



Australian Government
**Australian Transaction Reports
and Analysis Centre**

**Address by Thomas Story, Acting Chief Executive Officer, Australian
Transaction Reports and Analysis Centre (AUSTRAC), to the Australian
Bankers' Association, 4th Anti-Money Laundering Forum, 14 March 2008**

Thank you and it is a pleasure to be here.

Slide 2: Session overview

There are now just nine months to go before the first tranche of Australia's legislation on AML and CTF matters takes full effect. This is in accordance with the staggered dates set down in the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006*. The preparations for 12 December 2008 will represent the culmination of much activity and learning for AUSTRAC as well as industry.

As I look back over the last 15 months it has been a hectic pace and many changes for AUSTRAC, some of which I would like to elaborate upon today.

Before I set the scene for what you can expect from us in 2008, I would like to briefly review the key dates under the Act, including some comments on their rationale which I hope would be of interest. I will then discuss a few topical implementation issues and some of the changes we expect to introduce in 2008.

Slide 3: Staggered implementation dates

The timetable for implementation of the AML/CTF legislation reflected considerations of risk, practicalities and the burden on industry. Provisions covering the registration of designated remittance service providers, originator information in electronic funds transfer instructions and enhanced cross-border movement reporting were immediately effective upon enactment of the new law in December 2006. These provisions related to counter-terrorism safeguards and were therefore an immediate priority.

Correspondent banking provisions followed in mid-2007. These prohibit shell banking and require due diligence assessments of correspondent banking relationships. This timing broadly reflected the characterisation of such obligations as representing a less complex and less costly implementation and hence a 'quick win', as banks already were doing something similar. Also in mid-2007, we announced the compliance report obligation would cover a full year through to 31 December 2007 and be due by 31 March 2008. More on that later.

At the one-year anniversary (of enactment), i.e. 12 December 2007, requirements for Part A of an AML/CTF program to identify, manage and mitigate AML/CTF risks and Part B, new identification procedures, came into effect. Identification and verification of customers and AML/CTF programs were seen as clear priorities, but practicalities meant that industry needed to be given a reasonable period to implement.

The final obligations covering ongoing customer due diligence and the new reporting requirements on suspicious matters, international funds transfer instructions and threshold transactions, are effective from 12 December 2008. Ongoing customer due diligence systems were seen as a priority. However, commercial reality dictated that this was the most difficult of the obligations in terms of implementation. Industry successfully argued that the financial and administrative burden was too great if they were required to implement these obligations at the same time as customer identification obligations and AML/CTF programs.

Because reporting obligations under the *Financial Transaction Reports Act 1988* continue pending the AML/CTF Act equivalents taking effect, this area was not seen as such a high priority as the AML/CTF program and identification provisions, which are intended to have more of a deterrent/preventative effect. Hence reporting obligations will also come into effect in December 08.

Slide 4: Minister's Policy Principles

Discussions over the timing of introduction of the new measures were vigorous – there were various claims as to the most appropriate phase-in period. In response to industry concerns that these timeframes were going to be challenging, Government also decided that for the first 15 months after the date of effect for each obligation, the

AUSTRAC CEO may apply for a civil penalty order against a reporting entity for a contravention of a provision of the new Act only if the reporting entity had failed to take reasonable steps to comply with the provision. We characterise that as meaning that the reporting entity must demonstrate some progress and more than minimal steps towards compliance. You should note that the regulator may take alternative enforcement actions during the 15-month period such as seeking enforceable undertakings, requiring an external audit or seeking a remedial direction.

We provided guidance material on what has proved to be a difficult area, i.e. the interpretation of 'reasonable steps'. I want to discuss a specific illustration concerning the Minister's Policy Principles.

Some entities have indicated that they were not fully compliant with the 'know your customer' (KYC) provisions as at 12 December 2007, but advise that they will be fully compliant at some future date prior to expiry of the 15-month period – i.e. prior to 12 March 2009.

So an important issue that has arisen in this context, is to clarify a reporting entity's obligation, in respect of the capture of know your customer (KYC) information for new customers who are provided with a designated service after 12 December 2007, but before the reporting entity has reached full compliance.

