27th August 2021

Committee Secretary
Senate Legal and Constitutional Affairs Committee
PO Box 6100
Parliament House
Canberra ACT 2600

Email: legcon.sen@aph.gov.au

Dear Secretary,

The adequacy and efficacy of Australia's anti-money laundering and counter-terrorism financing (AML/CTF) regime

The Australian Financial Markets Association (**AFMA**) represents the interests of over 120 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 Committee's Inquiry into the adequacy and efficacy of Australia's anti-money-laundering and counter-terrorism financing (AML/CTF) regime (**the Inquiry**). Our comments address the terms of reference for the Inquiry and some of the matters outlined in the Committees' Discussion Paper. In particular, we have sought to highlight, from a reporting entity perspective, areas where Australia's framework is inefficient in terms of disrupting financial crime, resourcing issues which hinder the ability of reporting entities to disrupt serious financial crime and idiosyncrasies in the Australian framework which render Australia as out-of-step compared to other comparably-regulated jurisdictions.

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Regulation of Designated Non-Financial Businesses and Professions

Should the implementation of recommendations about DNFBPs be a priority? If so, why?

AFMA strongly supports the inclusion of Designated Non-Financial Businesses and Professions (DNFBPs or Tranche 2 entities) within the AML/CTF regulatory framework. The basis for this support is straightforward; money-laundering and terrorism-financing risks are relatively high in certain non-financial entities, but transactions conducted by these entities and information held by these entities are opaque from a regulatory perspective. This disproportionately exacerbates the burden on current reporting entities to provide intelligence to AUSTRAC based on necessarily incomplete information.

The Statutory Review into the AML/CTF Regime conducted by the Attorney-General's Department in 2016 clearly articulated the benefits from bringing Tranche 2 entities within the AML/CTF regulatory framework. The Review stated:

> "The extension of the AML/CTF regulation to the remaining DNFBPs would deliver a number of substantial benefits:
>
> - A current regulatory 'blind spot' would be removed and a broader range of information collected and reported to AUSTRAC, and shared with law enforcement;
> - Suspicions about transactions would be reported earlier in the transaction chain than occurs currently, providing earlier opportunities for law enforcement to disrupt criminal activity; and
> - More accurate information about the beneficial ownership of funds and assets would be collected when complex legal structures are first established."

The Review further stated that "Australia would become more hostile to ML/TF threats enhancing the integrity and credibility of Australia's financial institutions and financial system, bolstering the attractiveness of Australia as a place to conduct business and more strongly aligning the AML/CTF regime with FATF standards." AFMA endorses these comments.

What are the reputational risks to Australia if DNFBPs continue to fall outside the scope of AML/CTF regulation?

It is clear from AFMA's perspective that there is a positive correlation between the expansion of the scope of AML/CTF regulation to include DNFBPs and Australia's international reputation as a financial centre. Investors into Australia's financial markets will generally seek to ensure that ML/TF risk is mitigated to the extent possible and, for the reasons outlined above, keeping DNFBPs outside of the regulatory net does not meet that objective. This is particularly the case regionally, where, for example, such DBFBPs fall within the ambit of Singapore's regime.

The ongoing omission of DNFBPs within regulatory scope also detrimentally impacts existing reporting entities, particularly financial institutions who maintain and manage expectations of overseas institutions including correspondent banks to allow Australian customers to access overseas products

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and services. These financial institutions may be subject to significantly higher levels of due diligence due to the perception that Australia is a higher risk jurisdiction from a ML/TF perspective. Regulation of DNFBPs would help in part to mitigate this perception and therefore reduce the burden on Australian financial institutions.

What are the potential risks, costs or other unintended consequences of poor design or implementation of additional AML/CTF regulation?

AML/CTF regulation, through both the AML/CTF Act, the AML/CTF Rules and the regulatory guidance and enforcement undertaken by AUSTRAC, is a continuously evolving process. In December 2020, the "Phase 1.5 Bill" passed Parliament with a number of relevant reforms to the AML/CTF framework, which were augmented by the Phase 1.5 Rules. AFMA is in constant dialogue with AUSTRAC seeking clarification on regulatory expectations and notes there is a further reform project shortly to commence with the Department of Home Affairs.

