

implementation and compliance with legislative change consequential upon both the Wallis Financial Sector Reforms and Ralph Business Tax Reforms, resulting in significant rationalization within the industry.

Today, friendly societies conduct a range of diverse businesses and include organisations that provide some or all of the following types of financial products or services to Australian consumers (note that friendly societies also exist that do not provide financial services):

- Life insurance and investment products and financial advice
- Education savings and scholarship plans
- Mortgage lending including seniors reverse mortgage lending
- Funds management
- Health insurance
- Superannuation
- Funeral bonds and pre-paid funeral arrangements
- Retirement living services including retirement villages, aged care facilities, hostels and nursing homes

Note that some friendly societies continue to manage a number of traditional style products which no longer accept new insurance or investment business and which we will refer to as “closed products” (see further paragraph 2.5) alongside ongoing product offerings.

We believe it is important to bring to the Senate Legal and Constitutional Committee's attention our sectors' concern about the major cost implications of these significant and complex legislative changes as foreshadowed by the AML/CTF package, particularly for the small and medium sized sector. In this, we are not suggesting that the friendly society sector should be exempt from these reforms, however, we highlight in the following paragraphs some cases that we are developing for specific exemptions or low-risk designations and would request these be given full and fair consideration in light of the valuable service that these small to medium sized friendly societies continue to provide to the Australian public.

2.1 Exemptions and low-risk designations

Neither the Attorney-General's Department nor AUSTRAC have provided any indication as to what type of exemptions or low risk designations may be provided under the Rules, nor the factors that may be considered. This is a problematic issue for friendly societies as many have been exempt from the application of the *Financial Transactions Reporting Act 1988* (“FTRA”) in the past, either because of specific exemptions granted (eg. for funeral bonds/policies – see further para 2.3 below) or due to the more general exclusion applicable under the FTRA which arose where customer accounts could only be transacted on a “cheque in/cheque out” basis (see further discussion at para 2.4).

It would be helpful to our industry in particular to know if there were any intention to continue or look favourably at previously existing exempt products, services or transactions. This would both alleviate much concern and also minimise the time now being spent by industry on assessing the implications of the legislation, where it may not ultimately apply.

2.2 Risk-only insurance products

Many friendly societies have traditionally offered products that are regarded as “risk-only”. Essentially this means –

- (a) the product offers insurance cover payable on the occurrence of a particular event such as sickness, accident, death or distress, or which may be payable for particular purposes, such as to cover the cost of a funeral;
- (b) the premiums are relatively small and generally payable on an ongoing basis until a particular age is reached, or an insured event occurs;
- (c) the benefit payable is often a defined amount or specifically related to the expenses incurred upon the occurrence of the insured event;

- (d) no "investment" value accumulates in the product and the policyholder cannot surrender or withdraw any amount from the product.

It is not clear from the AML/CTF package and the designated services therein defined whether such risk-only insurance products are excluded, although it would seem to us that they are an obvious exclusion, most particularly as they are not likely to serve any useful purpose for persons involved in money laundering activities.

2.3 Funeral policies/bonds – a case for exemption

Funeral policies are policies designed for the restricted purpose of contributing to or covering the cost of the life insured's funeral. Funeral policies are available in 2 types –

- (a) risk-only policies as discussed in para 2.2 above; and
- (b) products commonly referred to as "funeral bonds", which are accumulation-style policies. Funeral bonds are often utilised as part of a pre-paid funeral arrangement whereby a customer enters into a contract with a funeral director to pre-purchase a funeral at today's prices, and then invests in the funeral bond the contracted amount. Under such contracts, the funeral bond proceeds are ultimately payable to the funeral director following the customer's death and the conclusion of the agreed funeral service.

Both types of funeral bonds/policies are payable only on death; no monies are accessible during the policyholder's lifetime and the policy proceeds are only payable for the purpose of meeting funeral expenses after death. In addition, under the applicable laws, a person may only contribute to a funeral policy/bond such amount as will provide, together with any allocated investment earnings (referred to as bonuses), for an adequate funeral service, thereby limiting the potential for a customer to use a funeral policy to "save" for future terrorist activities.

We submit that it is arguable that the likelihood that those involved in money laundering or terrorist financing would find a funeral policy/bond useful or desirable for their purposes is minimal, if not beyond the realms of probability. Note that funeral policies are currently exempt from the FTRA and are also specifically exempt from the application of the *Financial Services Reform Act 2001* ("FSRA"). We had understood that the AML/CTF package application was originally intended to be aligned with financial products and services subject to the FSRA, another factor supporting our case for exemption of funeral policies.

A further concern in this regard is the fact that funeral directors often act as intermediaries in the promotion of funeral policies, particularly in conjunction with pre-paid funeral arrangements. Note also that funeral directors are exempt from the FSRA requirements in respect of licensing of advisers. We would submit that this exemption should be continued into the AML/CTF regime, given the arguments put above in respect of the negligible risk that such products would be at all attractive to money launderers or terrorist financing.