Our response has been to remind reporting entities that the Minister's Policy Principles do not alter the commencement dates that were within the AML/CTF Act itself. The Act sets down the legal requirements, which include that all new customers were to be identified in accordance with the AML/CTF Act provisions from 12 December 2007. To avoid the possibility of enforcement action – including civil penalty orders, a reporting entity must by 12 March 2009, at the very latest, have undertaken KYC procedures on all customers for which there is a legal requirement from 12 December 2007. This applies regardless of the date during the 15-month period at which the reporting entity reaches full compliance. This means that the reporting entity which is delayed in achieving compliance, will need to backdate its data capture for these new customers to cover the period from 12 December 2007 to the date that full compliance is achieved.

I am aware that some reporting entities consider that for reasons of cost and practicality, that a requirement to 'backcapture' the KYC information is not reasonable. However there are wider considerations. For example, some industry members point out that, as they were fully compliant at 12 December 2007, and if a backcapture of KYC information was not required, then they are at a competitive disadvantage and hence penalised for their diligence in meeting the new legislative requirements.

This arises because compliant entities have incurred costs in meeting the 12 December 2007 date. It is also possible that some customers may prefer to deal with reporting entities that are not collecting KYC information until a later time (indeed industry representatives have reported this situation).

In addition, should reporting entities not have to backcapture KYC information, then this removes incentive for entities to become compliant at the earliest possible time rather than later in the 15-month period. It is also true that the availability of designated services where KYC information is not collected, is a money laundering risk.

AUSTRAC has advised reporting entities that are concerned with our approach to backcapture, that it is open for them to make confidential and case-by-case submissions on alternative approaches, that the entity may consider are practical and cognisant of their commercial circumstances, and which would be acceptable to AUSTRAC in terms of reasonable steps to meet compliance. In that respect, I note that should an entity elect to continue customer identification that is based on systems and processes applicable prior to the AML/CTF Act coming into effect, then we would generally take the view that reasonable steps had been taken. Though the previous system for customer identification under the *Financial Transaction Reports Act 1988* is limited to 'account-based customers', if these processes were also applied to customers seeking other designated services under the AML/CTF Act, then we would also generally take the view that in those circumstances, reasonable steps had been taken. Once a reporting entity has become compliant, its AML/CTF program would then be expected to identify on a risk basis those customers for whom more information needs to be collected or verified.

I also observe that in reaching such a conclusion, that the continued usage of the 100 point check is in our view, not necessarily in conflict with chapter 4 of the AML/CTF Rules. There is nothing in chapter 4 which limits a reporting entity to rely on one piece of verifying documentation. In other words, the safe harbour Rules in chapter 4, are intended to provide a choice of a simpler method and do not prevent a reporting entity from meeting the requirements for verification in another way. The 100 point check is one such other way, if a reporting entity determines that it is appropriate having regard to the ML/TF risk it reasonably faces and its risk-based systems and controls. In other words, this method may be one of the ways of satisfying the requirements in chapter 4. What is required is that reporting entities have risk-based systems and controls that enable them to be satisfied that the customer is, who they say they are.

Slide 5: Draft guidance on no-action letters

Some of you will be aware that AUSTRAC has recently issued a draft guidance note on its issue of no-action letters. A consultation period from February 28 through to yesterday had been declared, in order for external views on the draft guidance note to be provided. Where a reporting entity has breached or anticipates a breach of the AML/CTF Act, and approached AUSTRAC, then we propose to consider, on a case-by-case basis, and having regard to all the circumstances, the provision of a no-action letter relevant to the breach.

By issuing such a letter, AUSTRAC is stating that it will not take regulatory or enforcement action over a particular act or omission by that reporting entity. It is a statement of our approach with respect to that particular circumstance and of our intentions based on the information available at the time the no-action letter was issued. It is not an expression of legal views. Nor is it automatic. AUSTRAC may at any time revise or withdraw a no-action letter. However we would take account of, and make allowance for, the consequences for the reporting entity to whom the no-action letter was issued and who has acted in reasonable reliance on AUSTRAC's stated view.

