16 June 2023

Attorney-General's Department
4 National Circuit
BARTON ACT 2600

Via Email: economiccrime@ag.gov.au

Dear Sir/Madam,

Modernising Australia's Anti-Money Laundering and Counter-Terrorism Financing Regime

The Australian Financial Markets Association (**AFMA**) represents the interests of over 125 participants in Australia's wholesale banking and 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. A significant proportion of AFMA's members are reporting entities for the purposes of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (**the AML/CTF Act**).

We are pleased to provide a submission to the Department's Consultation Paper regarding modernising Australia's AML/CTF regime (**the Consultation Paper**). AFMA has long-supported both the simplification of the AML/CTF Act and Rules and the extension of the regulatory scope of the AML/CTF regime to incorporate Tranche Two entities. Accordingly, we are committed to engaging with the Department throughout the consultation process.

AFMA has had the opportunity to review the submission prepared to the Consultation Paper by the Australian Banking Association (**ABA**) and notes an alignment on the direction on key reforms.

AFMA's response to the Consultation Paper should be read in light of other submissions to relevant consultations such as the consultation to establish a public register of beneficial ownership and the strategic review of the payments system. We also note that the proposed Treasury consultation to license payment system providers will impact the issues raised in the Consultation Paper and we encourage the Government to be consistent in terms of the regulatory approach.

As requested by the Department, the structure of our submission is to highlight priority areas for simplification and then to respond to the consultation questions contained in the Consultation Paper. Acknowledging the consultation process as outlined by the Department, our focus in this submission

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is to highlight issues at this stage, with the specific policy positions arising to be refined through the consultation process.

Executive Summary

AFMA notes the following by way of executive summary in terms of our key priority areas, in no particular order:

- The Simplification Project should focus on reducing the level of prescription in the AML/CTF Act and Rules and restore the primacy of the risk-based approach. The current legislative framework is overly prescriptive and not fit for purpose in terms of technological advancement and innovation. Further, the Australian framework is not aligned with those in comparable offshore jurisdictions, meaning that the compliance burden in respect of the management of ML/TF risks for certain customers is not commensurate with the risks posed by such customers. The Simplification Project represents an opportunity to craft a framework that is future-proofed and reflective of international best practice;
- The tipping off prohibition is ripe for reform to allow for the disruption of serious financial crime through the effective sharing of information. AFMA supports a statutory construction where the offence is not invoked unless the information is shared with the intention of prejudicing a law enforcement investigation;
- The re-write of Part 5 of the Act should be a priority of the Simplification Project and should extend to simplification of the IFTI reporting framework. This should include consideration of changing the trigger for reporting from "instruction" to "transfer." This should assist with providing much-needed clarity on IFTI reporting obligations. The proposed exemptions to reporting that were previously proposed by AUSTRAC should be included and, in the case of derivatives, extended in the legislative framework;
- The Department should not proceed with the proposal to require offshore subsidiaries and branches of Australian reporting entities to be subject to additional Australian AML/CTF regulatory requirements;
- The definition of "bearer negotiable instrument" should be clarified to ensure that the regulatory burden for reporting entities is commensurate to the policy intent of reporting;
- The Department should consider further consultation on the concept of "designated services" as the trigger for regulating entities, with consideration of alternate models based on businesses undertaken and the commencement of a business relationship with a customer. At a minimum, AFMA requests that the Department review the current definitions of designated services, which are unecessarily complex to interpret. This would be of signficant benefit in terms of future-proofing Australia's AML/CTF regime;
- AFMA supports rationalisation and simplification of CDD requirements; and
- AFMA is supportive of the proposal to bring Tranche Two entities within the scope of the AML/CTF Act.

AFMA Priority Issues

1. Amending the Tipping Off Offence

AFMA agrees with the comments in the Consultation Paper that the structure of the tipping off offence, including the various exceptions, has "not kept pace with the increasingly complex business structures of regulated entities, the shift to a globalised risk management approach and changes in

supporting compliance." Indeed, the feedback from AFMA members is that the prohibition within the tipping off offence actually hinders the frustration of serious financial crime. The ambit of the tipping off offence is extended beyond that a Suspicious Matter Report (**SMR**) has been lodged through the application of the prohibition to any "information from which it could be reasonably inferred" that an SMR has been filed, and given that an SMR may be filed for a myriad of offences, not just ML/TF or fraud.

While there has been some reform allowing for the sharing of information within the corporate group, there remains prescription around the exemption relating to written undertakings which effectively prevents the efficient sharing of information within a corporate group. The extent to which Australia is an outlier in this regard is exemplified by the circumstances of global banks, where the Australian operations are able to obtain case information relating to a customer from an offshore related party but are unable to reciprocate.

AFMA's view is that the current tipping off offence should be rewritten to focus only on conduct aimed at compromising a law enforcement investigation, or proposed investigation. This would allow for reasonable sharing of information by reporting entities with related parties, including parties offshore, to support AML/CTF compliance. AFMA also supports the potential for reporting entities to share information with other reporting entities so as to properly disrupt money-laundering/terrorism financing and other serious financial crimes. Our approach aligns in principle with UK, Singaporean, Hong Kong and Canadian legislation, with AFMA having particular support for the Canadian requirement that the disclosure of the information is done with the intent of prejudicing the investigation.

