



22 March 2024

AUSTRAC
323 Castlereagh St
SYDNEY NSW 2000

Via email: Guidance_Consultation@austrac.gov.au

Dear AUSTRAC

Draft Outsourcing Guidance

The Australian Financial Markets Association (**AFMA**) represents the interests of over 130 participants in Australia's financial markets. Our members include Australian and foreign-owned banks, securities companies, treasury corporations, traders across a wide range of markets and industry service providers. AFMA's members are the major providers of wholesale banking and financial market services to Australian businesses and investors. A significant proportion of AFMA's members are reporting entities for the purposes of the AML/CTF Act.

We are pleased to lodge a submission on AUSTRAC's draft guidance in relation to outsourcing (**the Draft Guidance**).

Executive Summary

By way of executive summary, AFMA notes the following:

- To the extent that AUSTRAC is articulating its view as to legal obligations through the use of the word 'must' in guidance, the guidance should specifically reference the legal obligation, either in the Act or Rules;
- AUSTRAC should remove the reference to "must" in relation to the Board/Senior Management approving any changes to an AML/CTF Program and clarify its expectations as to the extent that each outsourcing agreement is specifically referenced in the AML/CTF Program;
- AUSTRAC's definition of outsourcing should align to that of APRA and there should be consistency as to the regulatory approach;
- AUSTRAC should provide clarity as to:
 - Whether an outsourcing party can be a related party, either onshore or offshore;
 - Whether the guidance is proposed to apply to specialist service providers where the reporting entity does not have the capability to perform the function internally;

- Whether the term outsourcing can be extended to the procurement of a product;
- AUSTRAC should exclude the undertaking of an independent review from being included as outsourcing;
- AUSTRAC should delineate between outsourcing and reliance and exclude reliance agreements from the scope of the guidance;
- The Draft Guidance should acknowledge the existence of service providers of sufficient scale for which a lack of tailoring may not be an indicator of deficiency from an outsourcing perspective.

Distinguishing Legal Requirements and Recommended Actions

The Draft Guidance states that it “uses the following words to distinguish between legal requirements and recommended actions:

- ‘Must’ indicates legally binding obligations
- ‘May’ indicates discretionary steps to achieve compliance
- ‘Should’ indicates good practice that is not a strict legal requirement”

This is the first time that AFMA has seen this section included in AUSTRAC guidance and its inclusion gives rise to a number of issues and questions.

Firstly, where ‘must’ is used to assert AUSTRAC’s view as to a legally binding obligation, the reference to the obligation, either in the AML/CTF Act or Rules, should be specifically included in the guidance. As noted below, there are uses of ‘must’ in the Draft Guidance in relation to which AFMA does not believe there is a legal requirement and the inclusion of the legal reference will assist in further engagement with AUSTRAC to clarify obligations.

Secondly, the use of ‘may’ as being a “discretionary step to achieve compliance” is not clear. The reference to “achieve compliance” infers that the step is something that will need to be undertaken by a reporting entity and therefore is not optional. AUSTRAC should consider whether there should only be two words with specific meaning; one that references a legally-binding obligation and one that references good practice.

Finally, to the extent that AUSTRAC is using guidance to communicate its view as to legally binding obligations, it may need to revisit the disclaimer that is used.

Regulatory Consistency

AFMA notes that the concept of outsourcing is not restricted to outsourcing of AML/CTF obligations but that it is commonly adopted across a number of regulatory requirements. In this regard, it is recommended that AUSTRAC, in the Draft Guidance, provide a technical definition of the term “outsourcing” and ensure that its meaning is aligned to the meaning adopted by other financial regulators, such as APRA in CPS 231.

In this regard, AFMA notes, with approval, the APRA definition of outsourcing, namely:

“‘Outsourcing’ involves an APRA-regulated institution, or an institution within a group that is not an APRA-regulated institution, entering into an arrangement with another

party (including a related body corporate) to perform, on a continuing basis, a business activity that currently is, or could be, undertaken by the institution itself.”

The Draft Guidance should also look to consolidate the various references to outsourcing and similar terms in the legislative framework, such as the references to functions “carried out by a third party” in Rule 9.1.7 and the use of agents in Section 37 of the Act. Given all of the instances relate to reporting entities seeking assistance from providers to discharge obligations while retaining liability, the Draft Guidance should provide the consistency of the requirements from each provision.

Definitions

AFMA’s view is that the Draft Guidance needs to clarify:

- Whether an outsource provider can be a related party, either onshore or offshore. The Draft Guidance is unclear on this point, as it refers to an “external party” but then appears to define an external party as potentially being an entity within a designated business group (**DBG**). This is a key definition on which AUSTRAC’s specific guidance is sought. In this regard, we note that having a requirement for outsourcing agreements within the DBG appears burdensome from a compliance perspective and inconsistent with the concept of a DBG;
- The scope of the term “service” in relation to independent specialist providers, such as auditors, consultants and specialist legal providers. AFMA seeks clarity as to whether the engagement of a specialist service provider, potentially on a one-off basis, is excluded from the term “outsourcing” where the function could not be conducted internally;
- The extent to which procurement of a product is considered to be a service. In this regard, we are of the view that given outsourcing refers to a continuing arrangement for another party to undertake an ordinary business activity, then the acquisition of a product should not be within the scope of the term “outsourcing.”

