



1 March 2011

Cost Recovery Impact Statement – Exposure Draft
Australian Transaction Reports and Analysis Centre
PO Box 13173
Law Courts Post Office
MELBOURNE VIC 8010

By email: cost_recovery@austrac.gov.au

Dear Sir/Madam

AFMA Submission on Cost Recovery Impact Statement Exposure Draft

Thank you for the opportunity to comment on the Cost Recovery Impact Statement Exposure Draft (exposure draft).

The Australian Financial Markets Association (AFMA) made a submission to the earlier consultation process and this submission should be read in conjunction with our earlier comments.

AFMA appreciates the readiness of AUSTRAC and the Government to consider changes to the cost recovery model in response to concerns that have been raised. However, it now appears that the revised model will impact on some AFMA members in the form of potentially much higher levies than might have been the case under the previous model.

AFMA members maintain, as stated in the earlier submission, that cost recovery is accepted as Government policy and that members are willing to pay their fair share of the costs of AUSTRAC regulation, provided that the charges are connected to the level of money laundering risk posed and the consequential supervision costs.

AFMA represents a range of financial markets members who have different business activities. Consequently, there are a range of views on some issues. The comments below relate to areas that are of concern to a number of members. We have also provided some specific examples of the potential, perhaps unintended, impact of the revised model.

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1. Definition of “large entity”

AFMA made comments in the earlier submission that the definition of “large entity” should be clarified. In particular, AFMA suggested that in calculating the number of full time equivalents (FTEs), only FTEs located in Australia and directly involved in providing a designated service should be included in the calculation.

For reasons that are not explained in the exposure draft, a very different approach has been taken so that any reporting entity, together with its parent company and any related entities wherever they are located, that has more than 200 FTEs, will be considered a large entity for the purposes of cost recovery.

For many AFMA members, and particularly those that are part of a global group, this means that every reporting entity within their respective designated business groups (DBG) will be captured as a large entity and required to pay the large entity component.

AFMA objects to this aspect of the cost recovery model.

The rationale for this component is that AUSTRAC incurs additional expenses in regulating large entities because they have relatively more customers and typically provide products that are more complex over multiple distribution channels and multiple jurisdictions. In addition, large reporting entities are relatively more important to the overall integrity of Australia’s financial system.

The proposal to apply the large entity levy on all reporting entities that belong to a group of companies with 200 or more FTEs does not take into consideration that while there may be complexity in the structure of large groups, they may not represent a higher ML/TF risk or have more customers than some other entities.

Similarly, there is no evidence in the exposure draft that large international transactions represent high risk. AFMA members commonly undertake these kinds of transactions. Corporate and institutional businesses, which are already highly regulated, make large international transfers that would be considered standard transactions. If a transaction was not standard, or considered out of the ordinary or unusual for a particular client, then the institution would make further enquiries and take additional steps to mitigate risk, or would make a suspicious matter report to AUSTRAC.

These considerations are material given the rationale for the large entity component.

In section 3.5 of the exposure draft, the large entity component is the method to be used by AUSTRAC to recover the costs of monitoring the appropriateness of reporting entities’ customer identification procedures through behavioural assessments, on-site assessments and desk reviews.

It is the experience of AFMA members that AUSTRAC’s monitoring and assessments are usually done at the DBG level if a DBG has been created. The purpose of forming a DBG is to enable members of related companies to adopt and maintain a joint AML/CTF

program. Therefore, while a group of companies may have a number of reporting entities, the concept of creating a DBG enables processes to be streamlined as the reporting entities can adopt the same program, share information, and submit one DBG report. As a result, the level of review and monitoring by AUSTRAC does not warrant a large entity component levy per reporting entity, but rather at the DBG level.

The following is an example of the impact of imposing the levy on each reporting entity.

In the investment and asset management industry, ABC Company may be the investment manager for a global Infrastructure fund that holds 30 infrastructure assets. As part of operating the fund, 30 special purpose vehicles (SPV) may be set up as trustee entities to hold each of these assets on behalf of clients. Each SPV trustee entity is a subsidiary of ABC Company but does not have any employees because it is a simple structure. The clients are already ABC Company's clients under an investment management agreement (item 33) but from an AML/CTF perspective are also considered the client of the SPV trustee entity because it is captured by the issue of units (item 35). In this circumstance, if the large entity component was to be applied to all 30 SPVs because ABC Company is a large entity, the cost would be:

$$30 \times \$9120 \text{ (est.)} = \$273,600$$

The fact that a reporting entity which is a SPV that issue units in a trust to one client will have to pay \$9120 (est.) will have a huge impact on the business model that many funds operate. While the cap of 40 times the large entity component proposed by AUSTRAC is recognised, this would have a substantial financial impact on a business that has few customers and little activity, and is lower risk.

Recommendation

The model should be revised so that it more accurately reflects the level of ML risk, and consequent supervision costs, posed by the business activities undertaken by reporting entities within a DBG. It is overly simplistic, and we submit – unfair – to assume that all reporting entities within a group pose the same level of risk, require the same level of supervision and should each be subject to the large entity component of the levy.

