Proposed reform to strengthen Customer Due Diligence

Regulation Impact Statement

AUSTRAC

May 2014

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Abbreviations

Abbreviation	Description
ABS	Australian Bureau of Statistics
ACC	Australian Crime Commission
AEOI	Automatic Exchange of Information
AGD	Australian Government Attorney-General's Department
AML/CTF	anti-money laundering and counter-terrorism financing
AML/CTF Act	*Anti-Money Laundering and Counter-Terrorism Financing Act 2006*
AML/CTF Rules	*Anti-Money Laundering and Counter-Terrorism Financing Rules Instrument 2007 (No. 1)*
ASX	Australian Stock Exchange
AUSTRAC	Australian Transaction Reports and Analysis Centre
CEO	Chief Executive Officer
CDD	customer due diligence
EU	European Union
FATCA	Foreign Account Tax Compliance Act
FATF	Financial Action Task Force
G8	Group of Eight
G20	Group of Twenty
Government	Unless otherwise stated, 'government' refers to the Australian Government and state and territory governments.
IMF	International Monetary Fund
KYC	Know Your Customer
NPV	Net Present Value
OBPR	Office of Best Practice Regulation
PEP	politically exposed person
PwC	PricewaterhouseCoopers
RIS	Regulation Impact Statement

Executive summary

Australia's anti-money laundering and counter-terrorism financing (AML/CTF) regime is a critical component in Australia's defence against money laundering and serious and organised crime. To effectively protect Australia's economy and its participants, including Australia's global counterparts, the Government seeks to ensure we have a robust and rigorous regime in place.

This single-stage details Regulation Impact Statement (RIS) was commissioned by the Australian Transaction Reports and Analysis Centre (AUSTRAC). It has the objective of assessing the proposed amendments and alternative options to enhance Australia's AML/CTF customer due diligence (CDD) regime. It considers the expected benefits from amending the AML/CTF Rules and the estimated costs to industry of implementing such amendments.

Current arrangements

Money laundering is the lifeblood of organised crime. It is a transnational crime that:

- threatens the integrity and stability of the financial system
- is a source of funds for criminal activity, including serious and organised crime and terrorism, which impacts on community safety and wellbeing.

Australia is a foundation member of the Financial Action Task Force (FATF), the inter-governmental global body that sets the international standards to combat money laundering and terrorism financing and the financing of proliferation of weapons of mass destruction, referred to as the FATF Standards.

In Australia, the current AML/CTF regime seeks to provide a comprehensive legal framework designed to ensure that Australia's financial system is hostile to money laundering and terrorism financing. The legislative authority and direction is provided by the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (AML/CTF Act) and the *Anti-Money Laundering and Counter-Terrorism Financing Rules Instrument 2007 (No.1)* (the AML/CTF Rules). In addition, some reporting entities (ie those with US based customers) are subject to the United States *Foreign Account Tax Compliance Act* (FATCA) which will require Australian financial institutions to report certain information to the US Internal Revenue Service (IRS) about customer accounts held by US taxpayers.

Customer Due Diligence (CDD)

CDD and reporting by businesses is the cornerstone of an effective AML/CTF regime. It is critical to enabling the prevention, detection, investigation and prosecution of criminal offences. In Australia, the AML/CTF Act and Rules sets out a principles-based framework, encouraging a risk-based approach to AML/CTF compliance. The risk-based approach commonly means the steps that a reporting entity must take are proportionate to the level of identified or perceived ML/TF risk. Under this approach, a reporting entity has flexibility in how it implements its obligations. This risk-based approach requires a reporting entity to assess and determine the level of risk associated with a customer and where it should maximise its level of effort and resources.

Australia's current regulatory CDD obligations in some instances do not require — and in others are not sufficiently explicit in obliging — reporting entities to undertake certain core CDD measures. For example, it is left to the discretion of reporting entities whether to undertake further measures in order to understand who ultimately owns or controls operations of various types of customers.