In addition, AFMA is of the view that secrecy and access provisions should be harmonised across State, Territory and Commonwealth legislation. AFMA also supports the ability for reporting entities to share information with external legal counsel and foreign regulators for global institutions. We also note that the issues raised above in relation to the current inability to effectively share SMR information extends also to Section 49 notices, which otherwise could act as a trigger for further due diligence but cannot be effectively shared.

2. IFTI Reporting Requirements

The Consultation Paper is largely silent on the requirements of reporting entities to report International Funds Transfer Instructions (IFTIs) and the circumstances in which reporting is required. As the Department is aware, there has been significant engagement between AFMA and AUSTRAC over the preceding two years regarding the reportability or otherwise of certain scenarios, with AUSTRAC not finalising its draft Regulatory Guide after this engagement, highlighting the extreme complexity of the IFTI reporting framework and the necessity for the IFTI reporting requirements to be prioritised in the Simplification Project.

AFMA notes that the simplification of the IFTI reporting framework has synergies with the comments in the Consultation Paper relating to the modernisation of the travel rule requirements. Broadly, these changes are designed to both ensure that the reporting requirements are future-proofed in light of technological advancements, particularly in relation to payments technology, and also to address Recommendation 16 of the 2015 FATF Mutual Evaluation of Australia's measures to combat money-laundering and terrorism-financing. It is noteworthy that Recommendation 16 of the FATF Review relates to "wire transfers."

The engagement between AFMA and AUSTRAC resulting in the draft Regulatory Guide highlights a number of areas where the IFTI reporting framework may be enhanced. We elaborate on these areas below:

- ***Definition of Financial Institution***: A significant compliance issue for reporting entities is the lack of alignment between the definition of "financial institution" in the AML/CTF Act and the definitions in both SWIFT and FATF. This means that reporting entities are required to manually screen and consider reporting obligations for message types that are utilised by SWIFT participants as "financial institutions" where the entity does not meet the definition under the AML/CTF Act. Given the narrow scope of the definition of financial institution under the AML/CTF Act to include only ADIs, banks, building societies and credit unions (apart from any institution prescribed in the Rules), AFMA reiterates its previous position that recommends the broad adoption of either the SWIFT definition of financial institution, such that a "financial institution" represents an organisation that is eligible as a SWIFT user, or the expanded definition of "financial institution" employed by FATF. This approach would ensure that reportability of wholesale payments would only arise in respect of these categories or where there has been misuse. The proposed approach would reflect the limited intelligence value generally associated with large institutional payments and would assist with the future proofing of the regime;
- ***Replacing "instruction" with "transfer"***: Reporting entities face considerable operational challenges adhering to IFTI reporting requirements where the initial instruction is amended, aborted or cancelled, particularly in circumstances where an IFTI was lodged based on the initial instruction. These operational challenges could be addressed by amending the trigger for the reporting obligation to the transfer of funds as opposed to the instruction to transfer funds, noting that in circumstances where an instruction was cancelled/aborted, it would remain open to the reporting entity to lodge an SMR where appropriate;
- ***Reportability of trade finance transactions***: AFMA maintains that, under the current legal framework that underpins the IFTI reporting requirements, a trade finance transaction does not give rise to an IFTI reporting obligation. Noting that the draft Regulatory Guide adopted an alternate position (i.e. one of reportability), it is clear that the IFTI reportability of trade finance transactions remains vexed from a legal perspective and that clarification of the legal obligation should be a key priority for the Simplification Project. AFMA's preferred position from a policy perspective remains that trade finance transactions should remain outside the scope of IFTI reporting, noting that reporting entities retain the ability to lodge an SMR in relation to trade finance transactions where circumstances warrant the lodgement of such reports. In the event that the legislation is clarified in a way that does result in trade finance transactions being within scope for IFTI reporting, there will need to be significant changes to the reporting schema to allow for such reporting to occur, together with significant systems changes for reporting entities to facilitate reporting. This is particularly the case given our understanding that MT700 messages, which are utilised for trade finance transactions, do not actually result in a transfer of funds;
- ***Other Exemptions:*** AFMA notes that the draft Regulatory Guide proposed various exemptions for:
    - Foreign exchange swap transactions (and we support the extension of the exemption to all derivatives, regardless of the legal form of the derivative and the underlying asset class);

- Credit-card pull payments;
- Instructions provided by way of cheque;
- Purely domestic transfers, even when the instruction is provided from offshore; and
- Transfers between financial institutions (noting the comments above regarding the definition of "financial institution").

AFMA supports these scenarios being excluded from the simplified IFTI reporting legislative framework.

3. Foreign Branches and Subsidiaries

The Consultation Paper includes, in relation to the obligations that apply to foreign branches and subsidiaries, a proposal that the Act could be amended to include specific requirements "including that Australian businesses operating overseas should apply measures consistent with their AML/CTF programs in their overseas operations, to the extent permitted by local law."

