



Credit Union
Industry Association

13 April 2006

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Dear Sir/Madam

AML/CTF Exposure Draft Bill, Rules and Guidelines

Credit Union Industry Association (CUIA) welcomes the opportunity to comment on the *Exposure Draft of the Anti-Money Laundering (AML) and Counter Terrorism Financing (CTF) Bill 2005* (the *exposure draft*) and available *Draft Rules* and *guidelines*. Our formal submission is attached.

CUIA (formally CUSCAL Industry Association) is the major industry body for credit unions. Collectively, Australia's 151 credit unions have over 3.6 million members and \$34.8 billion in assets. This makes credit unions the 7th largest deposit-taking force in the Australian market.

We look forward to seeing the May 2006 redrafted version of the proposed AML/CTF Bill and Rules package. In the interim, this submission highlights our high-level thoughts and concerns in response to the December 2005 AML/CTF package. Our submission should also be read with the broader industry-wide submission submitted by the Australian Bankers' Association (ABA), which we've contributed to and endorse.

Thank you for the opportunity to comment on this important policy matter. For more information on CUIA views or any issues raised in this submission, please contact Josh Moyes on (02) 8299 9033 or at jmoyes@cuscal.com.au or Luke Lawler on (02) 6232 6666 or at llawler@cuscal.com.au.

Yours sincerely

LOUISE PETSCHLER
Head of Public Affairs



Credit Union
Industry Association

13 April 2006

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Dear Ms Atkins

AML/CTF Exposure Draft Bill, Rules and Guidelines

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Credit Union Industry Association (CUIA)

*Submission on the Anti-Money Laundering
and Counter-Terrorism Financing (AML/CTF)
Exposure Draft Bill and Draft Rules*

13 April 2006



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1. Summary

Credit Union Industry Association (CUIA) welcomes the opportunity to comment on the *Exposure Draft of the Anti-Money Laundering (AML) and Counter Terrorism Financing (CTF) Bill 2005* (the *exposure draft*) and available *Draft Rules and guidelines*.

CUIA (formally CUSCAL Industry Association) is the major industry body for credit unions. Collectively, Australia's 151 credit unions have over 3.6 million members and \$34.8 billion in assets. This makes credit unions the 7th largest deposit-taking force in the Australian market.

Credit unions endorse the creation and maintenance of a world-class and robust AML and CTF regime that deters and detects illicit activity and strengthens the Australian financial system. Credit unions have always been supportive of AML laws and efforts to improve and widen the coverage of AML (and CTF) obligations, without unnecessarily invading the privacy of the vast majority of consumers who are not money launderers or terrorist financiers. CUIA argues, however, that AML/CTF goals need to be balanced against proportionate, sensible and reasonable compliance obligations for all Reporting Entities.

CUIA is looking forward to seeing the redrafted version of the proposed AML/CTF Bill and Rules package, scheduled for release in late May 2006¹. In the interim, this submission highlights CUIA's high-level thoughts and concerns in response to the December 2005 AML/CTF package. It should also be read with the broader industry-wide submission submitted by the Australian Bankers' Association (ABA), to which CUIA has contributed and endorses.

As mutual organisations, credit union members are both customers and owners. Credit unions are run for the benefit of their members, with each member entitled to a single vote providing an equal say in governance arrangements.

Credit unions are regulated by AUSTRAC as *cash dealers* and will be *Reporting Entities* under the expanded AML/CTF regime. Credit unions are also regulated by ASIC as Australian Financial Services (AFS) licensees, supervised by APRA as Authorised Deposit-taking Institutions (ADIs) and subject to the *Uniform Consumer Credit Code* (UCCC) as well as being subject to privacy, trade practices, taxation and other laws.

CUIA queries whether the right balance has been achieved in the proposals revealed to date. In particular, CUIA has the following concerns:

- the primary AML/CTF package released for widespread consultation in December 2005 was incomplete, making assessing its impact and costs very difficult;
- the absence of appropriate, proportionate and technology-neutral methods to meet new customer identification and verification, risk profiling and classification and transaction monitoring obligations;
- the need for thorough cost assessment of these proposals;

¹ See Senator the Hon. Chris Ellison's additional consultation phase outlined at the ABA's 2006 AML Forum on 7 April 2006.

- the need for a comprehensive public awareness and education campaign about the *'know your customer'* obligations of Reporting Entities;
- the need for appropriate commencement and transitional arrangements, including staggered commencement where appropriate; and
- the need for regulated entities to have access to official information and non-prescriptive guidance about money laundering and terrorism financing risks and proportionate responses to those risks.

Credit unions are concerned that extra compliance costs and burdens in response to these proposals could add pressure within the sector to consolidate². This would have a negative impact on competition and choice in the retail banking and financial services market – together with the community cost of losing credit unions that often service rural and regional areas – and should be considered in this policy process.

