Reforming Australia's anti-money laundering and counter-terrorism financing regime

FSC Submission to Attorney-General's Department

13 June 2024

FINANCIAL SERVICES COUNCIL

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1 About the Financial Services Council

The FSC is a peak body which sets mandatory Standards and develops policy for more than 100 member companies in one of Australia's largest industry sectors, financial services.

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds and financial advice licensees. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing more than $3 trillion on behalf of over 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is one of the largest pool of managed funds in the world.

The FSC's mission is to assist our members achieve the following outcomes for Australians:

- to increase their financial security and wellbeing;
- to protect their livelihoods;
- to provide them with a comfortable retirement;
- to champion integrity, ethics and social responsibility in financial services; and
- to advocate for financial literacy and inclusion.

2 Introduction

The FSC thanks the Attorney-General's Department (**AGD**) for the opportunity to provide a submission on the AGD's second series of consultation papers released in May 2024 containing various proposals to address vulnerabilities in tranche two sectors (Papers 1, 2 and 3), modernise digital currency and payments technology-related regulation (Paper 4) and simplify, clarify and modernise Australia's AML/CTF regime (Paper 5).

The FSC agrees that the Anti-Money Laundering and Counter-Terrorism Financing Act 2006 **(AML/CTF Act)**, the Anti-Money Laundering and Counter-Terrorism Financing Rules Instrument 2007 (No. 1) (**Rules**) and various accompanying guidance need simplification and modernisation to remove complexity, provide clarity and certainty as well as deliver regulatory efficiencies. It is also important that vulnerabilities in tranche two sectors are carefully considered, and that Australia complies with the Financial Action Task Force (**FATF**) Recommendations to reduce the impacts and consequences of continued non-compliance.

The FSC submits that the proposed reforms should enhance the ability of Australian regulators and businesses to efficiently work together to combat and disrupt serious financial crime (for example, through the harmonisation of information sharing obligations between public and private entities) without being overly prescriptive or unduly increasing the regulatory burden.

The FSC had expected that because of the extended period between the first and second consultations, the supporting consultation papers would include more detail concerning the

proposed reforms to simplify and modernise the regime. The lack of detail has made it somewhat challenging to provide considered feedback. It has also limited our ability to assess the impacts and consider the requirements and resourcing to accommodate the implementation of the reforms. A key concern remains that many of the proposals will be overly prescriptive (for example, with regard to risk assessments and risk ratings, see reply to questions d and e below) and increase the regulatory burden on industry.

The FSC notes that the FATF will be conducting its next Mutual Evaluation of Australia's AML/CTF regime commencing in late 2026. To address the uncertainty faced by regulated businesses, it is important that the AGD advise stakeholders of the intended timeframes covering the passage and implementation of the reforms. This indicative timetable should set out the dates for key milestones covering further consultation, including the release of a Draft Exposure Bill, and accompanying Draft AML/CTF Rules, the tabling of the final Draft Bill into the Australian Parliament and the proposed commencement dates leading up to the FATF mutual evaluation assessment in 2026. This information will assist reporting entities to undertake the necessary planning and preparation, including identifying and prioritising resourcing and systems requirements to facilitate the transition to the enhanced legal framework.

The focus of our members is on the content of Paper 5, although we also have some comments on Papers 4 and 2 and deal with them in that order.

3 Executive Summary and key points

The FSC makes the following comments.

Provide more detail. The FSC notes that the consultation papers are at a high-level and general in nature, focusing on policy outcomes. It is difficult to fully assess the impacts, especially in terms of costs and benefits, of the proposals based on the information to hand. The timely release of a Draft Exposure Bill, accompanying draft AML/CTF Rules and indicative guidance would be helpful and the most efficient method to provide clarity and certainty around the reforms. Without further details concerning the specific proposed changes to the wording of the AML/CTF Act, Rules, and guidance, it is not possible for reporting entities to assess with any certainty the extent of uplift required to implement the proposed core obligations.

Allow flexibility in assigning an initial customer risk rating at onboarding. The proposal to assign an initial customer risk rating prior to providing a designated service to the customer creates practical and operational challenges. In line with existing requirements, the FSC understands that industry practice has generally been to perform politically exposed person (PEP) and sanctions screening the day after the on-boarding of the customer. The outcomes of the screening are important factors to be considered in determining a customer's risk rating and is consistent with existing ongoing and enhanced CDD requirements. If the proposal proceeds as outlined in the consultation paper for existing reporting entities, it will create regulatory inefficiencies by increasing the regulatory burden where businesses need to adjust existing systems and onboarding procedures. This will also have implications for those reporting entities that engage third-party agents (such as

administrators) to conduct customer on-boarding. Further, the methodology and *number* and *type* of risk rating categories adopted by a reporting entity as part of its customer risk rating should not be prescribed in the AML/CTF Act or Rules. The proposed new customer due diligence (CDD) requirements assume that a reporting entity will always rate a customer using risk rating categories such as, for example, High/Medium/Low. This is not the model that all reporting entities use, nor is it appropriate or beneficial for all reporting entities to adopt that approach in the context of their business activities (including products and customer types). See reply to question d.

Avoid overly prescriptive risk assessment requirements. Reporting entities must retain control over how a risk assessment is carried out. It may be beneficial for AUSTRAC to refer to matters that a reporting entity should consider when performing a risk assessment, as far as they are applicable to the reporting entity's business. But the reporting entity should retain discretion over which factors to prioritise in their own circumstances. AUSTRAC should not prescribe which factors a reporting entity 'must' consider in all cases. See reply to question b.

Maintain the existing risk-based approach to re-verification requirements as part of OCDD. The FSC submits that the proposals should enable reporting entities to continue to apply the risk-based approach to re-verification of documentation and avoid undue prescription. Reporting entities should have the flexibility to design their AML/CTF program so that re-verification is linked to risk and not arbitrarily mandated, for example on the basis of a certain timeframe having elapsed since the initial CDD was performed. See reply to question d.