The problem

Money laundering has been identified by the Australian Crime Commission as one of the three critical risks facing Australia given the size of its potential impact on Australia's national security and prosperity and the possibility of money laundering and terrorism financing (ML/TF) activities undermining the integrity of the Australian financial system.[2]

The extent of money laundering and terrorism financing activities occurring within Australia's borders is difficult to accurately quantify, but the broader cost of organised crime to the Australian community has been conservatively estimated to be between $10-15 billion each year.[3]

The three underlying problems that warrant additional government intervention in the AML/CTF regime are:

- reduction in Australia's revenue base due to information failure
- adverse societal consequences (i.e. negative externalities)
- regulatory failure to meet Australia's international obligations

Problem 1 – Reduction in Australia's revenue base

Due to current gaps in the Australia's AML/CTF regime, there are examples where a lack of accurate or verified information has enabled core information regarding organised crime, terrorist and other organisations to be hidden from, or misrepresented to, financial institutions and, ultimately, government agencies. The information gaps resulting from inadequate CDD include no requirement for a financial institution (i.e. reporting entity) to:

- understand the control structures of a customer, meaning that control structures can sometimes be hidden.
- identify and verify the beneficial ownership and control of its customers, resulting in transactions taking place where the beneficial owner is not always evident.

These information asymmetries have resulted in law enforcement agencies being inadequately supplied with the necessary information to perform their duties.

There are several examples, such as those through the Australian Tax Office's (ATO's) Project Wickenby, where organised crime and activities associated with money laundering through complicated corporate and trust structures, have been demonstrated to result in a decline in the level of revenue expected to be received by the Australian government.

The extent of this lost revenue is likely to be significant. To provide an indication of the orders of magnitude involved, we note that the Australian Taxation Office (ATO) using existing AUSTRAC data identified1,428 ATO cases in 2012-13, resulting in $572 million in additional taxation assessments being raised.'[4] Marginal increases through better understanding the beneficial ownership of the customers reported in transactions to AUSTRAC may be expected to lead to year upon year increases in revenue collected by the ATO and better outcomes for law enforcement. This will occur both directly through investigation and indirectly through the deterrent benefit of increased transparency leading to increased voluntary compliance and payments of taxes.

2 Australian Crime Commission (2011) Organised Crime in Australia 2011. Available at: http://www.crimecommission.gov.au

3 Australian Crime Commission (2013) Organised Crime in Australia 2013. Available at: http://www.crimecommission.gov.au

4 *AUSTRAC Annual Report 2012-13*, page 60.

This also affects the broader Australian community as less revenue received by government due to tax evasion leads to either increased taxes on the Australian community to recover the lost revenue or otherwise reduced expenditure on social programs such as health and education.

Problem 2 – Adverse impacts on Australia's national security - societal consequences (i.e. negative externalities)

A closely related problem to that outlined above is that the financial institutions that may inadvertently facilitate transactions that result in tax evasion, money laundering or terrorism financing do not bear the full costs associated with these financial transactions. That is, the business arrangements between financial institutions and particular customers can lead to significant negative externalities for the broader community. The flow on effects of money laundering and terrorism financing are felt by other Australian businesses, the Australian Government, and the population at large. For example, the:

- loss in revenue to the Australian Government from ML activities (such as evading taxes) harms the population at large, rather than the institutions responsible for conducting the CDD
- criminal activities associated with money laundering and terrorism financing have negative impacts on the community through violent crime and other offences. As mentioned earlier, organised crime is conservatively estimated to cost Australia $10-15 billion each year.[5]

Financial institutions would incur additional costs to reduce the risk of these activities occurring, but would not directly benefit from the resultant lower levels of money laundering and terrorism financing activities. Therefore, financial institutions are unlikely to choose to bear the costs to mitigate these risks to a level that is optimal from a societal perspective.

Problem 3 – Regulatory Failure to meet Australia's international obligations

Australia has recently assumed the presidency of the G20. At the conclusion of the 2013 meeting of the G20 in St Petersburg, a Leaders Declaration was released which made the following commitment on behalf of its members, including Australia.

