



Abacus
Australian Mutuals

Association of Building Societies and Credit Unions

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The Secretary
Criminal Law Branch
Attorney-General's Department
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General Manager
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Dear Sir/Madam

Revised exposure draft AML/CTF Bill and draft consolidated AML/CTF Rules

Abacus – Australian Mutuals welcomes the opportunity to contribute to the development of the revised *Anti-Money Laundering and Counter-Terrorism Financing Bill 2006 (AML/CTF Bill)* and the draft consolidated *AML/CTF Rules*. This response follows the earlier submissions made by our predecessor organisations and should also be read with the broader industry-wide submission endorsed by *Abacus* and submitted by the Australian Bankers' Association (ABA).

Abacus is the peak association for mutual building societies and credit unions and was formed in July 2006 in a merger between the Credit Union Industry Association (CUA) and the Australian Association of Permanent Building Societies (AAPBS). *Abacus* brings together 136 credit union and mutual building society Authorised Deposit-taking Institutions (ADIs). The mutual ADI sector is the sixth largest deposit-taking force in Australia, after the big four banks and St George. Mutual ADIs have \$50 billion in total assets and 4.5 million members.

Building societies and credit unions support proportionate and cost-effective measures to strengthen the fight against money launderers and terrorism-financiers. As regulated cash dealers under the *Financial Transactions Reports Act 1988 (FTRA)*, building societies and credit unions have been at the front line of this fight for many years. *Abacus* recognises Australia has international AML/CTF obligations. However, *Abacus* is concerned about high regulatory compliance costs and risks to the privacy of legitimate customers posed by these new regulatory proposals.

Abacus supports a regime that:

- is focused on actual money laundering and terrorism-financing risks in Australia;
- does not disrupt long-standing business models in Australia; and
- does not alienate our members.

Abacus notes the AML/CTF proposals are being made at a time when Government is taking steps to address regulatory red tape, reviewing the private sector provisions of the *Privacy Act 1988* and developing wider identity verification requirements under

Access card proposals for welfare and Medicare purposes. Balancing the principles and standards in each of these policy areas will shape the development, implementation and acceptance of the AML/CTF regime. Given the extremely long list of agencies who can access information provided to AUSTRAC by Reporting Entities (REs), and the nature of that information, *Abacus* calls for the AML/CTF Bill's Explanatory Memorandum to comprehensively address the importance of privacy and the risks to privacy in an AML/CTF regime.

Abacus continues to question the inconsistency of imposing demanding new requirements on industry to verify identity but refusing to provide industry with capacity to verify the authenticity of government-issued documents.

The 13 July 2006 revised exposure draft Bill and draft *AML/CTF Rules* package is an improvement on the December 2005 package. *Abacus* welcomes the Government's response to industry's calls for a more risk-based approach. *Abacus* offers comment on specific provisions in the Bill and *AML/CTF Rules* later in this submission. *Abacus* notes the draft *Rules* remain incomplete and draft guidelines have not been released.

Guidelines

To fight money launderers and terrorism-financiers, building societies and credit unions and other REs need a flexible legislative regime and information and practical, non-prescriptive/non-binding guidance about various aspects of that regime. This means guidelines about money laundering and terrorism-financing risks and proportionate responses to those risks.

The importance of providing and sharing information has been recognised by the UK's AML regulator:

"It is not our place to tell firms exactly what they should be doing to prevent money laundering; our task is to put in place a regulatory regime that incentivises and empowers firms to manage their own risks effectively and this requires certain key ingredients:

- *good quality intelligence from law enforcement and other sources such as FATF typologies; and*
- *data sharing with other firms, trade associations, government and the regulator.*

*From a consultation we have just undertaken, it is also apparent that we need to get the worked up typologies to the industry a lot faster to help inform their risk mitigation strategies. Issuing something in our own countries two years after the threat is first identified is of little preventive use in a fast moving environment, especially as the criminals may have moved to another country and are repeating the technique there."*¹

Draft *AML/CTF Rule* 6.3.4 says a RE's transaction monitoring program "*should have regard to complex, unusual large transactions and unusual patterns of transactions, which have no apparent economic or visible lawful purpose.*" *Abacus* sees a need for information and non-prescriptive/non-binding guidance (including about technology-neutral methodologies) about such transactions and patterns.

Among other areas, *Abacus* sees a need for guidance on how to take advantage of electronic verification under the ID verification safe-harbour proposal (including the capacity to use credit reference checks given the prohibitions in the *Privacy Act 1988*), record retention requirements and suspicious matter reporting.