More importantly, expensive and highly complex compliance procedures may not add materially to efforts to improve the prevention of money laundering of terrorism financing, especially if applied at a broad level without sensitivity to the relationship base and know your customer strengths of different regulated sectors.

CUIA has raised these and other matters throughout the consultation process. This has included submissions to earlier policy documents from the Attorney General's Department, participation in the Ministerial Advisory Group and Technical and Systems Working Groups, and participation in the Ministerial Roundtables during 2005 through to representation on the Minister's current *AML/CTF Advisory Group*. Additionally, CUIA made submissions and gave evidence to the *Senate Legal and Constitutional Committee's* recent examination of the December AML/CTF package.

CUIA acknowledges that many of these matters remain the subject of ongoing discussion and debate with Government. CUIA appreciates and strongly endorses the consultative process by the Minister for Justice, Senator the Hon. Chris Ellison, and will continue to contribute to these constructive processes.

2. AML/CTF Package

Understandably, given the Government's focus on consultation, the reform package and proposals remain incomplete. This makes providing feedback complex. In particular, the delayed and staggered release of the AML/CTF Rules, which are designed to underpin the principles-based Act by containing the substantive details of the proposed regulatory obligations, has made determining the direct impact and likely implementation costs of these reforms on credit unions difficult. CUIA will provide detailed feedback in response to the revised package and as further rules are released in terms of the direct impact on credit unions.

Clearly these reforms represent significant change for many Reporting Entities and their customers. CUIA is concerned the rigidity in terms of the current consultation

² Credit unions have experienced considerable consolidation over the past decade; this is despite strongly growing total assets and member numbers. Whilst this consolidation is partly explained by industry evolution and a competitive market, a significant reason for consolidation in the sector is the steadily increasing regulatory compliance burden placed on credit unions, which are less able to absorb the fixed costs associated with regulatory compliance. Since 1990 credit union numbers have dropped from around 400 to 151 in 2006.

deadlines, notwithstanding the insertion of the extra consultation period in May, could result in a reform package that fails to deliver the Government's policy objectives, including a sensible constraint on compliance costs and effective improvements to Australia's AML/CTF capacity.

Given the importance of these reforms, CUIA believes that before these AML/CTF measures can be put to Parliament, sufficient time must be provided to stakeholders to enable them to make informed comment on the complete package.

Additionally, as the lessening of regulatory costs is an important objective of the Government and the subject of current Commonwealth³ and State-based red-tape reviews, CUIA urges close attention to the likely compliance burdens caused by the AML/CTF package to ensure the final regime facilitates effective and efficient compliance by credit unions and other Reporting Entities.

(a) Risk-based versus prescriptive approach

In principle, CUIA agrees with the proposed risk-based approach as settled at the Ministerial Roundtables during 2005. The trade off with the risk-based approach is uncertainty about exactly what the risks are and what the expectations – and supervisory approach – of the regulator might be in terms of regulatory compliance.

While acknowledging the challenge inherent in his process, CUIA emphasises the importance of AUSTRAC providing effective guidance to industry to support an effective compliance response. Credit unions need official information and non-prescriptive/non-binding guidance about money laundering risks, and particularly terrorism financing risks, to effectively meet the Government's AML/CTF and other policy objectives, such as protecting the right to privacy and minimising the regulatory compliance burden.

Additionally, for the AML/CTF regime to be reasonable and proportionate to these risks and acceptable to the vast majority of customers who are not money launderers or terrorism financiers, credit unions also need non-prescriptive/non-binding guidance about how Reporting Entities should (as good practice) respond to these risks. Credit unions will also look to the regulator, as well as the AML/CTF Bill, for an explanation of the legal basis on which Reporting Entities should decide money laundering or terror financing is taking place and under which circumstances Reporting Entities should close or hold accounts or abandon existing customer relationships.

Without appropriate flexibility – a core feature of any risk-based scheme that is adaptable to the individual institution's nature, size and characteristics – the proposed reforms have the potential to require all Reporting Entities to seek costly new technology solutions that may not significantly improve AML/CTF outcomes.

(b) AML/CTF Program

The *AML/CTF Program* requires each Reporting Entity to have *“appropriate risk-based systems and controls that are designed to effectively identify and materially*

³ See the Prime Minister's and Treasurer's *Taskforce on Reducing the Regulatory Burdens on Business* and its report *'Rethinking regulation'* (January 2006)

mitigate the risk” in respect of possible money laundering or terrorist financing. CUIA is concerned that the term “*materially mitigate*” remains unclear.

For example, the current drafting appears to set a higher standard than for an AFS licensee, which must maintain “*compliance measures, processes and procedures that ensure, as far as reasonably practicable, that the licensee complies with the financial services laws*”⁴. This issue is explored in further detail in the industry submission submitted by the ABA.