AFMA is very concerned with the potential for such a requirement which, on its face, could add complexity and uncertainty without necessarily improving processes for identifying, detecting and deterring ML/TF risks. The Consultation Paper suggests that the proposed amendment could represent "simplified and consolidated obligations in line with global best practice standards"; however, it is unclear what such standards are. To the extent that such obligations were implemented without material change to the existing Australian law, AFMA expects that its members would be placed at an operational and commercial disadvantage, given there are a number of idiosyncracies of Australia's AML/CTF framework that, if required to be adopted by foreign branches and subsidiaries, may result in duplication given home country requirements and increase the compliance burden without mitigating risk.

AFMA notes that, in the 2016 Statutory Review of the AML/CTF Act conducted by the Department, Recommendation 7.6 suggested foreign branches and subsidiaries of reporting entities to apply Australian AML/CTF measures only in circumstances where the AML/CTF measures in the other country are less strict than Australia. It is AFMA's understanding that the basis of this recommendation was designed to capture offshore service providers that provide services to customers within Australia, with the objective of the recommendation to create a level playing field with Australian service providers to Australian customers. It is not currently clear how "less strict" should be interpreted in the context of ML/TF risk, such that this could add complexity and confusion in the absence of the alignment of Australian law and AUSTRAC guidance to comparable offshore jurisdictions.

Where the entity is conducting activity in an offshore jurisdiction that has an AML/CTF regime that is effectively operating to manage ML/TF risk, AFMA's position is that this should be adequate unless there is a clear policy position to the contrary. In this regard, we note with approval the statement from the 2016 Statutory Review, which stated:

> "Where offshore-based businesses are located in jurisdictions that have appropriate AML/CTF regulation and similar customer identification requirements as Australia, the model should ensure there is no unnecessary duplication of AML/CTF obligations for a regulated entity."

Accordingly, AFMA's view is that to the extent there is any change to require that Australian businesses operating overseas apply measures consistent with their Australian AML/CTF programs to

those overseas operations, that it be closely considered to ensure unintended consequences are avoided. For instance, this may be appropriate only where the offshore business operations are in a jurisdiction with materially lower AML/CTF standards as assessed by AUSTRAC and communicated to regulated entities.

AFMA supports the reconsideration of the geographical link requirement in Section 6 of the Act to ensure that it does not capture offshore subsidiaries/branches of Australian entities that are not reporting entities. Further, in relation to Item 54 of Section 6 of the AML/CTF Act (making arrangements for a person to receive a designated service), in AFMA's view there is overreach as the CDD obligations may be triggered where a client is booked to an offshore entity but the local entity assisted with the arrangement of the transaction. In AFMA's view, in this situation there should be a nexus between the counterparty entering into the transaction and the customer to trigger a CDD requirement.

4. Bearer Negotiable Instruments

As the Department is aware, AFMA works closely with the ABA and shares many common members with the ABA. To this end, AFMA has been made aware of, and absolutely supports, the actions being undertaken by the ABA to clarify the regulatory approach to the reporting of bearer negotiable instruments (**BNIs**). AFMA agrees that the current definition of BNI in the AML/CTF Act is so broad as to capture transactions that should not be give rise to a reporting obligation from a policy perspective and that, accordingly, the regulatory burden arising from the definition is disproportionately large. This is particularly the case given that the enhanced regulatory burden is in respect of a product that has decreasing relevance in the Australian financial system and is not being prioritised by reporting entities. Our understanding is that the policy intent of the BNI reporting requirement is to capture cross border movements of BNIs by natural persons only; however, the current requirement is significantly broader.

For example, under the current reqirements, AFMA members must develop and implement a new report type, including assessing whether existing systems that contain relevant information need to be integrated or re-built to support the requirements.

On this basis, AFMA supports the clarification of the legislative definition of BNI to be a priority of the Simplification Project. AFMA encourages the Department to consider aligning the definition of BNI to the FATF definition.

5. Trigger for Regulation – Designated Service Concept

AFMA understands that the Department's current view is that, given the breadth of the Simplification Project to bring Tranche Two entities within regulatory scope and other priorities of the Simplification Project, the concept of the provision of a "designated service" to be the trigger for an entity to be regulated under the AML/CTF Act is not considered to be in scope.

That being said, AFMA would like to place on the record its perspective of the current list of fifty-four services which are included in the definition of "designated service" as set out in Section 6 of the Act is difficult to apply, is inefficient in light of product innovation and is a departure from international best practice. The current legislative construction is in contrast with a principles based legislative framework and, by specifying specific service types as "designated services", regulatory scope will

always lag innovation, particularly given that refinement to or expansion of the list of designated services requires legislative amendment. AFMA believes a principles based trigger for regulation, such as being based on the type of business being undertaken and the establishment of a "business relationship" would be both consistent with the objectives of the Simplification Project and also aligned with comparable jurisdictions. It would also assist with the regulation of Tranche Two entities, as opposed to adding to the list of designated services that apply to such entities. We agree with the comment from the 2016 Statutory Review that the designated service approach "continues to add a significant layer of technical and legal complexity."

