



Investment & Financial Services Association Ltd

ACN 080 744 163

Friday 21 September 2007

General Manager

Regulatory Policy
AUSTRAC
PO Box 5516
WEST CHATSWOOD NSW 1515
aml_ctf_rules@austrac.gov.au

Dear Madam/ Sir

IFSA Comments: Draft Rules

We refer to three Draft Rules that have been issued for consultation. We welcome the opportunity to provide comments and are grateful to AUSTRAC for extending the consultation period to respond to this important matter.

One difficulty we have encountered when assessing the draft rules is the lack of any explanatory statements to these rules. It would greatly assist our ability to comment on future drafts if we were provided with some explanations as to the draft rules' intent, the issues the rules are addressing, and where possible, the brief statements about the impact of the rules.

Such an approach would also greatly assist those who were not involved in the policy discussions to ascertain the policy intent behind the draft rules. This can be very important when rules seek to address complex issues such as those covered by the draft rules relating to securities and derivatives.

In the absence of such explanatory material, it is often very difficult to understand the intended operation of the draft rule giving rise to uncertainty and differing interpretations which ultimately impose a cost on industry.

This letter makes comments on the three following AUSTRAC draft rules:

1. Draft AML/CTF Rules relating to item 35 – issuing or selling a security or derivative
2. Draft AML/CTF Rules for ongoing customer due diligence
3. Draft AML/CTF Rules for reportable details relating to threshold transaction reports

1. Draft AML/CTF Rules for issuing or selling a security or derivative

As you are aware, IFSA has raised concerns on a number of occasions relating to item 35 of table 1 in section 6 of the AML/CTF Act. This draft rule appears to have sought to address:

- the interaction between item 33 and item 35 of the table (see a below); and
- institutional investor trading activities (see b below), including ongoing trading of securities or derivatives where that occurs on a financial market.

In our view, the draft rule does not appear to have addressed the issue of the treatment of new issues of interests in managed investment schemes that are about to be listed (see c below).

a. Interaction between item 33 and item 35 (paragraph 2 of the draft rule)

Paragraph 2 of this draft rule has sought to address the issue of overlap between item 33 and 35. It does this by purporting to exclude designated services provided under item 33 from having any application under item 35.

We believe that the wording in subparagraph 2(1) of the draft rule *does not* give rise to the intended effect. It does not ensure that Item 35 would not apply whenever Item 33 applies. Paragraph 2 of the draft rule states:

“For paragraph (d) of item 35 of table 1 in section 6 of the AML/CTF Act, the following condition applies:

- (1) the service is not one *described in* item 33 of the table 1 in section 6 of the AML/CTF Act.”

IFSA believes the words “described in” is create technical difficulty. This is because one transaction can cause different reporting entities to provide different designated services to the same customer, with effect that the same service can never be said to be “described” for the purposes of items 33 and 35.

We recommend that the draft words in subparagraph 2(1) of the draft rule be replaced with the following:

“in the case of a sale of a security or derivative – the reporting entity does not use the services of an agent to sell the security or derivative”

b. Institutional investors trading activities (paragraph 3 of the draft rule)

We believe paragraph 3 of the draft rule intends to extinguish designated services that arise with the trading activities of institutions for on-market transactions. While the paragraph addresses adequately the trading activities occurring on a prescribed market, we believe there are further issues that need to be addressed arising from the narrowness of the definition of “prescribed financial market”.

The draft rule adopts the Corporations Act definition of “prescribed financial market” under regulation 7.1.01 to mean the following market operators:

- “(aa) Australia Pacific Exchange Limited;
(a) Australian Stock Exchange Limited;
(b) Bendigo Stock Exchange Ltd; and
(c) Stock Exchange of Newcastle.”*

It seems clear that the current definition of prescribed financial market excludes many issues and sales of securities and derivatives. For example, issues and sale of derivatives in Regulated Markets such as the Sydney Futures Exchange. We recommend a broader approach to defining a market that also includes, besides Regulated Markets, certain overseas markets, bond and debt security markets.

All financial markets, wherever they are located and however they may be regulated should be exempt because of the impracticalities of identifying counterparties. The level of regulation applied to the market is irrelevant in this context.

c. Application of Item 35 to listed managed investment schemes

We had also understood that this draft rule would remove differences in the treatment of new issues of shares and debentures in a company, with the treatment of new issues of interests in managed investment schemes that are to be listed.

While item 35 includes an exemption for companies issuing shares or debentures in themselves, we have previously submitted that this exemption is specifically limited to “securities of a company”. The exemption does not extend to other entities or to other securities issued or sold by a company in carrying on a business of selling securities.

Nothing in subparagraph 2(1), which sought to reconcile the interactions of items 33 and 35, nor subparagraph 3, which applies to transactions that occur *on-market*, appear to address this issue. ie. new issue of interests in a managed investment scheme intended to be listed will be treated consistent with issues of shares and debentures in a company. We note that new issues of interests in a managed investment scheme that are about to be listed do not typically occur on-market.

This could be addressed by draft rules recognising that the reporting entity should apply for securities or derivatives to be quoted on a market within a period that is considered appropriate in these cases, say within 30 days.

These are major transaction undertaken by sophisticated institutions which will themselves be regulated for AML purposes. eg. like banks.

We would be pleased to further discuss this issue if the matters we have raised are unclear.

2. Draft AML/CTF Rules for Ongoing Customer Due Diligence

IFSA does not have any comments on this draft rule so long as suspicious matters that need to be reported are limited to those within the terms of section 41 of the AML/CTF Act.

3. Draft AML/CTF Rules for reportable details relating to threshold transaction reports

We are concerned about the impact of complying with subparagraph 2(4) of the draft rules relating to threshold transaction reports. The subparagraph requires the threshold transaction report to include details of “*either*”:

- (a) *the relevant industry code that applies to the customer’s business as published by the Australian Bureau of Statistics in the Australian and New Zealand Standard Industrial Classification (ANZSIC) 2006 (as amended from time to time);*
or
- (b) *the relevant industry code that applies to the customer’s business as published by the Australian Bureau of Statistics in the Australian and New Zealand Standard Classification of Occupations (ANZSCO) 2006 (as amended from time to time)”.*

It is unclear the reason why the above information is needed, they appear to exceed the minimum KYC information requirements. Compliance with this requirement would, therefore, require reporting entities to work through the 856 pages of occupational classifications. IFSA recommends that the relevant codes should only be required “if known”, this would make it at least consistent with paragraph 2(3) of the rules, which seeks information about the customer’s occupation.

Finally, still on the draft rules relating to threshold transactions, we are naturally keen to be informed if any future draft rules may alter the definitions of “money”, “e-currency” and “property”. All these are terms that are used under section 8 of these draft rules.

We would be appreciate being able to review any further drafts of the rules referred to above. Please do not hesitate to contact myself if you require any further assistance. I can be reached at 02 8235 2531.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Li Chang', with a small flourish at the end.

Li Chang
Investment and Financial Services Association