The evolutionary nature of AML/CTF regulation allows for risks arising from imperfect regulation to be mitigated. Moreover, any extension to the regulatory net to cover DNFBPs would be an improvement to the current arrangements. Specifically, noting the options put forward by the Statutory Review, an approach of "applying some of the existing AML/CTF obligations under the AML/CTF Act to DNFBPs (that is, 'light touch' regulation)" would allow for a determination of a proportionate regulatory response, balancing the improvement to the operation of Australia's AML/CTF framework relative to the increased regulatory burden imposed on DNFBPs, without imposing significant risks or costs.

Our view is that the experience derived from subjecting the current suite of reporting entities to AML/CTF regulation should mitigate the risks of poor design /implementation and that there are existing processes to continue to enhance the regulatory arrangements over time.

The other point AFMA would make is that in assessing the incremental regulatory burden to be placed on DNFBPs being brought into the ambit of AML/CTF regulation, it should be remembered that there will be an offset for the population of existing reporting entities due to the enhanced efficiency of their own programs based on more complete information.

To what extent do recommendations in the 2016 AGD Review remain relevant to the regulation of DNFBPs in Australia?

There are two further aspects of the recommendations of the Statutory Review in relation to DNFBPs that AFMA would like to comment on.

Firstly, the Statutory Review, disappointingly, fell short of actually recommending that DNFBPs be brought within the scope of AML/CTF regulation. The specific recommendation was to:

- “(a) develop options for regulating lawyers, conveyancers, accountants, high-value dealers, real estate agents and trust and company service providers under the AML/CTF Act; and
- b) conduct a cost-benefit analysis of the regulatory options for regulating lawyers, accountants, high-value dealers, real estate agents and trust and company service providers under the AML/CTF Act.”

In AFMA’s view, the lack of progress regarding bringing DNFPBs within the scope of AML/CTF regulation has arisen due to the lack of a positive recommendation from the Statutory Review to do so. It would have been appropriate for such a positive recommendation to have been made and then to determine the optimal model of such regulation. Without a commitment to expand the regulatory net, there was an absence of the necessity required to progress the amendments to the AML/CTF framework. As an aside, AFMA is not aware of the specific recommendations of the Statutory Review being progressed to completion.

Secondly, as noted in the Discussion paper, the Statutory Review found that “smaller businesses tend to seek more prescriptive AML/CTF rules and greater regulatory guidance.” While this may have been the case in 2016, at the time of the Statutory Review, our view is that the spate of enforcement action that has been undertaken by AUSTRAC in the intervening period has shifted the preferred approach for our members from one of adopting a risk-based approach to one of relying on clear guidance from AUSTRAC as to its regulatory expectations and framing their AML/CTF programs in that light. This makes it incumbent on AUSTRAC to clearly articulate its expectations through guidance and also have a mechanism where reporting entities can clarify expectations on a bilateral basis. AFMA’s perspective is that this has been a notable shift in the last five years.

To what extent are recommendations from the 2016 AGD Review and the 2017 project plan yet to be implemented?

AFMA supports the implementation of the recommendations of the 2016 AGD review and has assisted the Department of Home Affairs in relation to many of the amendments that were enacted in December 2020 as part of the “Phase 1.5 Bill,” particularly those relating to the sharing of information and the reliance provisions. In addition, we have assisted the Department in scoping the Phase 2 reform project.

AFMA particularly supports the overarching recommendations of the Review in relation to the simplification of the Act/Rules and ensuring that the Act/Rules are technology neutral.

In implementing the recommendations of the AGD Review, it is important to acknowledge that there has been significant innovation in technology and transaction types since the Review was undertaken. For example, the payments landscape has changed significantly and the recommendations in the Review in relation to payments may need to be expanded to include payment aggregators and card schemes within the scope of AML/CTF regulation.

Australian Transaction Reporting and Analysis Centre (AUSTRAC)

The Discussion Paper poses questions with respect to the regulation of Tranche 2 entities and specifically whether AUSTRAC is sufficiently resourced for implementing Tranche 2. The response to this question requires an exploration of the current funding model for AUSTRAC which, in AFMA's view, inappropriately allocates financial resources away from larger reporting entities' own AML/CTF programs.