At a mimimum, AFMA suggests that the Department engage with the reporting entity population to ascertain the appetite for what we acknowledge would be a fundamental change, but one which may be transformational in terms of simplifying the AML/CTF legislative framework and aligning the framework with international best practice.

To the extent that the current list approach is maintained, we would suggest that the Department explore refining the current list, such that the designated services are described in terms that are more high level and principles-based.

Finally, to the extent that the concept of designated service is retained as the trigger for AML/CTF regulation, a number of matters require clarification, including:

- The definition of the term "in the course of carrying on a business" to ensure that there is no regulatory capture for entities that are providing designated services sporadically. The scope of activity that this phrase intends to capture is not clear. Also, as expressly noted on AUSTRAC's website, an entity is still considered to be carrying on a business under the AML/CTF Act even if it is only providing a designated service once. This can result in entities being subject to enrolment requirements for very short periods because such entities do not otherwise provide designated services on an ongoing basis. For example, an SPV established by a group of investors to provide finance to a commercial venture;
- The term "derivative" within Item 35, given that the derivative is defined with reference to the Corporations Act, which is broad and includes instruments not generally construed as derivatives;
- The lack of definition of "factoring a receivable" for the purposes of Item 8;
- The concept "agents of customers" is is defined in Part 4.11 of the AML/CTF Rules as an individual who is authorised to act for or on behalf of the customer in relation to a designated service. This concept is broad and the AML/CTF Rules do not include express provisions to exclude employees or allow the ability to apply risk based assessment; and
- The definition of "account" is broad and retail focused. In the case of reporting entities that offer institutional services, these services may not neatly apply to the current definition of "account".

AFMA Lower Priority Issue

The following issue is raised in the Consultation Paper and, in the spirit of assisting the Department in determining those issues that warrant an allocation of resources, is considered a lower priority.

1. ***Streamlining AML/CTF Programs***

The Consultation Paper suggests that "Part A and Part B requirements could be streamlined into a single requirement to develop, implement and maintain an AML/CTF program that is effective in identifying, mitigating and managing a regulated business' money laundering and terrorism financing risk." This is on the basis that the current distinction between Part A and Part B is complex.

Whilst AFMA has sympathy for the view expressed in the Consultation Paper and agrees that the proposal may have some benefits, our concern is that the streamlining of the currently bifurcated model of AML/CTF programs into one program may give rise to unintended consequences in the form of increased compliance burden for reporting entities. Specifically:

- Currently Part B of the AML/CTF Program is not subject to board approval, a position that AFMA views as appropriate given the operational nature of Part B. Streamlining into a single program potentially brings both current Part A and Part B within scope for board approval, which reduces the efficiency of amending current Part B;
- Similarly, the current requirement is for Part A (only) of the AML/CTF Program to be subject to regular independent review. If the two parts of the Program were to be streamlined into one, it would potentially increase the scope of the aspects of the Program that require regular independent review, thereby adding to compliance costs; and
- The streamlining of Part A and Part B of the Program into one may have implications for the application of the civil penalty provisions.

AFMA is of the view that there should not be any specific requirement for board approval of Part A of the AML/CTF Program but rather the board should conduct oversight of the Program in accordance with the reporting entity's governance and risk management frameworks.

Consultation Paper Issues

This section sets out AFMA's response to the various questions in the Consultation Paper relevant to the AFMA membership, together with additional comments relating to the particular subject areas, where applicable.

1. AML/CTF Programs

How can the AML/CTF regime be modernised to assist regulated entities address their money laundering and terrorism financing risks?

Consistent feedback from AFMA members is that the AML/CTF legislative framework is overly prescriptive, with the Act and the Rules totalling more than 700 pages. As noted above in terms of our comments regarding "designated services," we support principles-based and outcomes focussed drafting that is flexible in light of technological innovation and also in terms of catering for businesses of different scope and scale. We agree with the aspiration that the Act should set out core obligations, the Rules specifying additional detail and the guidance providing regulatory expectations and practical examples of best practice. Embedded in the legislative approach should be clear support for the risk-based approach, with minimal prescription in the Act and Rules.

Similarly, the level of prescription in relation to timeframes should be aligned to the risk-based approach adopted by reporting entities. Matters such as initial enrolment, change of enrolment, changes to a designated business group and due diligence on correspondent banking relationships all

currently need to occur within strict timeframes stipulated in the Act or Rules. AFMA's view is that such prescription is inconsistent with the risk-based approach.

AFMA welcomes greater alignment and recognition of international AML requirements and regulatory regimes. The Act was written with a primary focus on the domestic market and does not recognise the increased globalisation of financial markets and the nature/structure of offshore customers. As a result, there are elements of the AML/CTF Act and Rules which emphasise distinctions between domestic and foreign concepts rather than applying a risk-based approach. The examples provided below demonstrate challenges and duplication created by this inflexible approach:

- A reporting entity is not able to recognise international regulators for access to simplified due diligence, on a risk-based approach. In Australia, simplified company verification and beneficial owner modifications are available for a company that is licensed and subject to regulatory oversight of a Commonwealth, State or Territory statutory regulator in relation to its activities as a company. Whereas, in the UK, a company may be authorised and registered by the Financial Conduct Authority (FCA) in respect of financial service activities, however, such companies are not considered "regulated" under the AML/CTF Act and therefore do not have access to simplified due diligence.
- The current regime does not have the flexibility to effectively recognise and consider common legal entity structures in international financial markets, such as Limited Liability Partnerships (LLPs).