Clarify that non-ADIs will not be subject to IFTI reporting obligations. It is unclear in Paper 4 the extent to which the IFTI reporting obligations will apply, particularly where the reporting entity 'closest to the customer' is a non-bank financial institution that is the client of an ADI. Any extension of the obligation to non-bank financial institutions to report IFTIs would be of significant concern for industry. Greater clarity is also required concerning the exclusion of 'value transfers performed by non-financial institutions incidentally to another service' from the value transfer chain and IFTI reporting. See reply to question m.

Maintain flexibility on IFTI reporting. The FSC submits that imposing IFTI reporting obligations on a new cohort of reporting entities will impose significant operational costs and potentially customer implications for businesses at the end of payment chains, for example establishing the appropriate automated IFTI reporting systems and controls. This would have a significant impact for smaller institutions that do not have overseas correspondent banking relationships and would need to develop new IFTI reporting systems and controls. The AGD should reconsider whether these changes are appropriate given the large-scale impacts. If the AGD is not willing to change the proposed requirement, an extended implementation period would be needed. See reply to question m.

Maintain and enhance the risk-based approach. More generally, while the purpose of the consultation is simplification and modernisation, it is important that changes (such as to align with FATF compliance) do not mean unjustifiably increasing regulation and costs for reporting entities in terms of new requirements, especially for small reporting entities. Such

unnecessary prescription would be at odds with the fundamental need to maintain a risk-based regime and the flexibility it provides reporting entities in the efficient use and application of resources to combat and disrupt financial crime. In our view, it is important to preserve the risk-based nature of the regime in compliance with FATF Standards and this principle should be clearly set out in the AML/CTF Act. Any changes should be consistent with the purpose of the AML/CTF Act. It is also important in this context that the AGD and AUSTRAC avoid regulatory creep, which is common under principles/outcome-based legislation and the application of the risk-based approach. This occurs through the demand for increased prescription resulting in the proliferation of rules and guidance products.

Coordinate reforms. The FSC agrees that the work to be undertaken by the AGD regarding the AML/CTF regime intersects and requires coordination with a number of other complementary policy areas currently being progressed, notably Privacy, the Australian Cyber Security Strategy, the establishment of a Beneficial Ownership Register and the digital identity strategy. The FSC would welcome more clarity as to how the AML/CTF reforms will be progressed in a coordinated manner between the relevant areas of government (and in due course, AUSTRAC, and other regulators such as APRA and ASIC) to avoid unintended consequences. It would be helpful to have a clear roadmap from the AGD that sets out the intended stages and accompanying time frames for the various contemplated changes as highlighted in the introductory section of this submission.

Delay commencement. The resources required for implementation of this revised framework should not be underestimated by the AGD and AUSTRAC, particularly as the reforms will include explicit obligations which have to date been otherwise implied or in response to enforcement action. It remains unclear how the transition processes to the reformed regime will be influenced by the forthcoming FATF Mutual Evaluation of Australia to achieve technical compliance. It is important that appropriate transition periods are accommodated, either by specifying staggered commencement dates around certain obligations and/or by applying appropriate Policy Principles periods of no less than 18 months. This approach will enable reporting entities to work through and accommodate comprehensive changes to the regime. Reporting entities anticipate that uplift would include, among other things, revising and realigning AML/CTF programs, policies, procedures, systems, and controls; as well as revisiting, reviewing, and updating ML/TF risk assessments and the underlying methodology. In addition to these documented updates, it will also be necessary for reporting entities to consider and implement upgrades to IT systems. It is important to acknowledge that in large part businesses will only be able to address these issues once the final regulatory changes have been enacted and related rules and guidance released by AUSTRAC, and not before.

5 Paper 5: Broader reforms to simply, clarify and modernise the regime

a. Under the outlined proposal, a business group head would ensure that the AML/CTF program applies to all branches and subsidiaries. Responsibility for some obligations (such as certain CDD requirements) could also be delegated to an entity within the group where appropriate. For example, a franchisor could take

responsibility for overseeing the implementation of transaction monitoring in line with a group-wide risk assessment. Would this proposal assist in alleviating some of the initial costs for smaller entities?

The FSC agrees in principle with the proposed 'business group concept' as it offers reporting entities the necessary flexibility and ability to implement more effective risk management practices through the sharing of information and leveraging of resources across related entities (including administrative or service entities). However, the proposed concept raises several issues requiring further clarification as follows.

Clarify meaning of business group head. Further detail is required regarding key definitions including 'business group head.' For example, where the parent company is not a reporting entity for the purposes of the AML/CTF Act, it should be clear that it can still fall within this definition. Also, it would be preferable if the relevant business group head should be able to select which entity in its corporate group it wishes to be part of the business group for the purpose of an AML/CTF program, especially those which don't make any decisions in respect of the AML/CTF program. Relevantly, the FSC notes the consultation paper comments as follows.

"The department proposes replacing the concept of a DBG with a simplified 'business group' concept, which would automatically include all related entities in a corporate group or other structure." (AGD Paper 5, Page 11)

While efforts to simplify arrangements are supported, it is not clear to us from the above statement whether inclusion of all entities within the business group is mandatory, or optional to allow the business group to simplify administrative arrangements. An example of the latter is where an entity in a corporate group provides no designated services but performs some AML/CTF functions on behalf of the related reporting entities.

Two different circumstances demonstrate the complexity that can be involved, and the likely need for flexibility despite an outwardly simple proposition.

Joint ventures

Two unrelated entities each own 50% of a third entity that is a reporting entity. Currently, that third entity would require its own AML/CTF program, but in the event of mandatory inclusion in a business group, it could be in the untenable position of being subject to two differing programs, with implications for any SMR obligations.

Item 54 Service providers.

Currently, many financial advisers are in small independent practices operating under a range of legal structures but are authorised representatives of a larger licensee dealer group. To the extent that it is providing Item 54 Services, the financial advice business is required to follow the AML/CTF program applicable to the licensee, which may in turn be a special AML/CTF program, and currently may be part of a DBG. Yet some of these practices provide other services that will likely be captured by Tranche 2, such as accounting and legal services (including in both instances activities such as company formation).

The FSC submits that further clarity should be provided around which program these entities follow, how this may impact the licensees themselves, and possible consequential issues such as third party reliance on the customer identification performed by the Item 54 provider.