AUSTRAC's operating costs are fully funded by a small proportion of reporting entities. In the 2019/20 AUSTRAC Annual Report, AUSTRAC received $72 million in appropriations to largely cover its operating costs; this amount was in turn recovered from reporting entities under the "Industry Contribution." Under the Industry Contribution model, the amount contributed by each reporting entity is a function of earnings (applicable to entities with earnings in excess of $100 million), volume of transaction reports lodged with AUSTRAC and value of transaction reports lodged with AUSTRAC.

AFMA has steadfastly objected to the calibration of the Industry Contribution model since its inception in 2014. Our main concerns stem from the fact that the Industry Contribution, while clearly being a measure of cost recovery, does not adhere to the Government's own Cost Recovery Guidelines, particularly as not all entities that create the need for the regulation are proportionately contributing to the cost of that regulation. Based on AUSTRAC's 2018/19 Industry Contribution Discussion Paper, only 570 of the 14,000 reporting entities that are subject to AUSTRAC regulation are liable to contribute to AUSTRAC's operating costs, based on a minimum payment threshold of $1,100.

AFMA's view is that the current industry contribution levy is inequitable and imposes a significantly disproportionate burden on a very small number of the total population of reporting entities. The current model does not take account of the level of AML/CTF risks posed by all reporting entities or the measures that entities take to mitigate those risks. There is a substantial cost to reporting entities to be compliant with the Australian AML/CTF regime and more broadly, the FATF regime and other home jurisdiction requirements where the entity is part of a global conglomerate.

On any metric, AUSTRAC generates significantly more revenue for the Government than its operating costs. As noted in AUSTRAC' 2019/20 Annual Report, over the last ten years, AUSTRAC's financial intelligence has been relied upon by the Australian Taxation Office to raise additional revenue for the Government in the order of $2.6 billion. In addition, there have been penalties imposed on reporting entities that would, if allocated to AUSTRAC's operating costs, would fund such costs for a significant period.

AFMA's members appropriately invest significant resources in ensuring that their AML/CTF programs are effective and consistent with AUSTRAC's expectations. It is unclear why the Government seeks to divert in excess of $70 million of resources to fund AUSTRAC's operating costs under a charging framework that is demonstrably flawed in its application.

To the extent that Tranche 2 entities come within the AML/CTF regulatory scope, then clearly the funding arrangements for AUSTRAC will need a fundamental overhaul, given the expansion of the

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number of regulated entities. When consideration is given to the regulatory burden associated with expanding AML/CTF to incorporate Tranche 2 entities, at the same time consideration should be given to recognising the public benefits (including additional tax revenue) arising from AML/CTF regulation in determining the funding arrangements for AUSTRAC and ensuring that any funding model aligns the cost of regulation to those that create the need for regulation, consistent with the Government's Cost Recovery Guidelines.

Enhancing Australia's Attractiveness for Capital Through Aligning AML/CTF Framework

The terms of reference for the Committee's Inquiry consider the impact on various aspects of Australia's AML/CTF framework on its capacity to access international capital. In AFMA's view, a particular hindrance on Australia's ability to access international capital from an AML//CTF perspective is the extent to which Australia's framework is idiosyncratic and does not align with other FATF jurisdictions. Accordingly, to improve the adequacy and efficacy of Australia's AML/CTF regime, consideration should be given to:

- simplification and alignment of Australia's IFTI reporting obligations with those in comparably regulated jurisdictions, particular in terms of the IFTI reporting requirements arising from the securities sector and also to address new payment methods;
- harmonisation of the definition of "financial institution" with other jurisdictions and in accordance with the Wolfsberg principles;
- permitting simplified due-diligence to be conducted in a broader range of scenarios, in accordance with the FATF guidance;
- allowing sharing of information with members of the same corporate group offshore that may not themselves be providing designated services;
- ensuring that the AML/CTF framework is agnostic to new technologies, such as through allowing for the potential adoption of a KYC utility.

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Thank you for the opportunity to make a submission in relation to the Committee's Inquiry. Please contact me at rcolquhoun@afma.com.au or on (02) 9776 7996 with any specific queries.

Yours sincerely,

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Director, Policy