What are your views on the proposal for an explicit obligation to assess and document money laundering and terrorism financing risks, and update this assessment on a regular basis?

AFMA sees no particular issue or concern with making such an obligation explicit in the Rules, as it is currently implicit and consistent with the way in which reporting entities conduct their AML/CTF programs.

In crafting the explicit obligation, the Department should be mindful:

- That the obligation be consistent with other regulatory obligations that go to the assessment of risk, such as the Product Design and Distribution obligations;
- To set out clear objectives to be achieved;
- To allow for a sufficient transition period to assess whether existing risk management practices align with the explicit obligation; and
- To allow for flexibility based on the nature and scale of the reporting entity's business and global structure.

AFMA does not agree that the Rules should specify event triggers for reviewing a risk assessment. Risk assessments should be reviewed on a risk-based approach and not be prescribed.

For currently regulated entities, to what extent do you expect that a simplified AML/CTF program obligation would affect your AML/CTF compliance costs?

As noted above, AFMA does not see the simplification of the AML/CTF Program through the streamlining of Part A and Part B would materially reduce compliance costs and may actually do the opposite. AFMA does not see this to be a priority issue for the Simplification Project.

We do note, however, that any proposal to streamline/simplify the AML/CTF program could be aligned to the Wolfsberg Effectiveness Principles, with the fundamental objectives of the AML/CTF program being to:

- Comply with AML/CTF laws and regulations;
- Provide highly useful information to relevant government agencies in defined priority areas; and
- Establish a reasonable and risk-based set of controls to mitigate the risks of a financial institution being used to facilitate illicit activity.

What kind of entities would you propose to include in a designated business group if membership were no longer limited to regulated entities, and what volume of AML/CTF information would you seek to share?

While AFMA has historically supported the extension of Designated Business Group (**DBG**) eligibility to all related entities, at least within Australia, we are mindful of ensuring that any extension of the DBG concept does not result in unintended consequences, particularly in relation to entities that are not reporting entities. As noted above with respect to the sharing of information and the tipping off offence, the inability for non-reporting entities not to be included within the DBG has prevented the efficient sharing of information to entities that may assist with AML/CTF compliance. Accordingly, it is expected that these entity types would be those that may be included in an expanded definition of DBG, although our preference remains to address the information sharing issue through reform to the tipping off provisions. To the extent that DBG entities could include entities offshore (such as centralised service entities), AFMA's view is that deference should be given to the AML/CTF standards in the home country jurisdiction where they are not materially lower to reduce duplication.

At a higher level, to the extent that the tipping off offence is refined in a manner that permits the sharing of information with related entities where the sharing is not aimed at prejudicing a law enforcement investigation, there is a question as to the utility of the concept of DBG. We note that entities providing designated services (or equivalent) would continue to need to register with AUSTRAC; however absent that requirement, it is not apparent that the DBG concept needs to persist, particularly if the the ability to have a joint program that covers related entities could otherwise be retained outside the DBG concept.

To the extent that the DBG concept is retained, the administration could be simplified such that only top level information is maintained, as opposed to full enrolment and designated service information. Administration of the DBG could be made more efficient through reducing duplication of enrolment requirements and by extending the notification period for changes to the DBG to at least 28 days.

How will a flexible approach that allows an AML/CTF program to incorporate all related entities within a designated business group affect your AML/CTF compliance and risk mitigation measures?

Our comments relating the suggestion that offshore subsidiaries and branches are subject to Australian AML/CTF regulation are set out above.

What are your views on the proposal to expressly set out the requirement for entities to identify, mitigate and manage their proliferation financing risks?

In principle, AFMA is supportive of a requirement for reporting entities to identify, mitigate and manage proliferation risk, although we note that most reporting entities currently consider

proliferation risk as part of their current programs. Given there is no express obligation for reporting entities to manage, for example, fraud/sanctions risk, we query why proliferation risk particularly warrants a legislative change.

To the extent that the requirement becomes specific, it will be necessary for AUSTRAC guidance as to how reporting entities will discharge their obligations under the requirement and how this differs from current obligations. Sufficient transition periods will be required for reporting entities to incorporate any changed expectations into their programs and AUSTRAC should update its National Proliferation Financing Risk Assessment on a regular basis to ensure that reporting entities are addressing current risks in their programs. It is imperative that there is no inconsistency with the operation of sanctions laws.

What guidance would you like to see from AUSTRAC in relation to AML/CTF programs?

Our comments below relate to AUSTRAC guidance more broadly, rather than just in relation to AML/CTF Programs.