We have recently initiated no-action letters and we anticipate finalising our policy framework for them in a guidance note by early April.

Slide 6: Assistance to industry

AUSTRAC has released a suite of products to assist industry understand their obligations. The *Regulatory Guide* incorporates reference material on AML/CTF programs, customer identification, compliance reporting, correspondent banking and *Financial Transaction Reports Act 1988* matters. We will be releasing further chapters of the Guide from mid-2008 with new chapters on ongoing customer due diligence, designated services, AML/CTF reporting obligations and electronic funds transfer instructions.

We have developed a course of electronic learning material to assist reporting entities, their staff, industry associations and the public understand the new obligations. The package contains modules on money laundering, the underlying techniques, terrorism financing, and the various obligations in the law. The e-learning tool is proving very popular and we have had over 353,000 hits to the site since its launch late last year. We have also launched a typologies report of 51 money laundering case studies – these are also available online. We intend to release a further report in mid-2008 and we are looking at options for how we can better tailor and organise the information for particular industry groups.

We have expanded our help line service. There is now a significant escalation in demand for information on the AML/CTF Act. We expect that we will experience a peak in calls to our Help Desk in the lead-up to the compliance report due date of 31 March. The call volume is expected to be a tenfold increase on daily volumes from last year.

We launched AUSTRAC Online, our new computer system for reporting entities, in December 2007. The system assists reporting entities identify obligations under the AML/CTF and FTR Acts; it facilitates viewing and updating of information held by AUSTRAC and provides electronic filing of compliance reports as well as online registration for providers of remittance services. We have over 2,000 reporting entities currently enrolled in the new system and this figure is now expected to climb quickly. The new system was developed in keeping with the timeframes necessary to meet the new legislative requirements and we are aware of a few teething problems, particularly affecting processing of information for designated business groups

(DBGs) where there are a large number of potential entities proposed for the DBG. If any processing problems have affected your ability to meet our reporting requirements, we will certainly look at how this can be accommodated and I encourage you to contact our staff.

Finally, we have another set of industry education seminars in the pipeline for the mid-year. These will cover financial factoring and leasing from April 2008, some accounting workshops also from April 2008, life insurance product issuers and some superannuation funds from June 2008, as well as security and derivatives and bullion dealers also for the mid-year. We expect to do a second round of seminars that will cover the banking industry and the new reporting provisions also in the second half of 2008.

Slide 7: Public Legal Interpretations

AUSTRAC has recognised that as with any new laws, a regulator's view of some complex legal issues can assist industry compliance and remove some uncertainties. We propose to establish a series of legal interpretations – around 10 or 12 annually – beginning in April 2008. The topics for the series in 2008 are settled and include item 54 of table 6 concerning Australian financial services license holders, what constitutes a reporting entity and an overview of section 41 and suspicious matters. We have established new industry consultation fora that are opportunities for senior management in AUSTRAC to meet with industry twice yearly. We will consult through these industry fora on future subject areas for the legal interpretative series.

Slide 8: Industry mail-outs and advertising

Some of you would have seen the recent advertising to alert potential reporting entities to the compliance reporting obligation. AUSTRAC has done a substantial mail-out to potential reporting entities in December 2007 and a second mail-out to industry participants who we believe are affected by tranche one obligations commences next week.

As you will imagine this is a substantial and complex exercise. We are about to issue reminder letters to over 17,000 entities. Where the entity fails to provide a compliance

report by 31 March 2008, we will be issuing further correspondence to seek clarification of their status as a reporting entity.

Slide 9: AML/CTF Rules

AUSTRAC has released in December 2007, and in accordance with its prior commitments, Rules that are necessary for the introduction of the December 2008 obligations. These include Rules covering new reporting requirements for suspicious matters and threshold reports. In addition, we have issued draft Rules for comment which include Rules relating to pre-commencement customers in the context of managed investment schemes; special circumstances for customer identification procedures; certain over-the-counter derivatives markets; takeovers, schemes of arrangement, business disposals and business assignments for customer identification procedures.

We also wish to provide draft file specifications to industry for electronic reporting by early April 2008 with a view to finalising these in May 2008.