Expand capacity of business group members to perform obligations. The FSC notes that under the current arrangement for designated business groups (DBGs), not all obligations can be performed by members, for example, where it involves a suspicious matter reporting (SMR) obligation. Clarity and details are required to understand whether the current arrangements for DBGs will apply or whether they will be expanded. To illustrate this point, consideration could be given to permit the reporting of one SMR on behalf of a group of reporting entities within a business group where the customer and/or the customer's transactions apply to one or more reporting entities within the group. Currently, separate SMRs must be submitted in AUSTRAC Online where a suspicious matter arises in relation to shared customers of members of the DBG. This process creates unnecessary duplication and administrative inefficiencies for no logical benefit. This will require realignment of the existing SMR reporting template and updating of AUSTRAC Online.

Enable transitioning to a simplified business group. The reforms should enable a streamlined administrative process to allow existing DBGs to transition to these new arrangements and to deliver regulatory efficiencies.

Clarify liability of simplified business group members. The FSC notes that the issue of legal liability under the AML/CTF Act currently draws on common law principles of agency. The FSC notes that under the proposed simplified business group, membership of the group will be extended to non-reporting entities, who may provide specific AML/CTF functions on behalf of reporting entities, for example, customer on-boarding or transaction monitoring. The AML/CTF Act should make it clear whether a default by one member of a group (for example, where that member has been appointed to carry out an obligation under the legislation on behalf of the other members of a group and fails to do so) creates a liability for the other members of that group and/or the defaulting member. The legislation should make it clear whether liability depends on whether any particular member is a reporting entity or not.

Provide details on the impacts to the AUSTRAC industry contribution. Clarification is also required as to how these changes will impact AUSTRAC industry contribution calculations, given that a non-reporting entity's earnings may be captured in the levy calculation. More generally, we refer you to the FSC submission on the recent *AUSTRAC industry contribution 2023-24 stakeholder consultation paper April 2024*[1]. Despite the foregoing, we understand that the AUSTRAC industry contribution will be revised given the proposed extension of the regime to encompass Tranche 2 entities. This will result in the considerable expansion of the regulated population, accompanied by the proportionate expansion and resourcing of AUSTRAC to supervise compliance and reporting of the newly regulated sectors. It is

[1] Provided separately.

expected that the current calculation methodology used for the AUSTRAC levy will become redundant because it would not be sustainable.

b. The streamlined AML/CTF program requirement outlined in this paper provides that the board or equivalent senior management of a reporting entity should ensure the entity's AML/CTF program is effectively identifying and mitigating risk. To what extent would this streamlined approach to oversight allow for a more flexible approach to changes in circumstance?

As a general matter the FSC supports the streamlined board and senior management requirements which propose that the board (or senior management equivalent) ensures that the entity's AML/CTF program is effectively identifying and mitigating ML and TF risks. This should allow boards to refocus their governance responsibilities while providing reporting entities with the flexibility to adopt reporting practices which concentrate on ML/TF risk management and the effectiveness of the AML/CTF program. Operational issues or AML/CTF program updates could be coordinated and approved by the AML compliance officer (AMLCO) to deliver and drive further efficiencies and enable the reporting entity to be more agile and responsive to change.

The FSC makes the further specific comments:

Provide guidance on meaning of 'fit and proper person', 'independence' and 'resourcing'. Noting that there is a clear step-change from the existing framework regarding the role and functions of the AMLCO, further clarity is requested on what is meant by 'fit and proper person', 'independence' and 'resourcing' in this context (we note on Page 9 of Paper 5 it states that the AMLCO will be an employee at management level responsible for overseeing and coordinating the day to day operations and effectiveness of the AML/CTF program). Clarity is also sought on the following:

- who in a reporting entity will have the responsibility to certify that the AMLCO is a fit and proper person,
- the expected frequency of such assessments,
- the scope of the 'fit and proper person' checks, for example, can they align with employee due diligence requirements,
- those responsibilities that more appropriately and currently sit with boards as opposed to the AMLCO, and
- the implications under the Financial Accountability Regime in circumstances where the AMLCO is classified as a senior executive.

Provide guidance on reporting requirements. AUSTRAC should also provide practical guidance and examples concerning its expectations for reporting to the board (or senior management equivalent), including the information to be reported to ensure that the board is reasonably satisfied that the AML/CTF program is effectively identifying, mitigating, and managing ML/TF risks. The FSC notes that currently relevant obligations can be conducted by the board of the main holding company of a Group when members of the DBG are related entities, and it should be clear that any changes continue to permit this outcome.

Avoid overly prescriptive risk assessment requirements in the legislation. It is anticipated that the legal framework will set out the guard rails to assist reporting entities in establishing and maintaining an enterprise-wide risk assessment, complemented by appropriate guidance.

However, reporting entities must retain control over how a risk assessment is carried out. AUSTRAC may refer to matters that a reporting entity should consider when performing a risk assessment, as far as they are applicable to the reporting entity's business. But the reporting entity should retain discretion over which factors to prioritise in their own circumstances. AUSTRAC should not prescribe which factors a reporting entity 'must' consider in all cases. The FSC submits that being too prescriptive would likely adversely impact entities with large DBG groups in particular (e.g., some have over 100 reporting entities) and it should be made clear that there will be no requirement for each reporting entity conduct a risk assessment. This would be exacerbated if the AML/CTF Act or Rules prescribe specific detail about the form of risk assessment (which may not always be appropriate on a risk basis given the size, complexity and nature of the reporting entity). We note that further complexity can arise in cases where reporting entities conduct both designated services and non-designated services.

Enable flexibility in documenting risk assessment methodology. It is noted on Page 7 of Paper 5 that a reporting entity will be required to document its risk assessment methodology as part of its AML/CTF program. To avoid overly lengthy or cumbersome documentation, the FSC suggests that flexibility be maintained in how this requirement is addressed in practice so that the most effective way to include the actual methodology can be used, (for example, through referencing the risk assessment methodology in the AML/CTF program, including it as an appendix or consolidating the methodology to highlight the key principles and incorporating a condensed version into the AML/CTF program).