In recent times, AFMA has engaged with AUSTRAC on a number of specific issues in relation to guidance. These issues may be summarised as:

- Clarification from AUSTRAC as to what publicly available AUSTRAC documents constitute "guidance" given the obligation in Rules 8.7.1 and 9.7.1 that, in developing Part A of a Program, a reporting entity must take into account any applicable guidance material disseminated or published by AUSTRAC;
- A desire from reporting entities for AUSTRAC to time-stamp guidance and to put in place a change notification process to ensure that reporting entities are aware when guidance or any otther website content is amended; and
- The implications of the trend by AUSTRAC to produce best practice guidance (as opposed clear statements of regulatory expectation) on how reporting entities discharge their obligations under Rules 8.7.1 and 9.7.1.

In AFMA's view, there is no need for a specific Rule that a reporting entity is required to incorporate AUSTRAC guidance into its Program, with the existence of such a Rule potentially being incompatible with the risk-based approach. It is customary for reporting entities to have regard to guidance in developing their processes, systems and controls in order to meet their obligations. By definition, guidance is not calibrated to the size and scale of the businesses undertaken by different reporting entities and, in AFMA's experience, the level of prescription sought in AUSTRAC guidance is dependent on the size and sophistication of the business of the reporting entity. That is, smaller reporting entities with less resources may seek granular statements as to AUSTRAC's expectations, while larger reporting entities are able to interpret and apply the legal requirements into their programs. This issue is exacerbated where AUSTRAC moves away from mandatory guidance towards statements of best practice, as it becomes unclear as to whether these statements need to be taken into account. AFMA's position is that reporting entities will take note of, and incorporate where appropriate, AUSTRAC guidance that is fit for purpose without a specific obligation to do so.

AFMA is also supportive of consideration of a private sector body to produce guidance in future, with such guidance being published with the imprimatur of the Department. This is the approach adopted by the Joint Money Laundering Steering Group (JMLSG) in the UK, with the guidance issued by the JMLSG not being legally binding, but having HM Treasury approval. AFMA is cognisant of the significant level of guidance that is going to be required for Tranche Two entities once they are brought

within regulatory scope and, as a body that sets market standards and conventions, AFMA understands the value of guidance being generated by market participants to promote a shared understanding of obligations and a competitively neutral playing field. AFMA is happy to engage on this further through the consultation process.

In consideration of the impact of guidance on reporting entities and their programs, AFMA's view is that the Act/Rules should specifically accommodate a period akin to a Policy Principles Period where AUSTRAC changes its view on an issue through published guidance. Currently a Policy Principles Period allows the Minister to provide comfort, in the circumstance of a change of law, that reporting entities can take time to adapt systems and processes to operationalise the new legal requirements as long as the reporting entity is undertaking best endeavours to comply with the changed law. However, no such mechanism is available to the Minister (or, indeed, the AUSTRAC CEO) where there has been a change of view from AUSTRAC. This has led to industry seeking correspondence from AUSTRAC, in the form of a "letter of regulatory pragmatism," that states that AUSTRAC will not apply compliance resources to reporting entities undertaking best endeavours to comply with the changed view. AFMA's position is that this position should have legal backing.

In terms of banking specific guidance, AFMA would support more focus on AML/CTF issues that arise in the institutional/wholesale areas as opposed to the current retail focus. We also support the guidance issued by FINTRAC in Canada as a model for AUSTRAC to aspire to.

2. Customer Due Diligence

What are your views on the proposed simplification of the customer due diligence obligations as outlined?

Do you have suggestions on other amendments to customer due diligence obligations?

AFMA supports simplification of the CDD obligations in Australia's AML/CTF regime, with our view being that the current obligations are overly complex, prescriptive, technical in nature and have not kept pace with technological innovation and advancement.

Specifically:

- Chapter 4 should be simplified such that it is a source of flexible, principles based obligations to carry out KYC as soon as reasonably practicable based on a risk-based approach, using independent and reliable sources;
- AFMA supports the use of simplified due diligence in a greater number of scenarios, as determined by the reporting entity in accordance with the entity's risk based approach. Foreign entities that are subject to comparable licensing and regulatory requirements, listed entities and authorised representatives of AFSL holders are examples of customers that, under a risk based approach, should be eligible for simplified due diligence;
- The prescribed timings currently in the Rules to undertake KYC should be removed and based on a requirement of reasonability based on the risk-based approach, particularly in relation to ongoing customer due diligence;
- The concept of "certified copy" should be revisited to contemplate the use of digital versions of original documents and digital forms of identification should be acknowledged in terms of the collection of customer identification. Certification does not necessarily enhance the veracity of documents as the certifier does not certify that the document is legally valid.

Particularly for lower risk counterparts, reporting entities should be able to rely on independent and reliable sources;

- Electronic signatures should be appropriate for all circumstances where there is currently a wet ink signature requirement;
- The KYC requirements for companies should be consistent regardless of the type of company (Australian company/foreign company registered with ASIC/foreign company not registered with ASIC);
- There should be less prescription in relation to the onboarding requirements for trusts, particularly in circumstances where there is no settlor of the trust and to reflect the existence of foreign custodians;
- There should be less prescription in relation to onboarding partnerships, acknowledging that a partner of a partnership may not be an individual;
- The Rules regarding electronic verification are restrictive insofar as they are more onerous for commercial providers and require verification from two sources. The use of electronic verification should be aligned with the risk-based approach of the reporting entity;
- The Consultation Paper states that the triggers for enhanced customer due diligence should be included in the Act. Our view is that these triggers are better placed in the Rules, with the Act continuing to set out high-level principles;
- Under a risk-based approach, it should not necessarily be the case that a Politically Exposed Person (**PEP**) is classified as high-risk and the reporting entity should determine the risk assessment of a PEP based on facts and circumstances; and
- AFMA is supportive of current Rule 4.11 being modernised to ensure that the term "agent" is defined in a way that is not unduly broad and that an agent presents a level of ML/TF risk that warrants identification and, potentially, verification. The concept of "verifying officer" is outdated and burdensome.