(c) Definitions and Scope

CUIA urges consistency in the use and definition of terms within the *exposure draft* where there is corresponding use in existing legislation. For example the definition of the term “officer” should reference the *Corporations Act 2001*.

Additionally, among others, CUIA would prefer further clarity in terms of the following definitions contained in s.5 of the *exposure draft*:

- ‘*account*’ includes a loan account but does not reference a deposit account, this is a variation from the existing FTRA definition;
- ‘*allowing a transaction*’ is key to triggering liability but it is not adequately defined;
- ‘*building society*’ is separately defined but ‘*credit union*’ is not;
- ‘*e-currency*’ is defined by reference to precious metals, bullion or a thing defined in the AML/CTF Rules but is not backed by cash. *ASIC Policy Statement 185*⁵ on non-cash payment systems notes that these types of facilities are an evolving area; and
- ‘*PEP*’ needs more definition; CUIA believes Government should lead this dialogue.

(d) Overseas experience

CUIA believes much can be learnt from international experience. In some overseas jurisdictions, such as the USA, AML/CTF laws have resulted in a huge increase in suspicious activity reports and an associated invasion of customer privacy. Most of these reports are of no use to law enforcement agencies and result from regulated entities engaging in ‘defensive filing’ to avoid regulatory scrutiny. It has been observed, particularly in relation to the CTF task, that law enforcement agencies that are already looking for a needle in a haystack have built a bigger haystack.

In the UK, revamped industry guidelines on AML/CTF were recently released. The UK *Joint Money Laundering Steering Group* (JMLSG) has said this new guidance will enable their financial industry to take a sharper more risk-based approach to financial crime. According to the JMLSG chairman, Mr Ian Mullen, the new guidance reflects the reality that most customers are neither money launderers nor terrorists:

“The guidance allows firms to counter money laundering and terrorist financing in a more proportionate, risk-based way, making better use of modern technology.”

⁴ *Pro Forma 209 Australian Financial Services Licence conditions [PF 209]*, Condition 4

⁵ [http://www.asic.gov.au/asic/pdf/lib.nsf/LookupByFileName/ps185.pdf/\\$file/ps185.pdf](http://www.asic.gov.au/asic/pdf/lib.nsf/LookupByFileName/ps185.pdf/$file/ps185.pdf)

CUIA urges consideration of these experiences in like-jurisdictions in terms of settling Australia's approach to AML and CTF and the design of regulatory responses that balance this important objective against increasing costs for Reporting Entities and other affected stakeholders.

3. ID and Verification, Profiling and Monitoring

(a) Identification and verification

One of the core obligations under the new AML/CTF regime will be for Reporting Entities to verify that a customer is the person that he or she claims to be. Identification documents issued by governments are the key means for verifying identity. For example, passports and driving licenses will be the easiest to verify from a counterfeit/fraud perspective especially with the possibility of using UV equipment to confirm authenticity. However, such documents can be faked and industry is unable to obtain a simple 'yes' or 'no' answer from issuers about a document's authenticity.

Accordingly, CUIA seeks a consistent approach to the primacy of this obligation by:

- giving the private sector the capacity to verify the authenticity of government-issued documents in a simple and efficient process; and
- allowing the use of a wider range of databases, such as credit files, to be used for identity verification.

Refusing this capacity to the financial sector makes little sense when compared to the wholesale enlistment of the sector in the AML/CTF battle as proposed in the *exposure draft*. Relevantly, government agencies are already using online and real-time systems to verify proof of identity documents.

Improving industry's capacity to verify identity will not only reduce money-laundering and terrorism financing but will be beneficial and convenient for consumers because it will promote competition and choice by facilitating account opening procedures for all Reporting Entities. Smaller institutions, such as credit unions, do not have national branch networks to facilitate face-to-face identity verification; therefore, continued cost-effective and practical alternative verification methods are critical in ensuring the reforms are not inherently anti-competitive.

For credit unions with national membership and limited branch structures (as one example, our defence force credit unions) practical alternative verification methods are vital in ensuring their ability to continue to deliver services and access to members.

The future of the Acceptable Referee method of identifying customers, as found in s.21 of the *Financial Transaction Reports ACT 1988* (FTRA), is also an important factor in maintaining the competitive neutrality of the new AML/CTF regime. One medium size credit union relies heavily on the Acceptable Referee method because it has a widely dispersed membership (spread across different geographic locations) but only one member service centre. Abolishing (without replacing) practical identification like the Acceptable Referee method would have a significant impact on

Reporting Entities in similar circumstances and a particularly harsh impact on credit unions.

Currently, defined categories of Acceptable Referees can carry out identification services without being authorised. But the *exposure draft* only allows for customer identification procedures to be carried out by another person who is authorised 'by writing'.

The 1 September 2005 AML Industry Roundtable, chaired by the Justice Minister, reached the following position on what might apply in future:

"Third party verification would encompass a broad range of regulated entities and agency arrangements. Transition arrangements will allow industry time to develop alternative arrangements to the use of acceptable referees."