Clarify timing of risk assessments and other reviews. Paper 5 notes (at page 7) that risk assessments should be repeated every 4 years at a minimum. If such risk assessments are required every 4 years, to maintain flexibility the FSC suggests that AUSTRAC clarify reporting entities should not necessarily be required to carry out the proposed AML/CTF program review and independent review (at page 11) at the same time or in the same year.

Consistency of proliferation financing risk requirements and sanctions legislation. The FSC notes that reporting entities should identify, mitigate and manage proliferation financing risks under their AML/CTF program in line with FATF Standards, as with any other predicate offence. However, if the AML/CTF Act or Rules are to be amended to refer to these risks specifically, careful consideration must be given to ensure there is no unnecessary overlap or inconsistency with Australia's sanctions laws. Alternatively, proliferation financing risks could be addressed in sanctions legislation. We request that proliferation risks continue to be addressed in AUSTRAC's National Risk Assessments and that insights be provided for entity-level risk assessments. Sufficient time should be allowed for reporting entities to determine whether their existing risk assessments require any update.

Consult more on proposed changes to AML/CTF program. Paper 5 proposes a number of changes which may impact the form and substance of a reporting entity's existing AML/CTF program. While some of these items are positioned as opportunities to streamline existing requirements (for example, bringing together Part A and Part B requirements), for some businesses these proposals could require significant work to review and uplift existing documentation. In certain instances, there are also broader and perhaps unforeseen consequences of proposed changes which the AGD have not yet provided clarity on. The

FSC suggests that the AGD discuss the specifics of any proposals with industry before the release of a Draft Exposure Bill.

Clarify changes to the application of civil penalty provisions. The draft consultation papers are silent on the application of proposed new penalty provisions arising from the reforms. For example, it is unclear whether the existing penalty provisions for compliance with Part A will also apply to Part B, or whether breaches of Part B will be covered under the Customer Due Diligence obligations. Given the expanded role and responsibilities of the AMLCO, clarification is also required on the application of existing penalties under s.174 (Ancillary Contravention of Civil Penalty Provisions) where the AMLCO is involved in the contravention.

c. Many modern business groups use structures that differ from the traditional parent subsidiary company arrangement. What forms and structures of groups should be captured by the group-wide AML/CTF program framework?

Avoid adverse impacts on foreign branches and subsidiaries. The FSC notes that Paper 5 (see Page 13) contemplates the potential extension of Australian AML/CTF requirements to customers and/or processes outside Australia where requirements are “less strict” than Australia, in alignment with FATF Recommendation 18. In our view there are two potential issues of concern that arise:

- It is not clear whether the proposed reforms will retain the existing exclusions in Part 2 of the AML/CTF Act for offshore permanent establishments where designated services are provided outside of Australia.
- It is not clear how the concept of “less strict” will be applied noting the existing Chapter 4 Rules have domestic-nuanced requirements that are a challenge for global operations for example, domestic definition of “regulated”. Australian laws and laws of other jurisdictions deal with AML/CTF in different ways. In some instances, this does not necessarily mean that one law has a higher standard than another.

The FSC submits that engagement with the AGD prior to the Draft Exposure Bill being released would be important to minimise the risk of any unintended impacts. It is essential that the proposed changes do not inhibit entities from effectively operating in offshore markets by creating unnecessary regulatory duplication through the extension of Australian AML/CTF obligations with respect to the provision of designated services at or through foreign branches or subsidiaries. Additional detail would assist reporting entities with a cross-border footprint to evaluate the equivalency of arrangements in other jurisdictions and further mitigate the risks of international financial crime.

d. To what extent do the proposed core obligations clarify the AML/CTF CDD framework?

The FSC considers that the proposed core obligations outlined in the consultation paper help to clarify and provide certainty concerning the AML/CTF CDD framework. While we note that the intention is to align with the FATF Standards and the processes in comparable jurisdictions, our primary issue is the lack of detail of what will be included in the AML/CTF Act, Rules, and guidance. Having regard to the detail we have been provided, we have a number of suggestions as follows.

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Applying initial customer risk ratings as part of the on-boarding process – PEP and Sanctions Screening. The proposal to apply an initial customer risk rating incorporating PEP and Sanctions screening prior to providing a designated service to the customer creates practical and operational challenges. In line with existing requirements, industry practice has been to perform PEP and sanctions screening the day after the on-boarding of the customer. The outcomes of the screening are important factors to be considered in assessing a customer's risk rating. If the proposal proceeds as outlined in the consultation papers for existing reporting entities, it will create regulatory inefficiencies and increase the regulatory burden in order to realign existing systems and onboarding procedures. The FSC suggests that the reforms maintain the existing requirements which enables PEP screening to be performed either before the provision of a designated service to the customer or as soon as practicable after the designated service which is consistent with current provisions in the Rules. The obligation to conduct a customer risk rating and complete PEP screening before providing the designated service will be very onerous and will interrupt the normal course of business for straight through processing of onboarding customers.

Relevantly, the FSC notes that the FATF does not require that a customer risk rating verification is completed before the provision of a designated service in all circumstances. FATF Recommendation 10[2] provides:

"Financial institutions should be required to verify the identity of the customer and beneficial owner before or during the course of establishing a business relationship or conducting transactions for occasional customers. ***Countries may permit financial institutions to complete the verification as soon as reasonably practicable following the establishment of the relationship, where the money laundering and terrorist financing risks are effectively managed and where this is essential not to interrupt the normal conduct of business."***

In the current digital environment, the FSC suggests flexibility is maintained in the AML/CTF Act concerning the requirement to apply an initial risk-rating to each individual customer and legal persons/arrangements given the configuration or the current on-boarding processes. For example, a reporting entity could apply a customer risk-rating based on the assessment of a customer cohort and a more complete understanding of the customer risk would be applied on an ongoing basis consistent with ongoing customer due diligence obligations having regard to certain criteria through the conduct of screening and transaction monitoring.