One particular issue that should be included in the scope of the Simplification Project is the extent to which a reporting entity can provide services to a customer prior to finalising KYC. This is an issue that has arisen in the past in a variety of contexts, including:

- Opening an account and accepting an initial deposit for a customer who is unable to be onboarded at the time of the initial deposit, such as where the customer is immigrating to Australia;
- Urgent markets transactions that may occur in the institutional space, such as block trades, where the ability to complete KYC prior to the transaction being completed is impractical.

In relation to the latter circumstance, there is currently a highly prescriptive list of conditions that must be satisfied where the service may be provided to the customer prior to the completion of KYC.

AFMA's view is that the ability to provide a service to a customer prior to completion of KYC should be simplified and clarified. We note with approval the approach that is adopted in New Zealand, where verification of the identity of a customer may be completed after the establishment of the business relationship where:

- It is essential not to disrupt normal business practice;
- ML/TF risks are managed through limitations on transactions and transaction monitoring; and

- Completion of KYC occurs as soon as practicable once the service is provided to the customer.

Customer due diligence is an area where allowing for industry to set standards and provide guidance, with the Department's imprimatur, would be particularly beneficial given the multitude of structures that exist within the reporting entity population meaning that legal prescription may be not optimal.

3. Regulation of Digital Currency Exchanges

What are the benefits and challenges of expanding the AML/CTF obligations to a broader range of digital currency-related services?

How can definitions under the Act be amended to integrate digital currency activity in payment-related obligations, such as activities associated with credit, debit and stored value cards and general transfers?

AFMA supports the expansion of the AML/CTF regime to cover a broader range of digital currency services. In order to ensure that the regulatory approach appropriately addresses innovation and the development of new assets, AFMA suggests the use of "digital assets" as opposed to "digital currency."

AFMA would also like to put on the record concerns expressed by our members regarding the use of the term "exchange" in relation to those firms that are registered with AUSTRAC to swap digital currency for fiat currency or vice versa. In the broader financial markets context, the term "exchange" is properly applied only to those entities that hold a market operator licence and our view is that the current terminology for those entities registered by AUSTRAC may confer unwarranted legitimacy on the entities as market operators where they are not licenced to do so.

The benefits associated with the expansion of regulatory scope to include digital asset exchanges include:

- Enabling a level-playing field for businesses offering digital asset services;
- Promote transparency and safeguard the integrity of enhancing KYC/CDD requirements;
- Enhancing Australia's attractiveness as a location for digital asset providers to conduct business by bringing Australia in line with FATF standards;
- Enabling existing reporting entities that wish to offer increased digital asset services to operate within existing controls and policies.

4. Amending the Tipping Off Offence

Are there aspects of the tipping-off offence that prevent you from exchanging information, which would assist in managing your risks?

What features would you like to retain or change about the current tipping-off offence?

What safeguards are needed to protect against the disclosure of SMR-related information? Has the current tipping-off offence achieved the right balance between protecting against the risk of leaked SMR information and disclosures which help manage shared risks?

Please refer to AFMA's comments above.

5. Modernising the Travel Rule Obligations

What are the benefits and challenges for financial institutions in applying the existing travel rule obligations?

Would the proposed model assist in addressing these challenges?

AFMA's response to the proposal in the Consultation Paper to update the travel rule through requiring payer information to be verified and to require the inclusion of payee information is heavily dependent on where the Simplification Project lands in relation to Part 5 of the Act, including the IFTI issues raised above. Given that Australia's IFTI reporting regime is idiosyncratic, the implications of adopting the FATF standards in Australia with respect to the travel rule will be different than for other jurisdictions. Without a fundamental redesign of Part 5 of the Act, it is unclear how compliance with the enhanced travel rule requirements could be achieved.

Prima facie, the proposed changes will create additional complexity and enhance the regulatory burden for affected reporting entities, particularly in relation to incoming instructions. Delays in verification based on incomplete information may adversely affect both the customer experience and the efficiency of financial markets. As such, the proposal does not appear to adhere to the goals of simplification and modernisation.

It also has been suggested that, in instances where the payer is a customer of the ordering institution, then that institution needs to verify the payer's details both at the time of onboarding (and through the OCDD process) and also at the time of each payment, which appears duplicative. Clarification of the obligation is sought through the consultation process.

In AFMA's view, this proposal needs to be considered operationally in light of the requirements for participants in the NPP and the way that cross-border payments are administered by the various participants in the NPP.