2.4 "Cheque in/cheque out" only facilities

As mentioned briefly above, many friendly societies were not subject to the FTRA requirements on the basis that they did not accept any payments or policy contributions from customers in cash nor were any claims or withdrawals paid in cash. All transactions were conducted only by use of cheque facilities. The philosophy behind this was that appropriate identification of the customer in respect of such transactions would occur at the level of the cheque account facility. It is not clear to us if the continuation of this exemption has been overlooked or was deliberately left out of the AML/CTF package. The vast majority of friendly societies are now in the position of being unsure as to whether such arrangements would again be excluded from the operation of the AML/CTF package, or whether the proposed regime will in fact apply to products where "cheque in/cheque out" arrangements are the only alternative.

We submit that there would be merit in re-assessing the continuation of the existing provisions enabling these exclusions, at least in respect of existing customers, if not for all customers.

2.5 Existing Customers, "Continuous Relationship" and Closed Products

We understand that there are concerns throughout the financial services industry that a consequence of the AML/CTF package in its present form is that it may transpire that some or all existing customers will need to be re-verified. These concerns are particularly the case:

- (a) where the friendly society has not previously been required to verify the identity of those customers (such as described in paras. 2.3 and 2.4 above) leading to there being a large number of customers with an established relationship whose orderly conduct of their financial affairs could be unduly interrupted by a requirement to carry out a verification process; and
- (b) where, despite the proposed exemption that will apply where there has been a "continuous relationship" with the customer, we are concerned about the interpretation of the concept of "continuous relationship" in relation to some types of products offered by friendly societies. An example is an existing single premium 10-year insurance bond client, where the client deposited a single amount many years ago, but has not transacted any further deposit or withdrawal since that time. Another example is a funeral bond client who has not had any dealings with the friendly society over the many years since first investing in a funeral bond.

Some clarity with regard to the "continuous relationship" test is necessary, at minimum, enabling the organisation to determine what is to be regarded as appropriate in the context of the specific product offering.

We are also concerned that, despite an appropriate interpretation of the "continuous relationship" test, there may still be a de facto requirement to verify existing customers, and despite the agreement during the industry roundtable meetings that existing customers would be excluded from the AML/CTF package. This concern arises because of the requirement to give a risk classification to all customers (including existing customers) and then to assess each such customer to determine whether, because of the risk factors, the "know your customer" information must be obtained. To be able to assign a risk classification it may be necessary to collect further information from the customer. This could be a time consuming and costly exercise. We would refer you to the ABA submission on this particular point for further elaboration.

Despite the reconsideration by government of the concerns raised above, we would submit our proposal that there be exclusions from any requirement whatsoever to carry out any form of verification of existing customers for some product types. These include:

- (c) friendly society products which are "closed" such that no new contributions will be accepted (ie. the society is simply continuing to manage this product for the existing customers until there is complete run-off); and
- (d) friendly society products which are closed to new customers but which may accept additional contributions from existing customers. Note that taxation rules applicable to such products limit any additional contributions to an amount equal to the previous year's contribution plus an additional 25% of that contribution.

These products cannot accept new customers and, we submit, should be allowed to run down without new legislative requirements of this type and magnitude impacting significantly on the costs of managing those products, costs which will ultimately be borne by the customer.

This is particularly an issue for the smaller societies that are closed to all new business as the cost implications of AML/CTF compliance will potentially have major ramifications on their continued existence.

2.6 Retirement village accommodation bonds

It is not clear to us if retirement village accommodation bonds might be caught up in the diverse categories of "designated services". We suspect that this would not have been the intention and that it should be made clear that such arrangements are not subject to the AML/CTF package.

2.7 Products where the recipient beneficiary may be changed

A number of friendly society products may be arranged in such a way that there is a separate policyholder (the owner of and contributor to the policy) and a separate beneficiary, the latter being open to change during the life of the policy. For example, an Education Savings Plan might involve a parent as a policyholder and the nominated beneficiary being a child of that parent. Under such policies, it may be possible that the nominated beneficiary may be changed by the policyholder to another child, or even a grandchild. In addition, depending on the age of the child, a policy benefit paid for the purposes of meeting school or university tuition costs may be regarded from a tax perspective as received by the policyholder (the parent) albeit paid for the benefit of the child, or received by the child, where he or she is over 18 years of age.

We note that the definition of the customer under section 6 of the Exposure Draft indicates that the "customer" can be both the policyholder (on the acceptance of the premium for a policy) as well as the "person" to whom a payment is made under the policy.

It is not as yet clear to us that all the repercussions of these definitions in these variable cases have been fully considered. We will be developing these considerations further over the next few weeks.

2.8 Elderly customers

Many friendly society clients are elderly members of the Australian population, particularly clients of funeral bonds/policies and reverse mortgages. We are concerned as to whether appropriate consideration has been given to the fact that many elderly people may find the identification processes confronting, not least because, due to their age, they may not hold a current passport nor driver's licence, nor any credit cards. We submit that careful thought be given to requirements in respect of identification of persons in such a position.

Finally, we highlight for your information that we are still assessing the implications of the AML/CTF package in respect of the full scope of friendly society financial products and services and whether there are other matters that may warrant particular comment. These will be raised more fully in our submission to the Attorney-General's Department and to AUSTRAC.

On behalf of members of AFSA, we appreciate this opportunity to participate in this inquiry. AFSA would be grateful for your consideration of the matters raised herein. We would also welcome the opportunity to discuss this submission further with you or to provide any additional information. Please do not hesitate to contact me on 03 9685 7543 or by email jane.southwell@afsa.com.au.

Yours sincerely



Jane Southwell
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