¹ Speech by Philip Robinson, Financial Crime Sector Leader, FSA, Asia-Pacific Financial Crime Conference & Exhibition 2006, Singapore, July 27 2006

Abacus also looks forward to seeing guidelines from AUSTRAC about its expectations of REs. It is important that any and all guidelines are subject to industry consultation. Abacus welcomes the opportunity to participate in such a process and believes there is a constructive role for industry to play in the development and prioritisation of guidelines.

The challenge facing REs in responding to the risk of terrorism-financing in particular is illustrated by the *Report of the Official Account of the Bombings in London on 7 July 2005*². The House of Commons report found:

- the bombs were home-made from ingredients readily commercially available and not particularly expensive;
- no great expertise was required to assemble the bombs;
- the group was self financed;
- there was no evidence of external sources of income; and,
- the overall cost estimated 8000 pounds.

"The group appears to have raised the necessary cash by methods that would be extremely difficult to identify as related to terrorism or other serious criminality," the report said.

Transition arrangements

The transition period to full implementation of the new AML/CTF regime must reflect the significant new compliance obligations imposed.

REs need sufficient time to assess and determine their money laundering and terrorism-financing risks and then to put in place systems and controls appropriate to meet their AML/CTF obligations. In the meantime, the existing FTRA regime will continue to guard against money laundering and terrorism-financing activity.

Despite the technology neutral goals of the proposed regime there are substantial and unavoidable systems implications that require adequate time for design and development. In addition, adequate time will be needed to scope and develop new processes and staff training, and then rollout training and production of new documentation for internal and external use. The impact of these costs, particularly for smaller REs, will be far higher if big changes are rushed.

Accordingly, Abacus believes the complexity, expense and wide-reaching impact of these reforms warrant a 3-year transition period for the bulk of the regime as well as consideration of longer transitional arrangements for particular proposed changes, such as abolition of the current Acceptable Referee method of identity verification.

It will be important to time implementation periods from the release of the relevant rules or guidelines. For example, key policy statements detailing compliance obligations were released throughout the two-year transition period to full implementation of the *Financial Services Reform* (FSR) regime. Also, important aspects of the FSR regime were amended during the transition period as unintended policy outcomes were exposed.

Abacus supports consideration of staggered or phased implementation of parts of the new AML/CTF regime, subject to further industry consultation. For example, smaller ADIs should be permitted to build their systems and capabilities over time. This is particularly relevant where technology-based solutions are cost prohibitive and manual

² *Report of the Official Account of the Bombings in London on 7 July 2005* House of Commons, 11 May 2006

alternatives may not be feasible, for instance in relation to transaction monitoring or e-verification.

Costs

Minimising regulatory compliance costs is an important objective of the Federal Government and is a current policy priority. *Abacus* believes there is a high risk the compliance burden of the new AML/CTF regime will be a cumbersome addition to the heavy compliance obligations already carried by ADIs.

The cost impact is particularly important to credit unions and building societies due to their limited resources and the impact of fixed costs on smaller operators.

The key factor will be the approach of the powerful new regulator. The risk-based approach should enable REs to set in place an *AML/CTF Program* that is proportionate and sensible, if they are confident about meeting the expectations of AUSTRAC.

Abacus welcomes the obligation imposed on AUSTRAC under s.173 to consult with REs or representatives of REs and the potential for AUSTRAC's approach to be modified by policy principles set down by the Minister under s.174.

Authorised persons (s.34 – 34A; Chapter 5 AML/CTF Rules)

The draft Bill does not appear to allow a continuation of the Acceptable Referee identity verification method permitted under s.21 of the FTRA.

Abolishing the Acceptable Referee method will be disruptive to the business models of many ADIs, particularly credit unions, and is inconsistent with a risk-based approach to AML/CTF. Alternatives to the Acceptable Referee method are costly or simply not yet available in the marketplace.

Industrially-bonded credit unions, such as Railways Credit Union in Queensland and defence force, teachers and police credit unions, rely on the Acceptable Referee method because the dispersed nature of their membership does not allow for large branch networks. Traditional Credit Union, which serves Aborigines in remote communities in the Northern Territory, also relies on the Acceptable Referee method in the absence of alternative identity verification methods.

These REs have unique characteristics and a built-in 'know your customer' factor that means that use of the Acceptable Referee method is entirely consistent with vigilance against money laundering and terrorism-financing.