We propose two alternatives:

- modify and strengthen the existing Acceptable Referee method and maintain its availability to Reporting Entities until electronic identity verification is broadly available and affordable; and/or
- allow Reporting Entities to authorise a class of accredited third party identifiers, based on a narrower version of the current Acceptable Referee list (and the more robust procedures described in the Appendix to this submission), without a requirement to pre-authorise individual third party identifiers.

These proposals are consistent with a risk-based approach and with FATF Recommendation 9, which requires that where reliance on a third party is permitted, *"the ultimate responsibility for customer identification and verification remains with the financial institution relying on the third party."*

Identity verification is only one AML/CTF tool. Element (d) of FATF Recommendation 5 on customer due diligence also requires:

"ongoing due diligence on the business relationship and scrutiny of transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with the institution's knowledge of the customer, their business and risk profile, including, where necessary, the source of funds."

[Note: see Appendix for further information about a stronger Acceptable Referee method.]

(b) Risk profiling and classifying

CUIA is concerned about the adequacy of information available for Reporting Entities to identify money laundering and terrorism financing risks and to determine appropriate responses to those risks. While FTRA experience and some familiarity with money laundering typologies provides a start, exposure to terrorism financing as a body of experience remains in its infancy.

Another challenge for Reporting Entities is that customers – as well as their activities and transactions – are to be risk assessed continuously, which means that support, in the form of non-prescriptive/non-binding guidance, provided by AUSTRAC will be fundamental to establishing and maintaining this process.

Further, the lack of clarity about what triggers might prompt a change in a customer's risk classification presents additional challenges. This seems to be an inherently subjective (and potentially unfair) process, which may be a recipe for customer backlash due to highly inconsistent performance across the regulated community.

CUIA is also concerned that the current reform package leaves the following questions unanswered:

- as existing customers do not have a risk classification does this effectively mean they will need to be re-identified at the point where an initial classification is applied or when there is a change to that initial classification?
- when seeking additional *Know Your Customer* (KYC) information due to a customer's risk profile, will Reporting Entities be expected to disclose that profile in response to requests from customers about their risk weighting or expected pattern of behaviour? and
- what protection will there be for Reporting Entities and their staff in terms of legal action by customers who object to their risk classification?

The most recent version of the *Draft Rule* on customer identification requires a regulated entity to determine not only a risk classification at this threshold point in the customer relationship but also make an assessment about a customer's expected pattern of behaviour. The requirement to make such an assessment at that early stage appears to raise practical difficulties and is inconsistent with the risk-based approach.

(c) Transaction Monitoring

While credit unions agree transaction monitoring is an integral feature of the new AML/CTF regime, CUIA remains concerned this obligation implies a heavy reliance on costly new technology, which in itself may not bring significant improvement to AML/CTF outcomes. Without alternatives, this will apply a substantial cost in terms of systems upgrades, staff training requirements and process implications.

A possible model, to get an idea of the implications of this requirement, would be for a transaction monitoring requirement to involve the development of an electronic system that can, among other things, identify and match:

- smurfing practices (regular transactions structured to avoid reporting thresholds);
- accounts operating outside the estimated account turnover or expected activity;
- deposits made to various branches on the same day; and
- cash transactions and IFTIs over a set threshold.

In response to the above triggers, an electronic suspicious matter report would then be generated for internal review and investigation and then, if the requisite suspicion is founded, then reported externally to AUSTRAC.

In addition to this systems development, such an approach will involve substantial frontline staff training, including in relation to manual raising of suspicious matter reports to operate concurrently with this elaborate electronic system.

Credit unions are not in a position to determine cost implications for the design, build and implementation of such a system. Further, the degree of monitoring, where individual monitoring is more intensive than generic or class based-assessments, will also impact on these costs.

CUIA is also concerned the current reform package leaves the following questions unanswered:

- how should a Reporting Entity determine appropriate monitoring for certain customers – what differential applies as between low and medium risk for example?
- how does a Reporting Entity identify '*unusual*' behaviour – will guidance be provided with typologies in terms of money laundering and terrorism financing matters? and
- will Reporting Entities need to query each '*unusual*' transaction (which could relate to house sale, redundancy, inheritance, relationship separation etc) and, if so, how can this be done without triggering a tipping off offence or breaching privacy obligations?

Additionally, sufficient time will be needed to prepare for and implement these systems-based responses.

One core banking system (CBS) provider to a substantial group of credit unions informally estimates that a 'basic' transaction monitoring system could cost between \$500,000 and \$1 million and a highly sophisticated transaction monitoring system could cost the CBS supplier \$5 million.

Further, there would be significant licensing and administration costs for the supplier that would be passed on to credit unions. These costs would be borne proportionately by the large, medium and small credit union CBS users. Credit unions would also have their own staff training and other costs associated with new transaction monitoring obligations.