Noting our comments above, AFMA would support the extension of any travel rule requirements to remitters and digital currency exchange providers, with the latter extension implying that the travel rule would not just apply to transfers of fiat currency.

6. Exemptions for Assisting an Investigation of a Serious Offence

Are there any additional issues that would not be addressed by the proposed approach for exemptions for assisting an investigation of a serious offence?

This section of the Consultation Paper canvasses many of the issues that were consulted on by the Department of Home Affairs in relation to the proposal to legislate the exemption currently within Chapter 75 of the Rules for reporting entities to assist specified agencies with investigations. Considerable concern was expressed at the time of the consultation that by no longer having AUSTRAC have central oversight of the notices, there would be a significant spike in the number of notices issued.

AFMA's view is that the proposal in the Consultation Paper, which is to not require eligible agencies to apply for AUSTRAC for an exemption but rather for eligible agencies to provide a written "keep open" notice to regulated entities and copied to AUSTRAC, does not address these previously articulated concerns. The Consultation Paper refers to AUSTRAC maintaining oversight of the exemptions, requiring periodic reporting and and monitoring trends, but none of these, of themselves, would necessarily limit the number of notices that are being issued.

Feedback from our members is that the proposed model would require additional staffing for reporting entities, the development of new processes to address the different agencies that the notices could be generated from and, accordingly, increased costs and regulatory burden.

AFMA is aware that the proposed changes canvassed in the Consultation Paper are aimed at enhanced FATF compliance and we are willing to engage with the Department to find a solution that achieves compliance without materially exacerbating the compliance burden for reporting entities. Our view is that there should be tighter controls that need to be adhered to prior to a notice being issued for a reporting entity to assist in an investigation.

7. Revised Obligations During COVID-19

With the ability to use COVID-19 Rules lapsing, what innovations adopted by regulated entities to deliver services online and remotely during the pandemic could be maintained or enhanced in ways that effectively mitigate money laundering and terrorism financing risks?

AFMA strongly supports the use by reporting entities of flexible approaches, including those that arose during the COVID-19 restrictions, in accordance with the risk-based approach. It is appropriate under a simplified approach that the Act and Rules are less prescriptive as to how a reporting entity determines and verifies the identity of its customers, with such an approach future-proofing the legislative framework in light of technological innovation.

In putting forward this approach, it is noted that Chapter 4 does not contemplate any of the following given that they were not in existence when Chapter 4 requirements were drafted and are considered to be potentially more robust than the existing safeharbour provisions:

- Digital credit checks;
- Biometric identity checks;
- Digital signatures;
- Video enabled calls.

As noted above, AFMA believes that the concept of certified copy is anachronistic and should not persist.

8. Tranche Two Entities

AFMA continues to support the extension of AML/CTF regulation to Designated Non-Financial Business Providers, including legal practitioners, accountants, conveyancers, trust/company service prioviders, real estate agents and dealers in precious metals and stones. This extension will ensure that all participants in a transaction life-cycle are able to report on suspicious matters, thereby enhancing the disruption of serious financial crime.

Other Issues

The following issues and comments are not specifically mentioned in the Consultation Paper but have been raised by AFMA members through the consultation process:

1. SMR Reporting

Currently, the low threshold for suspicion and the extension of the suspicion to all crimes leads to a significant number of SMRs being reported that may have limited intelligence value. Additionally, the SMR requirement in Part 3 of the Act is difficult to apply in circumstances where a suspicion arises in Australia but the customer is a counterparty with an offshore entity. The thresholds and structure of the SMR requirements should be considered as part of the Simplification Project.

2. TTR Reporting

AFMA members have noted that there is ambiguity as to whether there is a duplicate reporting requirement for reporting entities engaged in the wholesale buying and selling of physical currency to non-ADIs, i.e. both a TTR and a CBM-MI reporting requirement. Our view is that the CBM-MI reporting mechanism is appropriate in these circumstances and that TTR reporting is more appropriate for those depositing large sums of cash.

3. Correspondent Banking

Consistent with the position set out in the submission, AFMA supports less prescription in terms of the frequency of due diligence on correspondent banking relationships, the timing of the requirement for a written record and senior management approval, with the frequency being aligned to the risk-based approach. Clarity is also sought that electronic records satisfy the "written record" requirement.

4. Reliance

Our understanding is that the reliance changes that were brought in as part of the Phase 1.5 reforms only permit reliance for CDD purposes where the party being relied upon is itself a reporting entity. This effectively prevents the development of KYC utilities and limits the ability of vendors to assist with CDD obligations. The Department should consider expanding the ability for reliance to occur to not preclude the existence of third party repositories that may hold KYC information. AFMA's view is that the reliance provisions should be agnostic between branches and subsidiaries, such that a local part of a reporting entity is able to rely on on-boarding conducted by an offshore branch as it could an offshore subsidiary.

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AFMA appreciates the opportuntity to lodge a submission in relation to the Consultation Paper and is committed to work with the Department and AUSTRAC throughout the consultation process to ensure that Australia's AML/CTF legislative framework in a way that reflects international best practice and is effective at frustrating serious financial crime. Please contact me with any questions.

Yours sincerely,

Rob Colquhoun
Director, Policy