As noted above, the FSC understands that for many businesses not all of the six KYC requirements set out on Page 18 of Paper 5 would be carried out on Day 1 – notably PEP screening and investigation of beneficial ownership information as is currently enabled under the AML/CTF Rules. If reporting entities are required to complete all these steps prior to providing a service (in particular if they are required to be "reasonably satisfied" to the standard set out on Page 18 which refers to collection and possibly verification) this will likely delay significantly customer onboarding processes. The adverse customer impacts could include:

[2] See The FATF Recommendations (fatf-gafi.org)

- preventing account origination outside of business hours where operations teams are based in Australia without sending customer data and shifting alert dispositions offshore; and
- for vulnerable customers who may have challenges in providing this information in a prompt manner.

The reforms should permit scope for a form of initial customer risk rating which can then be confirmed or amended as appropriate when all KYC requirements have been completed. Removing flexibility in the onboarding processes will have significant cost implications and increase the regulatory burden when assigning risk ratings before designated services are provided to customers as CDD may need to include an upfront enhanced CDD (ECDD) component. To re-configure the onboarding arrangements will require a significant technology and process uplift for many businesses, resulting in considerable compliance costs.

The FSC submits that the AGD should reconsider whether these changes are appropriate given the large-scale impacts and a disproportionate burden on reporting entities. We recommend that the AGD engage further with stakeholders on this issue prior to the release of a Draft Exposure Bill to minimise the risk of any unintended impacts.

Maintain the existing risk-based approach to re-verification as part of OCDD. The FSC submits that the proposals should maintain the risk-based approach to re-verification of documentation under OCDD processes to avoid undue prescription. Reporting entities should retain the flexibility to design their AML/CTF program so that re-verification is linked to risk and not arbitrarily mandated, for example, on the basis of a certain timeframe having elapsed since the initial CDD was performed. Existing reporting entities have adopted a risk-based approach under the ongoing customer due diligence processes and procedure to ensure that customer KYC information remains current and accurate. Many reporting entities currently would only require re-verification for certain high-risk customers, or in response to certain suspicious matters or transactions, but not necessarily on a periodic basis, but in accordance with the risk appetite.

Provide more detail on item 54 program. Paper 5 is silent on whether there will be changes to an item 54 only service provider being able to adopt a special AML/CTF program. Clarity on this matter would be welcomed.

Clarify requirements for the certification of KYC documents. Noting that in a post-COVID environment, businesses now have limited face-to-face interaction with customers resulting in many reporting entities operating entirely in a digital environment and branchless. It is suggested that the Rules should no longer prescribe the requirements to obtain certified copies under CDD. This would allow reporting entities flexibility in aligning the processes with a risk-based approach.

Introduce regulated entities register. The FSC suggests that the AGD consider the introduction of an AUSTRAC regulated entities register similar, for example, to the Reserve Bank of New Zealand, or the Department of Internal Affairs (NZ), where the public can verify whether a reporting entity is enrolled and/or registered with AUSTRAC. This is particularly relevant with the introduction of Tranche 2 entities.

e. What circumstances should support consideration of simplified due diligence measures?

The FSC supports the proposed approach to simplified CDD which would give reporting entities the discretion to apply simplified CDD measures where the risk is low. This matter was flagged in the Report of the Statutory Review from 2016. However, there are several statements in Paper 5 which require clarification.

Clarify requirements on KYC and verification. Paper 5 introduces new concepts of Simplified CDD (Low Risk), Enhanced CDD (High Risk) and Standard CDD (explained as being done in line with amended Rules and in circumstances outside enhanced CDD and Simplified CDD). While it appears the AGD is seeking to reduce the CDD burden for Low Risk customers, the concepts in Paper 5 appear conflicting and are somewhat unclear on how the new customer risk rating/CDD concepts will work in practice, in particular for retail sectors with straight-through processing.

Specifically, Page 16 in relation to Simplified CDD states a reporting entity "must believe on reasonable grounds that it knows the identity of its customer" and references "inferring (rather than collecting) KYC" and "verifying less". However, these Page 16 concepts appear to potentially conflict with the Page 18 concepts which set out 6 elements that a reporting entity needs to be "reasonably satisfied" it knows before providing a designated service – including beneficial ownership identification, ownership/control and PEP alert closures. "Reasonably satisfied" is also defined as collecting/verifying customer identity and being satisfied with who they are but doesn't cover the other five KYC requirements listed on Page 18 explicitly. These inconsistencies in the consultation paper have created confusion on how Simplified CDD will operate in practice.

As a result , it is unclear–

- how the regulatory burden is lessened for Low-Risk customers if the six customer KYC requirements listed on Page 18 are mandated for collection and verification for all customers.
- if current simplified company and trustee verification procedures will be retained. Simplified CDD (Low) may be intended to compensate for these but it is unclear how in practice.
- how the AGD intends for "inferring (rather than collecting) KYC" to work, and whether that concept would in practice only be able to be applied to a limited subset of customers.

The FSC submits that further clarity on how Simplified CDD (Low Risk) would work in practice needs to be provided. AUSTRAC guidance should provide worked examples of what is considered as "having reasonable grounds to believe that the customer is who they claim to be" (see Page 18). Particularly when electronic KYC verification is used for the purpose of onboarding, and there are no face-to-face interactions with the customer.

Maintain flexibility for risk rating categories. The FSC submits that reporting entities must retain the ability to adopt their own risk rating categories and be able to pre-determine what risk factors will drive a high-risk rating for its customers. For some businesses, applying High/Medium/Low ratings to its customer base may be appropriate, while for others, a simpler High/Low rating model is more appropriate. AUSTRAC should not prescribe the particular categories or design the AML/CTF Rules (associated with CDD or Ongoing CDD

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obligations) on the basis that a reporting entity will apply a High/Medium/Low risk rating model. Some reporting entities have existing customer risk rating models in place which are appropriate for their business, and the introduction of prescription around mandatory risk rating categories would result in significant design and operational impacts for their AML programs, with no 'value-add' in relation to ML/TF risk management outcomes.

Permit alignment with risk assessments. It should be confirmed that the approach to determining when simplified CDD measures are applied may be aligned to a reporting entity's customer risk rating. Certain parameters or examples could be communicated in guidance of specific low risk circumstances relating, for example, to the four primary risk factors: customer type, jurisdiction or location of the customer, the designated service being provided and the method of delivery. However, reporting entities should also be able to determine that certain types of customers (for example, regulated or listed entities) will be low risk by default.