Abacus seeks reconsideration of the requirement in s.34 of the revised draft AML/CTF Bill for a RE to authorise another person "*by writing*" to carry out identification procedures on the RE's behalf. The requirement to authorise a particular person in advance rules out the Acceptable Referee alternative.

Consistent with risk-based approach, *Abacus* proposes allowing REs to authorise a class of persons to carry out identification procedures without the requirement to do so "*by writing*". These persons would by reason of profession, occupation or licensing, have sufficient skills and knowledge to carry out the identification procedures. (For further detail about this proposal see the CUIA's 13 April 2006 AML/CTF submission to the Attorney-General's Department and AUSTRAC.)

Draft *AML/CTF Rules* 5.2.1 to 5.2.5, impose requirements on '*the authorised person*' that could make the process unworkable. These requirements should apply to the RE rather than the authorised person.

The new AML/CTF regime will also need to provide for identify verification of children, recent arrivals to Australia, recipients of social security benefits, as currently dealt with in FTR Regulations 6 to 10B.

Reverification (s.27A – s.28A and s.32; Chapter 4 AML/CTF Rules)

There are separate tests that may arise to require a RE to re-identify its customers. For example, s.27A requires re-verification of a pre-commencement customer if a suspicious matter reporting obligation arises for that customer. Re-verification of an agent of a pre-commencement customer faces mirrored obligations in s.27B. Similarly, s.28A requires re-verification for low risk customers if a suspicious matter reporting obligation arises for that low risk customer. In both scenarios, pre-commencement and low risk customers, the RE is required to discontinue its provision of designated services or is prevented from beginning to provide a designated service.

The same prohibitions apply in s.32, which sets out the triggers for re-verification of the identity of customers generally; i.e. for customers that are post-commencement and are not recipients of low-risk designated services. However, the s.32 re-verification trigger appears to involve instances where the RE has reasonable grounds to doubt a customer is who they claim to be. Consequently, the s.32 trigger appears to be a narrower ground than the broader suspicious matter grounds in s.27A or s.28. Additionally, for general identification purposes, Chapter 4 of the *AML/CTF Rules* requires the RE to *take appropriate and reasonable steps to satisfy itself* as to the person's identity as well as other appropriate action commensurate with the money laundering or terrorism-financing risk the RE may face. This is a significantly different response to the action required in s.27A(2) or s.28A(2).

Apart from creating different triggers for re-verification, which adds to regulatory complexity and compliance costs, *Abacus* is concerned that for s.27A and s.28A re-verifications, a suspicious matter report may have nothing to do with the customer's identity and that a halt on providing services to these existing customers may be practically difficult to achieve – mortgage or credit card customers for example – and damaging to these potentially longstanding customer relationships. Such remedial actions may also expose the RE to an inadvertent tipping off offence.

Instead, *Abacus* supports a risk-based approach that leaves to the RE to determine the most suitable and practical action, which could involve cessation of a designated service, but this should not be mandated in the Bill. *Abacus* believes the risk-based approach set out in Chapter 4 of the *AML/CTF Rules* in relation to how a RE should respond to s.32 triggers is also an appropriate pathway for the RE in relation to s.27A and s.28A re-verification triggers. The Bill should be amended accordingly.

Suspicious matter reporting (s.39; Chapter 9 AML/CTF Rules)

Abacus is concerned that the 24-hour reporting timeframe applicable to the financing of terrorism and incidents of money laundering in s.39(2) and s.39(6) may in practice cover the bulk of all suspicious matter reporting. As the vast majority of suspicious matters will tend to relate to money laundering it appears these will need to be reported within the 24-hour timeframe once a reasonable suspicion has been formed by the RE. *Abacus* accepts terrorism-financing may justify an urgent reporting framework. However, the 24-hour requirement is a significant change from the existing money laundering suspect transaction reporting (SUSTR) obligations in s.16(1) of the FTRA, which requires reporting to occur *“as soon as practicable after forming that suspicion.”*

Abacus urges amendment to the Bill to ensure money laundering is removed from s.39(1)(g)(iv) and relocated within s.39(1)(f). This would give suspicious matter reporting for money laundering incidents the more sensible 3-day reporting period. Additionally, the Bill should put beyond doubt that these various timeframes only begin once the RE has the reasonable suspicion and not when the suspicion was first observed.