Ultimately, while CUIA appreciates that AUSTRAC has agreed to explore technology-neutral methodologies in AML/CTF Rules or Guidelines, which should offer clarity, these are yet to be released. CUIA also looks to AUSTRAC for official non-prescriptive/non-binding guidance about what constitutes an irregular event and the level of response expected under the regime to assist in complying with the new obligations.

4. Know Your Customer (KYC)

The proposed AML/CTF regime has significant implications for the privacy of all Australians. CUIA acknowledges the view that people today may be more likely to be tolerant of intrusions into their privacy due to concerns about terrorism. However, the proposed AML/CTF regime will authorise the collection and retention by private businesses⁶ of vast new amounts of personal information to be shared with a wide range of Federal, State and Territory Government agencies.

⁶ Many of these regulated entities have not been subject to the *Financial Transactions Reports Act 1988* and may not be subject to the *Privacy Act 1988*

A small credit union has observed that in relation to standard deposit taking accounts it may be difficult to collect certain personal details such as business activities, purpose of account, assets and liabilities and financial position. It may be less difficult when assessing a credit application. Classes of customers posing identification verification challenges include recent arrivals to Australia, school students and recent school leavers and any other customer whose access or exposure to reliable identification documents is limited.

Clearly, an effective AML/CTF regime will, in establishing strong AML/CTF measures, also seek to avoid acting as a further exclusionary mechanism for consumers in such circumstances.

Credit unions are conscious of the rationale behind more pervasive customer information collection and retention, but are equally aware of the potential risk to customer relationships where these measures could at best intimidate existing customers or at worst scare off potential new and legitimate customers.

(a) Minimum KYC information

Credit unions accept the need for Reporting Entities to collect minimum *Know Your Customer* (KYC) information in the form of name, address and date of birth. CUIA appreciates the shift in policy from the initial Draft Rule on identification that also listed *'place of birth'*, *'country of citizenship'* and *'country of residence'* as required minimum information.

(b) Additional KYC information

The *'additional KYC information'* set out in Draft Rules, currently includes:

- the customer's place of birth;
- the customer's occupation, business activities or functions;
- the nature of the customer's business with the Reporting Entity – including where appropriate:
 - the purpose of specific transactions; or
 - the expected nature and level of transaction behaviour;
- the income or assets available to the customer;
- the customer's source of funds, and where appropriate, origin of funds; and
- the customer's financial position.

Whether any or all of this additional KYC information must be collected is a matter for the Reporting Entity's *AML/CTF Program* and the risk classification assigned to the customer. However, a Reporting Entity's decision to pursue information about a customer's *'financial position'* or *'income and assets'*, for example, will be entirely subjective and highly variable across the financial services sector.

CUIA accepts that a degree of subjectivity and variability in outcomes for customers is unavoidably an outcome of the risk-based, rather than prescriptive, approach. However, it is CUIA's strong view that the risk-based approach will only work effectively if there is sufficient official information and non-prescriptive/non-binding guidance available to enable Reporting Entities to confidently and proportionately tailor their responses to the particular risks they face.

In the absence of such information and guidance, compliance costs will be too high (and privacy impacts on customers too severe) for Reporting Entities that over-estimate their risks and too low for those who under-estimate their risks. In this context *'risks'* include the likelihood of regulatory action for inadequate compliance, as well as the risk of money laundering and terrorism financing occurring. Ultimately, customers will bear the burden of high regulatory and privacy costs without, necessarily, a corresponding or proportionate impact on money laundering or terrorism financing.

Take the example of collecting *'place of birth'* as additional KYC. This could be collecting information about race or ethnic origin. Such information is *'sensitive information'* under the *Privacy Act 1988* and its collection and retention has cost implications. According to the Office of the Privacy Commissioner, the sensitivity of personal information being stored is an important factor and higher levels of security could be expected for sensitive information.⁷

5. Suspicious Matter Reporting

The requirement to report suspicious matters appears to operate with a reverse onus, that is, as a medium size credit union has observed, where there is insufficient evidence to prove money laundering or terrorism financing is not taking place then a suspicious matter report is required. However, rarely will such evidence (such as the source of funds) be presented or made available, at least in the initial stages of the relationship unless the customer is aware of the Reporting Entity's AML/CTF requirements. Additionally, where customers are remote, Reporting Entities cannot eyeball the customer and must rely on systems and alerts in terms of unusual transactions.

CUIA agrees that suspicious matter reporting can only be effective so long as customers are not tipped off and there is no inference that an AML/CTF or other suspicion has been formed on the part of the Reporting Entity. However, asking customers for additional information in response to an emerging suspicion is fraught in terms of seeking to attain the necessary investigative information vis-à-vis inadvertently alerting the customer (and potentially the money launderer or terrorism financier) to the suspicion.