Maintain existing Simplified CDD for certain entities. The FSC submits that Simplified CDD should be able to be applied for certain categories of customers or customer types, for example, trusts and companies currently prescribed in the AML/CTF Rules. Reporting entities should not be required to determine whether each individual customer who is, for example a regulated, listed or government entity is high or low risk and therefore also required to determine on an individual basis whether Simplified CDD can be applied. Reporting entities should be able treat certain customer types as low risk and be able to apply Simplified CDD as standard, unless they are otherwise on notice of a high risk circumstance. This is important because it allows reporting entities to design and standardise CDD procedures within online and offline application flows/forms, a necessary requirement for not interrupting the normal course of business. Where high-risk factors are present, additional measures could be applied *as appropriate*.

Comparable foreign jurisdictions. Flexibility should be permitted so that SDD can apply to similar entities meeting SDD requirements in comparable foreign jurisdictions. For example, we note that in New Zealand, it has specified low risk circumstances in section 18 of the New Zealand AML/CTF Act and at Clause 37 of the UK *Money Laundering Regulations*. In New Zealand, the circumstances were aligned with the findings and conclusions of its National ML/TF Risk Assessment (refer to the FATF Mutual Assessment of New Zealand, 2021).

Conduct regular national risk assessments. To support reporting entities in being able to effectively conduct appropriate and enterprise risk assessment, it underlines the importance of AUSTRAC conducting regular national risk assessments at more regular intervals. This obligation could be mandated in the legal framework to provide reporting entities with the necessary assurance.

Provide guidance on verification of beneficial ownership and control. Consideration should be given to developing appropriate guardrails where it applies to verification of beneficial ownership and control. It is important that there is a consistency in the application of CDD processes in determining beneficial ownership and control, for example, addressing non-beneficially held shares, and assessing unregulated trusts and their appointors. Under any new CDD rules, reporting entities should continue to be able to rely on information provided by the customer regarding beneficial ownership (where required), rather than having to determine who the beneficial owners are through additional verification procedures in all

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cases. While verification of who the beneficial owners of an entity are may be appropriate in certain higher-risk scenarios, it should not be a standard requirement that reporting entities must follow. This is also relevant having regard to the application of reliance (for example, providing guidance on when it would be appropriate to permit reliance on a letter from a legal practitioner or accountant (which would have its own AML obligations) when seeking to verify beneficial ownership and control in certain circumstances.

Provide more flexibility for reporting entities in determining whether a PEP is 'high-risk'. The FSC notes that there is inconsistency in the Rules currently regarding the treatment of foreign PEPs. Current guidance on AUSTRAC's website states that a foreign PEP (or the relevant 'customer') must be rated 'high-risk'. While Chapter 4.13 of the Rules currently requires that *ECDD be performed* for foreign PEPs, there is no explicit requirement which mandates that a high-risk rating is applied to the customer. The FSC submits that the current Rules are considered appropriate, because there may be cases where a foreign PEP is associated with a low-risk customer and the role of the PEP does not introduce additional ML/TF risk. For example, a reporting entity may onboard a large, foreign regulated or other large unregulated entity as its customer, and the entity may have a foreign PEP on its board. While a PEP may have some influence on decisions made by the entity's board, this does not necessarily mean the customer should be rated 'high-risk'. In such cases, the PEP (potentially a former member of parliament, a former senior official with a foreign regulator or another type of current PEP who does not present a high level of ML/TF risk) is merely a member of the board of the entity. The PEP's own source of funds or wealth may be irrelevant to the customer relationship. Reporting entities should therefore have flexibility around how to apply a customer risk rating where there is a PEP connected to the entity customer.

f. What guidance should AUSTRAC produce to assist reporting entities to meet the expectations of an outcomes-focused approach to CDD?

The FSC makes the following suggestions.

Require AUSTRAC to publish more information. The AML/CTF Act should be amended to mandate that AUSTRAC publish its strategic priorities (regulatory compliance and intelligence priorities) on an annual basis. It should also be amended to mandate that AUSTRAC conduct and publish national Money Laundering and Terrorism Financing risk assessments at regular intervals or conduct updates in response to significant changes in the risk environment. This is a FATF requirement under FATF Recommendation 1 and is a valuable resource for reporting entities in applying the risk -based approach. The FSC submits that intervals of 2-3 years would be appropriate and in line with other comparable jurisdictions. Other information of a thematic nature, such as SMR trends, should be published more frequently to better assist stakeholders in assessing recent information relevant to changes in the ML/TF risk environment.

Provide more internationally aligned guidance. By adopting an outcomes-based and risk-based approach to CDD, guidance on certain guard-rails, risks and regulatory expectations will be crucial to the effectiveness of the framework. Given that the proposed CDD framework will primarily align with the FATF standards, the AGD and AUSTRAC should look to the approaches and lessons learnt from like-minded jurisdictions (e.g., UK, New Zealand, Canada) on tried and tested approaches. This may include practical or worked examples which demonstrate an outcome and risk-based approach.

Specific guidance. AUSTRAC could also produce targeted and sector specific guidance where appropriate to promote and encourage a more consistent approach to meeting obligations without being overly prescriptive. Some of our members have commented that it would be helpful to have practical guidance on the legal or regulatory aspects of matters relating to:

- wording on closure and restrictions letters on customer accounts as a result of an SMR.
- non face to face interaction which may involve certification via video call.
- use of digital signature instead of wet signature for certifying an ID as a true copy of the original ID.
- ID certification over video calls and whether that's acceptable given the law currently defines certified copy is one that has been certified as a true copy of the original ID (we note that in this situation a certification does not attest that the copy is a copy of a genuine document, only that it is a copy of a document presented).
- When a business should enrol vs. register with AUSTRAC or whether both terms are used interchangeably.

Manage the proliferation of guidance. It is important to note, however, that one of the downsides of outcome-based and risk-based regulation is managing the proliferation of guidance and prescription creep. It is important that AUSTRAC work closely with industry in developing practical guidance which can be operationalised effectively and efficiently, while promoting and embedding the risk-based approach. Guidance should generally include sufficiently detailed wording that can be reviewed, clarified, and challenged, and include illustrative and sector specific examples where appropriate.