Under the FSR regime, licensees have 5 business days to report a breach after becoming aware of the breach. ASIC's guidelines say:

*"We will administer this requirement as meaning that you become aware of a breach or likely breach when a person responsible for compliance becomes aware of the breach. We expect your internal systems to make the relevant people aware of breaches in a timely and efficient manner."*³

A risk with a tight reporting requirement is the possibility that REs will expedite their internal investigations thus allowing incomplete or defensive suspicious matter reports to be made to AUSTRAC. These timing concerns may be exacerbated – in terms of being able to receive and assess relevant information and make the prescribed report to AUSTRAC – where a RE relies on a person authorised per s.34.

Further, it should be clear that the reporting timeframe should only commence once the RE receives a report from its third party provider.

Draft *AML/CTF Rule 9.2.2* specifies that a suspicious matter report "*must contain*" the full name of the customer and the customer's address. These details may not be known due to the circumstances of the suspicious matter so the *AML/CTF Rule* should include the words "*if known*" as the end of 9.2.2 (a) and (b).

Abacus also looks forward to the inclusion in Chapter 9 of the *AML/CTF Rules* of matters to be taken into account when determining whether a RE (or s.34 authorised person) has reasonable grounds to form a suspicion, which is indicated in s.39(10). Together with guidelines, this type of information should assist REs to understand their suspicious matter reporting obligations.

Records retention (s.84 – 91)

Recording when a RE commences to provide a designated service has been added into the new s.84. However, it is unclear what this provision might involve. Will the issuing of a terms and conditions disclosure document be sufficient? *Abacus* looks forward to guidelines to provide clarity in relation to these situations.

Abacus is disappointed that the record retention period prescribed in s.85 and s.86 (among other provisions in Part 10 of the revised Bill) is for a 7-year period rather than the 5-year FATF standard. *Abacus* believes the shorter period is a suitable balance considering the additional information that REs must collect and store for regulatory purposes. *Abacus* also seeks clarification within the Bill to make it clear that record retention can be achieved by electronic means. Electronic storage may present an upfront cost to REs but over time represents savings and efficiency.

Additionally, the new s.86AA and s.86AB require a transferee ADI (the recipient of a customer account) to retain relevant documents about that account for 7-years from the transfer date. *Abacus* is concerned this arbitrary requirement ignores the time the relevant documents have already been retained and could, in some circumstances,

³ Breach reporting by AFS licensees – An ASIC Guide. May 2006.

result in unnecessarily extending the period for which certain documents must be maintained.

Tipping off (s.95)

Disclosure of certain information is permissible under s.95(5) where it is provided to a legal practitioner for the purpose of obtaining legal advice. *Abacus* believes the complex and dynamic nature of money laundering and terrorism-financing means that this relief should be extended to other professionals such as forensic accountants or AML/CTF specialists. Additionally, s.95(7) provides relief where disclosure relates to a suspicion within a group but it does not appear to cover disclosure about an actual report made to AUSTRAC. Nor does it permit disclosure as between s.34 authorised persons. Accordingly, s.95(7) should include sharing of reporting information between these parties.

Offences

Abacus is concerned the construction of s.110 makes it an offence for an RE to provide a designated service if the customer uses a false name without any regard to the intent of the RE. *Abacus* urges amendment to this provision to allow for unintentional provision and successful frauds.

Protections from liability

The general protection in the new s.195A is limited to acts *done, omitted to be done, in good faith* but does not appear to cover acts done in compliance with the law, such as privacy obligations or anti-discrimination laws or compliance with State or Territory laws. *Abacus* welcomes the inclusion of a good faith defence, but believes it should be extended to capture act done in compliance with other laws. *Abacus* also welcomes the s.195B *reasonable precautions and exercising due diligence* defence. Although in practice this may be too restrictive and may be improved by including acts undertaken under a mistaken belief, without negligence and in good faith.

Compliance reports

The requirement for *AML/CTF compliance reports* set out in s.43 will add to the already large number of reports building societies and credit unions provide to regulators but it will not necessarily mitigate money laundering and terrorism-financing. Given that AUSTRAC is empowered to audit and review an RE's *AML/CTF Program*, *Abacus* recommends the requirement be removed. Additionally, the requirement in s.73 that REs comply with their *AML/CTF Program* and the independent review in *AML/CTF Rule 8.7* further suggest that the s.43 compliance reports are unnecessary.