Clearly, information and guidance from AUSTRAC on what constitutes a reasonable suspicion in the circumstances is needed, along with information and guidance about the appropriate and proportionate response expected of Reporting Entities.

6. Employee and Third Party Due Diligence

The draft *AML/CTF Program Rule* require an employee due diligence program that covers employee screening, fit and proper tests, and disciplinary measures. These obligations would be an additional layer on top of obligations on AFS Licensees to have adequately trained and competent representatives and responsible officers and on ADIs to assess, and annually reassess, the fitness and propriety of responsible persons under APS 520.

⁷ *Information Sheet 6 – 2001 Security and Personal Information* Office of the Privacy Commissioner, Dec 2001.

The proposed third party due diligence program *'must apply'* whenever a third party is providing services which *'have a connection'* with a designated service provided by the Reporting Entity. Further, the Reporting Entity is obliged to ensure the third party receives AML/CTF risk awareness training as if the third party were an employee of the Reporting Entity.

CUIA notes the Government's current policy priority is to minimise regulatory duplication and overlap.⁸ Yet, these due diligence requirements are onerous, overly prescriptive and inconsistent with the risk-based approach.

7. Compliance Burdens and Costs

For credit unions, as small ADIs in the retail banking market, compliance costs can have a direct impact on their operations. Like other heavily regulated ADIs, credit unions will have new obligations to undertake customer profiling, monitoring, ongoing due diligence, staff training and due diligence, third party due diligence, reporting and record-keeping.

However, without further guidance an accurate estimate as to costs is difficult to quantify. Nevertheless, it is clear that credit unions face significant new compliance costs due to AML/CTF reform.

Consumer-focused ADIs competing in the domestic deposit-taking, lending and payments product markets are likely to face a broadly similar range of risks that are of a different order of magnitude to the money laundering and terrorism financing risks faced by global banks.

CUIA seeks the provision of information and non-prescriptive/non-binding guidance by the regulator to the small ADI sector about their money laundering and terrorism financing risks and proportionate responses. Consistency in the application of scarce resources to risks is the desired outcome. For example, it is impossible to estimate the cost to credit unions of the proposed mandatory requirement to carry out transaction monitoring without further consultation on the regulator's expectations about the intensity of such monitoring by reference to the type of risks faced by these Reporting Entities.

Regulated entities should not be left in an information vacuum trying to guess the regulator's expectations. Further, at this stage, industry has no indication about AUSTRAC's likely supervisory approach. Draft guidelines released so far do not add significantly to the Rules in terms of information and guidance available to Reporting Entities.

8. Public Awareness and Education

CUIA calls on the Government and AUSTRAC to undertake a broad community education campaign about this new regime prior to its commencement. This awareness campaign should be designed to inform consumers about these new laws and how they will impact on their banking and financial services activity, as well as their property purchases, accounting or legal work and betting activities and other aspects of daily life.

⁸ *Rethinking Regulation: Australian Government's Interim Response 7 April 2006*

It should be clear to customers 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. Additionally, adequate resources will need to be allocated to this campaign as well as significant engagement of the regulated community in developing and distributing this message.

CUIA is concerned that, considering its current role, AUSTRAC may face challenges in developing an effective campaign. A well-funded and clear campaign is essential to credit unions, and other Reporting Entities, to manage what may be significant community concerns about the new AML/CTF laws.

9. Commencement and Transition

CUIA calls for a sensible implementation period that provides Reporting Entities with sufficient time to assess their new AML/CTF obligations, to undertake the necessary preparatory analysis leading to systems purchases or build, staff training and development, planning and delivery of new process and procedures.

In the meantime, the existing FTRA regime will continue to guard against money laundering and terrorism financing risks.

CUIA is open to the idea of a staggered or phased implementation subject to further consultation. However, with reference to the complexity, expense and wide-reaching impact of these reforms, CUIA seeks a 3-year transition period for the bulk of the regime as well as consideration of longer transitional arrangements for individual sets of obligations.

For example, CUIA supports separate transition arrangements applying to replacement of the Acceptable Referee method of customer identification. Retention of the Acceptable Referee method, with some modifications, is important for competitive neutrality until viable alternative identification and verification methods are available.

Additionally, smaller Reporting Entities like credit unions may be able to work towards basic compliance from commencement with a view to their systems and capacities building over time. This is particularly relevant where technology-based solutions are cost prohibitive and manual alternatives may not be feasible, for instance in relation to transaction monitoring.

Further discussion, following the re-release of the complete AML/CTF package in May, is warranted in relation to commencement and transitional arrangements.

Regulatory capacity

It remains unclear how the *AML/CTF Rules and Guidelines* will be developed or modified in the future. It is critical that AUSTRAC continue to look to industry for input in this process, particularly given AUSTRAC's relative unfamiliarity with the wider field of financial services products, services and delivery – and the regulator's need to understand and regulate and balance the impacts of these reforms on a plethora of other industry groups as well.