*Clarify legal status of guidan*ce. The FSC suggests that the legal status of guidance should be clarified. We note that under the current AML/CTF Rules, reporting entities have an obligation to consider AUSTRAC Guidance. In reviewing the most recent FATF ME Follow-up Report of March 2024, as outlined under sub-heading criterion 18.1 on Pages 18-19, the reference suggests that failure to take into account guidance disseminated or published by AUSTRAC constitutes 'enforceable means' because it could ultimately constitute a breach of the requirement to adopt and maintain an AML/CTF program at section 81 of the AML/CTF Act. It is important that the guidance does not become a de facto replacement for what is currently prescribed in detail in the AML/CTF Rules.

See also requests for guidance in response to questions b, d and e above and i and f below.

g. When do you think should be considered the conclusion of a 'business relationship'?

The following could assist in determining when a business relationship could be considered to have concluded:

- all outstanding transactions or designated services have concluded;
- funds owed to the customer have been paid or returned;
- fees that must be charged to the customer have concluded; and
- all accounts relating to the customer have been closed.

Additionally, 'inactive' or 'Nil balances' should also be considered for some situations. For example, the FSC notes that some reporting entities that manage a register of funds do not

necessarily 'close' accounts. They may be flagged inactive where that system functionality exists, or the account may be treated as 'Nil'. Nil accounts can still be used if the customer acquires more assets e.g. units in a fund.

h. What timeframe would be suitable for reporting entities to give a risk rating to all pre-commencement customers?

Changes to the revised CDD framework, which will require updating processes, procedures and system upgrades, should be in place prior to developing and implementing a framework for risk rating pre-commencement customers.

We consider that the timeframes to require existing reporting entities to apply a risk rating to pre-commencement customers should consider the size and complexity of the pre-commencement customer base. In some situations, it will be problematic to have a basis for establishing a risk rating, noting that the risk assessment will be based on limited information held by the entity about the customer. For example, the FSC understands that not all relevant businesses are required to maintain a registered street address nor a date of birth of a customer and not all systems will hold that information nor have the functionality to do so.

i. Are there situations where SMR or section 49 related information may need to be disclosed for legitimate purposes but would still be prevented by the proposed framing of the offence?

The FSC supports the reforms to the tipping off provisions to improve better information sharing outcomes. However, further detail is required on any guard-rails or measures reporting entities will be required to have in place to prevent tipping off to defend against intentional, reckless, or negligent disclosures. Reporting entities will require guidance that establishes guardrails and practical worked examples around a 'reasonableness test' to determine whether a disclosure is likely to prejudice a criminal investigation to understand how an amended tipping off prohibition will operate in practice.

We note that Paper 5 states that the reforms will be framed in such a way that could help facilitate private-to-private information sharing in future subject to appropriate actions being in place. The FSC submits that this should be recognised as a high priority, particularly in the current environment involving the proliferation and constantly evolving nature of fraud and scams activity. Reporting entities that are not members of the AFCX or the Fintel Alliance are at a disadvantage because the tipping off provisions in their current form and the proposed revisions prohibit meaningful information sharing arrangement within sector cohorts, for example, superannuation and wealth management. It is suggested that further clarification be provided on how the proposed reforms will balance the loosening of the tipping off framework to improve sharing of information among reporting entities on the one hand with the current protections regarding SMRs/SMR information on the other.

In broad terms, the proposed framing of the offence appears to be consistent with the way the offence has been framed in the UK and Hong Kong and we understand it is generally regarded to be operating as intended. However, clarity on the wording in the AML/CTF Act / Rules / Guidance is required to ensure that the updated wording does not unintentionally restrict the sharing of information.

It appears to us that the proposed new offence language covering "*any information about a SMR", "SMR information" or "section 49 related information*" may be ambiguous.

It is not clear whether this would allow the disclosure of any information that could give the inference that an SMR has been submitted. In our experience it is the current prohibition against the disclosure of any information which could give an "inference" as to a SMR having been provided which is problematic. This arises specifically where there are situations where persons engaged in either alleged:(i) scam payment transactions; (ii) fraudulent payment transactions; or (iii) other suspicious payment transactions, may take action against a bank at AFCA or in Court (in respect of its conduct to freeze, close or return moneys in an account), and in such situations, due to the broad nature of the current prohibition (as described above), the bank is unable to disclose the reasons for which it may have acted in respect of an account in its proceedings with the Court or AFCA disputes.

It is our submission that any proposed new offence be drafted to make it explicitly clear as to what "*any information about*" or "*SMR information*" or '*section 49 related information*" each mean and whether the proposed offence would prohibit disclosure about the relevant transaction which is the substance of the SMR.

If there is ambiguity in this respect, then the proposed new regime would not have assisted with striking the correct balance between facilitating reporting entities to comply with their AML/CTF obligations and protecting the integrity of law enforcement investigations.

It would be our preference (and submission) that information which gives rise to an "inference" that a SMR has been submitted is not restricted from being disclosed under the proposed new offence, while we accept that the fact a SMR has been submitted must remain the subject of the tipping off offence. At the very least, such information should be allowed to be disclosed by the financial institution where it is involved in AFCA or Court proceedings in order that it can provide relevant and substantial information in the relevant forum as to the reasons for its conduct.

If, however, '*any information about a SMR*', '*SMR information'* or '*section 49 related information'* is to be broadly defined as inclusive of information that is inferential, it would assist if there could be a specific exemption in any case for such information to be confidentially provided to an AFCA or Court adjudicator (i.e. judge).

Further, regardless of the manner in which '*any information about a SMR'* , '*SMR information'* or '*section 49 related information'* is to be defined (noting our comments above), it would be helpful if examples of circumstances of disclosure which would not likely prejudice any investigation or potential investigation could be provided in the Rules.

Further, the draft legislation should identify what types of investigations are proposed to be covered. It is assumed this is AUSTRAC or police investigations. It would be helpful to have this confirmed.

j. Are there any unintended consequences that could arise due to the proposed changes to the tipping off offence?