Designated services (s.6)

The revised draft Bill now refers to *designated business groups* where it will be permissible to share identification information without triggering a tipping off offence as well as subscribing to a single joint-*AML/CTF Program*. There is currently no Rule covering the use of the *designated business groups* concept and it is therefore unclear what impact it may have (such as in relation to the board oversight or AML Officer roles) or in what scenarios it may be applicable. *Abacus* seeks clarity about how entities that may not be part of a group but remain commercially connected can benefit from this definition.

Definitions (s.5)

ADI

The initial draft Bill had a non-specific definition of *financial institution* but the revised draft has a conclusive definition that lists *ADI, bank, building society* and *credit union* separately. Additionally, as with the initial draft, *building society* is separately defined

but neither *credit union* nor *bank* is individually defined. *Abacus* believes that a reference to an *ADI* – as defined in the *Banking Act 1959* – would capture building societies, credit unions and banks as one. All banks, building societies and credit unions are ADIs and an entity can't call itself a bank, building society or credit union unless it is an ADI. It is unclear to us why they have been differentially identified in the current draft, particularly as they all face the same obligations as *Reporting Entities (RE)* under the *AML/CTF Bill and Rules*. The same approach should be adopted to definitions under *designated services*. Including ADI is sufficient and there is no need to list 'bank', 'building society' and 'credit union'.

Correspondent banking

The definition of *Correspondent banking relationship* is unhelpful. Section 81(a)(i) is of particular concern as it suggests that the correspondent banking provisions would apply to domestic relationships between two Australian-based financial institutions even where there are no cross-border transactions. The Bill should make clear that correspondent banking relationships are international in nature. The requirement to apply initial and ongoing due diligence should not apply to a domestic relationship between two Australia-based ADIs. There is also a need for clarity in terms of how correspondent banking relationships and the agent provisions interact.

Deposit-taking

Deposit-taking activities by non-ADIs appear to be unregulated by the draft Bill. Deposit-taking as a designated service appears to apply only to an ADI or a person specified in the *AML/CTF Rules*. If non-ADI deposit taking, for example by church development funds, is not covered by the AML/CTF regime such deposit taking is likely to be targeted by money launderers.

Politically Exposed Persons

The definition of a *Politically Exposed Person (PEP)* has been removed from the original draft Bill and there is no defining reference to a PEP in the draft consolidated *AML/CTF Rules*, although the risk posed by PEPs must be considered under draft *AML/CTF Rule 1.2.2 (a)*. *Abacus* believes PEPs should be specifically defined. That definition, whether located in the Bill or Rules, should restrict PEPs to foreign citizens only. FATF says PEPs are:

"individuals who are or have been entrusted with prominent public functions in a foreign country, for example Heads of State or of government, senior politicians, senior government, judicial or military officials, senior executives of state owned corporations, important political party officials. Business relationships with family members or close associates of PEPs involve reputational risks similar to those with PEPs themselves. The definition is not intended to cover middle ranking or more junior individuals in the foregoing categories."

Additionally, Government should include in the definition – or otherwise provide – access to a list of individuals or types of individuals it considers to be PEPs. The use of commercial lists of PEPs will be prohibitively expensive for smaller ADIs. The concept of PEPs issuing a self-declaration was canvassed in earlier consultations but is not reflected in the revised draft Bill or Rules.

Public awareness campaign

Abacus takes this opportunity to again emphasise the importance of an effective and timely public education campaign about the new AML/CTF regime. Despite a willingness to support vigilance against terrorist-financiers, many consumers may balk at the personal intrusion caused by the identification and monitoring requirements.

Abacus seeks to participate in consultation on designing the campaign. We see a need to prepare consumers for the impact of these new laws on their day-to-day lives, focusing on the legal obligations on REs to gather 'know your customer' information and to undertake customer due diligence including transaction monitoring.

The campaign should aim to ensure that REs are not subjected to a consumer backlash simply for meeting their regulatory responsibilities. *Abacus* believes it should be well understood by consumers that the obligation to pry into a person's background and activities is not commercially-driven but is a direct consequence of the Government's AML/CTF regime. Adequate resources will need to be allocated to the campaign as well as significant engagement of the regulated community in developing and distributing appropriate messages.

Thank you for the opportunity to comment on this important policy matter. For more information on *Abacus* or any issues raised in this submission, please contact me on (02) 6232 6666 or at llawler@abacus.org.au or Josh Moyes on (02) 8299 9033 or at jmoyes@abacus.org.au.

Yours sincerely,



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