CUIA is also concerned that AUSTRAC avoids an early heavy-handed regulatory approach that involves applying strict adherence without due regard for the challenge and difficulty in implementing the regime or the diversity of the regulated community.

CUIA also wishes to ensure that AUSTRAC's budget allocation will be commensurate with its much broader new obligations.

10. Conclusion

CUIA appreciates the opportunity to continue working with the Attorney General's Department and AUSTRAC to develop an effective AML/CTF regime that does not unnecessarily increase the regulatory compliance burden on credit unions or unnecessarily reduce the privacy of credit union members.

The risk-based approach is the right approach due to the wide diversity of Regulated Entities and the risks they face. Money laundering and terrorism financing risks cannot be entirely eliminated without a completely disproportionate regulatory burden on business.

Credit unions seek close engagement and cooperation with AUSTRAC and AML/CTF policymakers about finding the balance of identifying and responding to risks without unduly burdening the vast majority of credit union members who are not money launderers or terrorism financiers.

To fight money launderers and terrorism financiers, credit unions need a flexible legislative regime and information and practical, non-prescriptive/non-binding guidance about money laundering and terrorism financing risks and proportionate responses.

CUIA urges a consistent policy emphasis across legislative regimes on the importance of verifying identity and on the need to promote competition and choice and to avoid anti-competitive outcomes.

The credit union sector looks forward to continuing to contribute to the development of the proposed AML/CTF legislation and regulatory regime.

13 April 2006

APPENDIX: THE ACCEPTABLE REFEREE PROCESS

The Draft Exposure Bill allows for customer identification procedures to be carried out by another person. Section 34 says:

- (1) *A reporting entity may, by writing, authorise another person to carry out applicable customer identification procedures and applicable agent identification procedures on the reporting entity's behalf, so long as the other person is:*
- (a) an internal agent of the reporting entity; or*
 - (b) an external agent of the reporting entity; or*
 - (c) another reporting entity; or*
 - (d) accredited under AML/CTF Rules made for the purposes of this paragraph.*

This compares with the current regime where defined categories of Acceptable Referees can carry out identification services without being authorised in writing by the Reporting Entity.

The Acceptable Referee method is an important factor in maintaining a competitive and contestable financial services market. It allows smaller players to compete against large entities with extensive branch networks. It is convenient for consumers and facilitates choice.

The 1 September 2005 AML Industry Roundtable, chaired by the Justice Minister, reached the following position on what might apply in future:

"Third party verification would encompass a broad range of regulated entities and agency arrangements. Transition arrangements will allow industry time to develop alternative arrangements to the use of acceptable referees."

We propose two alternatives:

- modify and strengthen the existing Acceptable Referee method and maintain its availability to Reporting Entities until electronic identity verification is available; or
- allow Reporting Entities to authorise a class of accredited third party identifiers, based on a narrower version of the current Acceptable Referee list (and the more robust procedures described below), without a requirement to pre-authorise individual third party identifiers.

These proposals are consistent with a risk based approach and with FATF Recommendation 9's requirement that where reliance on a third party is permitted, *"the ultimate responsibility for customer identification and verification remains with the financial institution relying on the third party."*

Identity verification is only one AML tool. Element (d) of FATF Recommendation 5 on customer due diligence requires "ongoing due diligence on the business relationship and scrutiny of transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with the institution's knowledge of the customer, their business and risk profile, including, where necessary, the source of funds."

PROPOSED APPROACH

Section 21 of the *Financial Transaction Reports Act 1988* (FTRA) creates a process by which a person seeking to become a signatory to an account with a financial institution may be identified by an acceptable referee. This method of identification, which uses the approved Acceptable Referee Identification Reference form (s21 form), is a widely accepted form of identification for most Australian financial sector participants.

We propose an improved Acceptable Referee Identification Reference that is better able to meet the requirements of FATF Recommendation 9 than the existing process.

It will provide for:

- a remote but robust verification procedure;
- a restricted group of acceptable referees;
- a requirement on the referee to make, and the financial institution to collect and retain, copies of identification documents sighted by the referee; and
- verification of the referee by the financial institution.

Acceptable referees will be limited to a core group of persons who by reason of profession, occupation or licensing have sufficient skills and knowledge to understand and perform identification verification. As an example, a police officer or a teacher (currently categories 22, 23 & 26) would fall within this amended form. However, it could be suggested that a member of the Institution of Engineers (currently category 33) does not, by reason of profession, occupation or licensing, have this level of skill and knowledge. Therefore, this category of referee should be removed.

A list of suggested acceptable referees is attached.

The requirement for the referee to have known the customer for a period of longer than 12 months is removed. This is necessary because the list of possible referees is limited. However, the new s21 form will include a "period known for" question that asks how long the referee has known the signatory. The inference is that the longer the period "known for", the lower the risk for this identification reference.