As stated at the beginning of this letter, AFMA members accept that cost recovery will be imposed. However, it should be based on factors that go to the actual risks inherent in the types of transactions conducted and the clients involved in those transactions, and not an artificial measure such as the number of FTEs.

AUSTRAC no doubt has a range of measures (public or otherwise) that it takes into account when determining the risk profile of an entity. The same methodology could be applied – for example, by a reporting entity on a self-assessment basis – to determine whether it should pay a large entity component. It is already implicit in the current model that there will be some level of self-assessment by reporting entities in calculating the number of FTEs. What we propose is another step forward in making the

cost recovery model more robust and predictable over the longer term, which is in everyone's interests.

Alternatively, we ask for reconsideration of AFMA's previous suggestion that only FTEs located in Australia who are involved in providing designated services be counted for purposes of determining whether an entity is a large entity, to remove the extraterritorial effect.

2. Higher transaction value component

The transaction reporting component has been revised to fix the volume element at 1 cent per transaction and increase the value element to \$0.0000048 per dollar of value of transaction report lodged with AUSTRAC.

AFMA members appreciate the reasons why the volume element has been fixed.

As noted above, because of the nature of wholesale and institutional business, AFMA members routinely conduct and report large value transactions, but it does not immediately follow that all of these transactions are high risk. An example of the potential impact is described below.

One of the roles of custodians is to arrange for the settlement of securities transactions entered into by their clients. These include managed investment vehicles, superannuation funds, life insurance companies, sovereign wealth funds, and the like. These sorts of investors typically invest in both Australia and overseas, and their securities settlements will therefore often give rise to international funds transfer instructions, often in significant amounts. However, these sorts of transactions represent extremely low ML risk.

The exposure draft states at page 21 that the three components of the cost recovery (base, large entity and transaction reporting) are "...reflective of the exposure to ML/TF risk of reporting entities, the supervisory effort applied by AUSTRAC in regulating different reporting entities and the costs associated with those regulatory activities."

However, these large custody payments represent very low ML risk, and any risk inherent in them certainly does not rise commensurately with the size of the payment. Further, there is no incremental cost to AUSTRAC in processing large transaction reports compared to low value reports.

In terms of risk, it should be noted that AML/CTF due diligence in this industry is undertaken at multiple levels, including by the asset owner, the investment manager, the sell-side firm, the custodian and the bank processing the payment. So by the time the international payment is made, there is very little AML/CTF risk left.

In levying the fee based on value, or at the least not placing a cap on high value reports, entities involved in high value payments that are typical of those engaged in custody businesses will be contributing to the total cost recovery in amounts that are out of all

proportion to the ML risks they incur and in the cost of regulation that flows from their activities.

For example, a \$250 million payment would generate a reporting fee of approximately \$1200, which is disproportionately high as a cost recovery exercise and bears no relationship to the risk of the transaction.

It is important to note that in many cases the entity which facilitates such a payment does not “own” the funds being transferred, but it is the entity which has the obligation to report the transaction to AUSTRAC and pay the transaction reporting component.

The increased costs will generally need to be passed on in the form of higher fees and charges, which will impact clients such as managed investments and superannuation funds with international investment portfolios.

In conducting their normal business, many AFMA members will be subject to both the large entity component and the large transaction value component. AUSTRAC has acknowledged the importance of large reporting entities to the overall integrity of Australia’s financial system. However, the cost recovery model as proposed is over-compensating for small business.

Recommendation

The model should be revised in the following way to recoup the overall amount:

- (a) a modest upward adjustment in the volume element; and
- (b) a cap on the amount payable in relation to the value element so that a flat amount is payable on transactions over a certain size.

A cap on the amount payable in relation to the value element will make the levy more akin to cost recovery and less like a tax on each high value payment.

Another option to reduce the burden on IFTI reporters, which would work in combination with a cap on high value payments, is to treat threshold transactions reports (TTRs) and IFTI reports separately. TTRs are significant generators of ML risk and yet, because the values are often small, the cost recovery from TTRs will be small compared to cost recovery from IFTIs, particularly if the volume levy is 1 cent per transaction. The figures are not broken down in the exposure draft, but of the \$16 million forecast to be recovered from the value component, the majority is likely to come from IFTIs, as the value of most TTRs would probably be under \$100,000. In our view, the current model involves a substantial subsidy of threshold transactions reporters by IFTI reporters.

We suggest that AUSTRAC should determine the appropriate cost recovery from TTRs and IFTIs separately, based on ML risk and associated supervision costs, and then set the levy on each accordingly.

In the event that AUSTRAC and the Government are not willing to consider further revisions along the lines suggested above at this stage, AFMA requests a review of the operation of the model and its impact earlier than the 5 years proposed in the first discussion paper.

A review after 2 years, or at most 3 years, is more appropriate to thoroughly examine which entities and sectors are paying the bulk of cost recovery and whether this is occurring on a reasonable and equitable basis.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Tracey Lyons'.

Tracey Lyons
Director Market Operations