It is difficult to give a view on this question without more clarity in the proposed drafting (please see our comments above). For example, using the words "*would prejudice or likely prejudice an investigation"* when there are no means – while there is no public information about any investigation - to identify whether an investigation may take place, means that it appears one must always assume an investigation would take place.

6 Paper 4: Further information for digital currency exchange providers (DCEPs), remittance service providers and financial institutions

b. How should the scope of NFTs subject to AML/CTF regulation be clarified?

It would be helpful for some businesses to make it clear that the scope does not inadvertently capture traditional banking products.

f. Are there any services currently provided by financial institutions that fall outside the definition of 'electronic funds transfer instruction', but would be captured by the 'value transfer' concept?

For some businesses the term "value transfer" as a definition could be made clearer as to what is being captured. In particular, the value definition in s5 of AML/CTF Act relates to property which itself is defined as not being money or digital currency. Clarity is needed on the "value" to be captured by this proposed concept.

i. What flexibility should be permitted to address the sunrise issue or where a financial institution or digital asset service provider has doubts about an overseas counterparty's implementation of adequate data security and privacy protections? What risk mitigation measures should be required?

The proposal suggests that each intermediary in the chain will potentially need to know each other intermediary and if they have adequate data security and privacy protections. It is not clear what steps an intermediary would be expected to take to be able to determine which institution and/or countries have complied with these requirements (for example, relying on SWIFT certifications)? The FSC suggests that further clarity is provided.

m. What is the anticipated regulatory impact for smaller financial institutions and remittance providers in giving them primary responsibility to report IFTIs sent or received by their customers? Could this impact be offset by continuing to allow intermediary institutions to submit IFTI reports on behalf of smaller reporting entities, but with requirements for appropriate safeguards to ensure the accuracy and completeness of reports?

IFTIs are currently reported by Australian intermediary institutions who receive the first leg in and last leg out of Australia on payment chains. These institutions have existing infrastructures and scale in place to facilitate large volumes of IFTIs.

The FSC submits that changing the reporting entity will cause significant operational, cost and potentially customer implications for banks at the end of payment chains. Industry-wide

implications may include inability to use direct entry (DE) payments as part of a domestic leg of international payments as they do not include a flag field for the end-institution to identify that it is an international payment for IFTI reporting.

The FSC submits there would be a significant impact for smaller institutions that do not have overseas correspondent banking relationships to develop IFTI reporting systems and controls. We would expect many smaller institutions would prefer for the IFTI reporting obligations to stay with the “first in, last out” approach. The FSC submits that the AGD should reconsider whether these changes are appropriate given the large-scale impacts. If the AGD is not willing to change the proposed requirement, an extended implementation period would be needed. If these changes are made, clarification & simplification feedback around IFTIs that has been raised by industry but is not reflected in the Round 2 consultation will be critical given the increased operational and cost impact on certain businesses through the proposed changes. The timing of that clarification, which may be through Rules/Guidance, is important so that those businesses are able to build their systems and operational functions appropriately.

Relatedly, AUSTRAC must clarify that non-ADIs will **not** be subject to IFTI reporting obligations. That is, even though the reporting obligation may move to the ADI that is ‘closest to the customer’, it will not extend to a non-bank financial institution that is the client of the ADI. Any extension of this obligation to non-bank financial institutions would be of very significant concern for industry. For example, Paper 4 at pages 16/17 states that ***“****The department proposes that the obligation to report IFTIs should rest with Australian institutions that initiate the outgoing transaction, or make the incoming payment available, for their customers. These institutions have a direct relationship with the payer and payee respectively.”* Clarification should be provided that this would not capture financial institutions other than ADIs where sending or receiving payment is only incidental to their business (for example, the business of providing superannuation or pension products).

n. What should be the ‘trigger’ for reporting IFTIs? At what point is a reporting entity reasonably certain that the value transfer message will not be cancelled or refused, and the value transferred?

We would suggest that, for incoming value, an IFTI should be submitted upon the beneficiary institution receiving the value and crediting it to the beneficiary. If the instruction is recalled at any time after the beneficiary institution has accepted the value, an outgoing IFTI should be submitted. For outgoing value, an IFTI should be submitted upon the ordering institution sending the value. Again, if the value is to be returned (cancelled or refused) an incoming IFTI should be submitted.

o. What information should be required to be reported in a unified IFTI reporting template, covering both IFTI-Es and IFTI-DRAs?

The FSC suggests that consideration be given to including the following:

- Institutions in the funds transfer chain including, BIC code,
- A unique identifier for the transaction.

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- The beneficiary information,
- The originator information.
- The value of the transaction and currency.

q. Would the proposed amendments to the BNI definition in the Act reduce the volume of reportable BNIs and regulatory impost on business.

Yes, the amendment should include the removal of non-negotiable instructions in the definition of BNIs.

We do not have specific comments on the other questions in this Paper.

7 Paper 2: Further information for professional service providers

a. Are there any terms contained in the proposed designated services for PSPs that require a statutory definition to clarify their ordinary meaning?

The FSC requests clarity on the meaning and intent of designated service 5:

"Formation, creation, operation or management of a legal entity (excluding a testamentary trust), on behalf of a person, in the course of carrying on a business. The customer is the person".

Specifically, query if it would include new company establishments registered by an ASIC Registered Agent or arranging the declaration of a trust with a state regulator on behalf of another PSP i.e., an accountant, or a direct individual client.

f. What additional information, guidance and materials would you require from AUSTRAC to help you comply with your new AML/CTF obligations?

The FSC requests the following:

- Clearer guidance for trust and company service providers who provide services to lawyers or accountants but do not provide specialist skills/advice, technical proficiency or knowledge that could assist in criminal money laundering schemes.
- Clearer guidance on the definition of a trust and company service providers – and whether businesses that provide "back-office" services to lawyers, accountants and financial advisers are intended to be captured.
- Specifically, whether trust and company service providers could provide a designated service while not dealing directly with an end client (acting only on behalf of another PSP, or in an administrative capacity)

We do not have specific comments on the other questions in this Paper.