The Reporting Entity will be required to perform verification on the referee to confirm that the identification reference was indeed carried out by the referee and that the referee is a member of one of the acceptable referee categories.

This could involve confirmation of the referee's name, address and contact details from a publicly available source of information and confirmation that the acceptable referee completed the identification process.

The amended Acceptable Referee Identification Reference would be consistent, in the main, with existing FTR Act requirements. The process would involve:

- remote signatory obtains a copy of the financial institution's "Acceptable Referee Identification Reference" form;
- signatory meets with an acceptable referee, the signatory having the form and acceptable "primary" and "secondary" identification documents;

- referee witnesses the completion of the form by the signatory, completes the referee's own details and views the identification documents presented;
- signatory and referee both sign the form;
- referee or signatory takes photocopies of all identification forms sighted;
- signatory then returns the form with the completed details and copies of the identification documents to the financial institution; and
- Reporting Entity then performs verification on the referee by a robust method.

Only after referee verification has occurred, can the Reporting Entity accept the identification reference. In the verification process, the Reporting Entity may also apply a risk-based approach to the length of time the referee has known the signatory.

A Reporting Entity may choose to apply further checks.

The UK Joint Money Laundering Steering Group's recently revised guidance carries a warning about the risk of impersonation fraud arising from non-face-to-face identification and verification:

5.4.32 Where identity is verified electronically, or copy documents are relied on, a firm should apply an additional verification check to manage the risk of impersonation fraud. The additional check may consist of robust anti-fraud checks that the firm routinely undertakes as part of its existing procedures, or another measure, such as:

- *requiring the first payment to be carried out through an account in the customer's name with a UK or EU regulated credit institution or one from a comparable jurisdiction;*
- *verifying additional aspects of the customer's identity, or of his electronic 'footprint' (see paragraph 5.3.1);*
- *telephone contact with the customer prior to opening the account on a home or business number which has been verified (electronically or otherwise), or a "welcome call" to the customer before transactions are permitted, using it to verify additional aspects of personal identity information that have been previously provided during the setting up of the account;*
- *communicating with the customer at an address that has been verified (such communication may take the form of a direct mailing of account opening documentation to him, which, in full or in part, might be required to be returned completed or acknowledged without alteration);*
- *internet sign-on following verification procedures where the customer uses security codes, tokens, and/or other passwords which have been set up during account opening and provided by mail (or secure delivery) to the named individual at an independently verified address;*
- *requiring copy documents to be certified by an appropriate person.*

One of the categories of Acceptable Referees that is removed under the approach proposed in this paper, category 27, will need to be replaced with special arrangements. Category 27 under the current Acceptable Referee arrangements allows identification to be carried by an individual who, in relation to an Aboriginal community:

- is recognised by the members of the community to be a community elder; or

- if there is an elected Aboriginal council that represents the community – is an elected member of the council.

PROPOSED CATEGORIES OF ACCEPTABLE REFEREES

1. A member of:
 - (a) the Institute of Chartered Accountants in Australia; or
 - (b) the Australian Society of Certified Practising Accountants; or
 - (c) the National Institute of Accountants.
2. An employee of a financial institution who is authorised by the financial institution to open accounts with the institution.
3. An agent of a financial institution who is authorised by the financial institution to open accounts with the institution.
4. A legal practitioner (however described) of a Federal, State or Territory court.
5. A registrar, clerk, sheriff or bailiff of a Federal, State or Territory court.
6. An officer within the meaning of the *Defence Act 1903*.
7. A diplomatic or consular officer of an Australian Embassy, High Commission or Consulate, in Australia or overseas.
8. A judge or master of a Federal, State or Territory court.
9. A stipendiary magistrate of the Commonwealth or of a State or Territory.
10. A justice of the peace of a State or Territory.
11. A member of the Parliament or a State Parliament.
12. A member of the Legislative Assembly of the Australian Capital Territory, the Northern Territory or Norfolk Island.
13. A member of the Australian Federal Police, or of the police force of a State or Territory, who, in the normal course of his or her duties, is in charge of a police station.
14. A member of the Australian Federal Police, or of the police force of a State or Territory, of or above the rank of sergeant.
15. An individual employed as a full-time teacher or as a principal at one or more of the following educational institutions:
 - (a) a primary or secondary school forming part of the education system in State or Territory; or
 - (b) an institution listed in section 4 or paragraphs 34(4)(b)-(j) (inclusive) of the *Higher Education Funding Act 1988*;who has been so employed continuously for a period of at least 5 years.

16. A commissioner for oaths of a State or Territory.
17. A member or fellow of the Association of Taxation and Management Accountants.
18. A fellow member of the National Tax and Accountants' Association Limited.
19. An Australian Financial Services Licensee or authorised representative of an AFSL.