Non-Inclusion of Parties Undertaking Independent Review

The need for a clear definition of “outsourcing” is highlighted by the ambiguity as to whether the party engaged by a reporting entity to conduct an independent review is within scope.

The Draft Guidance indicates that outsourcing extends to parties assisting reporting entities to carry out independent reviews. This is in contrast to the existing position, which is that the obligation of the reporting entity is only to ensure that the independent review is conducted but not to perform the review. The performance of independent review is not a service that the reporting entity could complete by itself and hence AFMA’s view is that it cannot be outsourced.

The AUSTRAC Compliance Report states that outsourcing extends only to entering into an agreement with a third party to undertake aspects of your AML/CTF framework on your behalf, i.e., in relation to customer identification, AML/CTF program development, transaction monitoring and transaction reporting. It appears that extending the scope of outsourcing to encompass the independent review is a change of approach from AUSTRAC and requires greater scrutiny and justification than as set out in the Draft Guidance.

Accordingly, AFMA's view is that the Draft Guidance should remove specific references to independent review.

Governance and Board Approval

The Draft Guidance states that "Your board or senior management must approve any update to your AML/CTF program. They should record this approval in writing along with their reasons."

This comment should be excluded from the Draft Guidance as it is drafted to apply more broadly than just in the context of outsourcing. Moreover, AFMA queries whether the comment is appropriate, particularly given the use of the word "must" and its designation in the Draft Guidance as conferring a legal requirement. AFMA is not of the view that every change to an AML/CTF Program, regardless of materiality, requires the approval of Board or Senior Management and the Draft Guidance should be refined accordingly.

Additionally, the Draft Guidance states that "Your AML/CTF program should document any outsourcing arrangements that carry ML/TF risk, and the controls you apply to mitigate and manage these risks." It is unclear as to whether this means that all outsourcing arrangements need to be specifically articulated in the AML/CTF program, together with an assessment as to the risk arising and the controls implemented. AFMA queries whether, if this is the intention, this is a reasonable compliance burden and appropriate from a governance perspective. Further, the comment in the Draft Guidance that "you should ensure that your outsourcing agreement, and any subsequent amendments to this agreement, remain within the scope of your AML/CTF Program as approved by your board or senior management" will need to be clarified in light of the above, as will the requirements where the specific outsourcing agreements sit outside the AML/CTF program.

Outsourcing v Reliance

AUSTRAC should ensure that the Draft Guidance makes an appropriate distinction between outsourcing and reliance in the context of discharging requirements in relation to Applicable Customer Identification Procedures (**ACIP**). The key difference from an AFMA perspective is that under a reliance agreement, the liability for completing ACIP correctly shifts to the party undertaking ACIP as opposed to the relying party, i.e., there is a shift from a liability perspective. This can be contrasted with an outsourcing agreement where liability remains with the reporting entity.

Reliance arrangements are subject to a broad range of contractual and due diligence requirements in the Act, which this Draft Guidance cannot replace and does not consider. Accordingly, AFMA recommends that references to reliance are removed from the Draft Guidance.

Due Diligence Requirements

A recurring theme in the Draft Guidance is that reporting entities should be able to negotiate and tailor the outsourcing arrangements to the ML/TF risks that exist for the reporting entity. This approach does not acknowledge that many providers are large service providers that are generally not amenable to specific requests. Accordingly, the Draft Guidance should reflect that an inability for the services to be tailored should not, of itself, heighten the risks associated with the provider where the provider is a well-established provider with substantial scale and offers generic services. On a similar point, the suggestions in the Draft Guidance that the use of generic templates and/or developing products without consultation as indicia of a provider lacking appropriate expertise may not be consistent with the scale and business undertaken by the outsource provider.

The due diligence requirements that are recommended in the Draft Guidance may not be practical from a confidentiality perspective. The Draft Guidance suggests that, in conducting due diligence on the provider, reporting entities should consider, for example:

- Expertise/qualifications in Australia’s AML/CTF regime and your industry;
- Verification of their AML/CTF qualifications, resourcing and performance history; and
- Verification that the provider’s services can be adapted to meet the reporting entity’s obligations and specific ML/TF circumstances.

In practice, obtaining this information in advance of the outsourcing engagement may be impractical where the matters subject to due diligence are not publicly available.

Understand Information Sharing Restrictions

AFMA notes that the section of the Draft Guidance relating to understanding information sharing restrictions does not actually provide any guidance but merely suggests that reporting entities may want to obtain legal advice, together with enumerating legal issues. In AFMA’s view, this section should be expanded to provide guidance as to support reporting entities in complying with the legal requirements.

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Thank you for the opportunity to provide a submission in relation to the Draft Guidance. Please contact me on (02) 9776 7996 or at rcolquhoun@afma.com.au to discuss any of the matters that we have raised in this submission.

Yours sincerely,



Rob Colquhoun