Slide 10: Expectations of AML/CTF programs

Our on-site review program has commenced and we are currently reviewing compliance with correspondent banking obligations in selected entities. This activity will progressively expand as we build organisational capability in the Compliance and Enforcement branch in industry supervision techniques. It is envisaged that we will build this capability steadily between now and 2010 and we are very pleased with the early results of our recruitment.

I have been asked to comment on how we would be persuaded that your AML/CTF activities are comprehensive and appropriate. The AML/CTF regime is a risk-based one. Reporting entities should adopt an approach that allows them to allocate their resources efficiently having regard to their own risk appetite, rational business judgment and rigorous assessment of ML/TF risk. This approach necessarily means that AML/CTF programs will differ between similar reporting entities. However, there are some fundamental aspects to a reporting entity's AML/CTF activities that ought to be common across reporting entities. I want to highlight a few of these characteristics.

First, risk modelling would be expected to have a similar degree of rigour and result in broadly similar dimensions to the risk profiles generated across a cohort of like entities.

Reporting entities have a large number of customers utilising a wide variety of products through a number of distribution channels; possibly across a number of different jurisdictions. This complexity requires that a risk assessment model be adopted that is tested for its robustness. It will likely consider in some form of risk matrix, customer segments and product and service offerings.

The aim of adopting a risk assessment model is to ensure that higher-risk customers, products, channels and jurisdictions are identified effectively. We would expect that any such model would:

- be applied consistently across the organisation's business units and entities within the designated business group (though taking account of the risk reasonably faced by *each* of the entities in the DBG)
- be integrated into the entity's usual risk assessment tools such as credit, operational, regulatory and reputation risk assessments to ensure that new services, technologies and delivery mechanisms are risk assessed from an ML/TF perspective
- review all products and service channels to determine if they fall within the AML/CTF Act requirements
- acknowledge the inherent ML/TF risk within the reporting entity's customer and product suite and determine what level can't be mitigated
- explore the risk appetite of the entity so that additional controls above the minimum can be identified for implementation
- be methodically evidenced, documented and approved within the entity's governance structure.

All of these activities both in a development phase and finally in the 'business as usual' stage ought to be independently reviewed, tested and verified. A sound independent review will foster achieving full compliance and requires that the

reviewer have an intimate knowledge of the reporting entity's customer, product, and delivery channel and jurisdiction matrix.

We expect that the review should consider:

- the control environment around AML/CTF activities
- whether the AML program is tailored to monitor unusual or suspicious activity that might be encountered in the entity
- the control mechanisms in place to ensure that board and management directives are carried out
- the quality of strategic, compliance and operational information driving the AML/CTF activities
- the strength and quality of the ongoing compliance monitoring function, and
- quality, effectiveness and relevance of AML/CTF training.

Finally a strong culture of self assessment of the reporting entity's adherence to its AML/CTF program and compliance framework will assist in achieving full compliance. Reflecting such a culture AML/CTF activities and programs should be dynamic, and thus open to changing circumstances. Regular reviews of the risk assessment methodology and the results of its application should be embedded in ongoing, business as usual, activities.

Of course achieving full compliance also requires that all new process and systems are implemented and operating effectively by the legislative milestones dates.

Slide 11: Terrorism financing

Before I close, I note that AUSTRAC had been asked to provide additional information on indicators of terrorism financing. There have been some prominent terrorism financing cases in Australia and some are before the courts right now. Therefore I am necessarily limited in what I can say today.

The slide indicates some common typologies – none of which will surprise. We have had the good fortune of having access to a prominent international expert in this area who has assisted our staff with some cutting-edge research in this difficult area where

we have a limited evidence base and matters sub judice further constrain us. We have proposed to issue in the second half of 2008 a publication that describes the most recent trends in this area. We regret that it cannot be tabled here today. We will look to the key funding sources, the emerging trends in financing patterns – that is from formal and visible channels to the informal and covert; and the demographic patterns for terrorism financing which will cover dominant forms for raising funds across different regions and terrorist groups.

Thank you and I look forward to continuing the strong partnership and support of the ABA in this important year for AML/CTF implementation.