> *'We reiterate our commitment to FATF's work in fighting money laundering and terrorism financing and its key contribution into tackling other crimes such as tax crimes, corruption, terrorism, and drug trafficking. In particular, we support the identification and monitoring of high-risk jurisdictions with strategic anti-money laundering (AML)/countering the financing of terrorism (CFT) deficiencies while recognizing the countries' positive progress in fulfilling the FATF's standards. We encourage all countries to tackle the risks raised by opacity of legal persons and legal arrangements, and we commit to take measures to ensure that we meet the FATF standards regarding the identification of the beneficial owners of companies and other legal arrangements such as trusts that are also relevant for tax purposes. We ask our Finance Ministers to update us by our next meeting on the steps taken to meet FATF standards regarding the beneficial ownership of companies and other legal arrangements such as trusts by G20 countries leading by example.'*[6]

In 2005, a review of Australia's AML/CTF framework was conducted against the FATF standards. The evaluation identified a number of deficiencies, with the most critical matters relating to CDD obligations. While some of these deficiencies have been partly addressed in consequent legislation, concerns remain that certain core measures relating to customer due diligence are not part of the current requirements.

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5 Australian Crime Commission (2013) *Organised Crime in Australia 2013*. Available at: http://www.crimecommission.gov.au

6 G20, 2013,'Leader's Declaration' https://www.g20.org/sites/default/files/g20_resources/library/Saint_Petersburg_Declaration_ENG.pdf

This has a direct correlation to Australia's work in fighting money laundering and terrorism financing. Deficiencies presently allow a reporting entity to provide designated services without fully assessing all risks associated with a customer.

Australia's deficiencies in this area may also be viewed as a regulatory failure as Australia's regulatory approach is inconsistent with endorsed international standards. The consequence of regulatory failure is that Australia's financial system remains vulnerable to serious and organised crime, and criminals are not deterred from pursuing illicit profits through drug trafficking, fraud, tax evasion and other criminal and corrupt activities.

International reputation about the strength of AML/CTF safeguards is increasingly important as it can guide investment decisions, but also influence opinions about the attitude the government of a country has towards making real steps to prevent money laundering and terrorism financing. Damage to international reputation not only deters and weakens legitimate investment, but also encourages criminal elements to mobilise within vulnerable jurisdictions.

Options

Three options were developed and are subject to analysis in this RIS:

- **Option A:** *Status quo* — current regulatory approach maintained.
- **Option B:** *Code of best practice* — current regulations and rules remain in their current state. They would however, be supplemented with additional guidance and material to provide clarity and assist reporting entities develop an industry consensus — or best practice.
- **Option C:** *Regulatory change* — the AML/CTF Rules would be amended. On 9 December 2013, AUSTRAC released for consultation the document titled *Explanatory statement: draft amendments to the AML/CTF Rules relating to customer due diligence* and the draft amendments to the AML/CTF Rules, Chapters 1, 4, 5, 8, 9, 15 and 30. This was the first of three versions of Draft AML/CTF Rules that were consulted upon. Fundamentally, the existing regulatory framework would be maintained but with additional requirements to largely clarify and codify current expectations to ensure consistency in the application of CDD preventative measures across the regulated population.

Impact analysis

Given the 'hidden' nature of money laundering and terrorism financing, the task of estimating costs and benefits associated with the proposed amendments to the AML/CTF regime faces significant evidential challenges, including the limited empirical evidence available on the scale of ML/TF. In light of these difficulties, the analysis within this RIS attempts to quantify impacts wherever possible, however, in many cases the analysis relies on adopting a large number of assumptions and qualitative discussion.

Option A – Status quo

If Australia maintains the current AML/CTF framework, it may create hurdles for businesses, government and society in international trade and transactions, as well as risk Australia's financial rating and credibility as a G20 country and a participant in other global forums. As a consequence of remaining deficient against the international FATF Standards, Australia may be removed, for example, from the European Union's (EU's) equivalence list resulting in higher compliance and transaction costs for business. Remaining deficient would also see Australia's reputation as hostile to money laundering and terrorism financing falling resulting in increased scrutiny from trading partners. Further, there would be ongoing costs of crime and money laundering to society and government, with the potential for these costs to increase over time if money launderers and organised criminals were to move their operations to

Australia to take advantage of a situation of ongoing deficiencies in Australia (particularly in light of the global trend towards closing such loopholes in AML/CTF regulation).

In summary, although there is no direct regulatory cost upon business, none of the problems identified are addressed, unknown indirect costs may result upon Australia business and no incremental benefits are expected from retaining the *status quo*.

Option B – Code of best practice

The level of cost associated with Option B depends on the extent to which businesses adopt the guidelines. Likely, based on stakeholder input, the major Australian and foreign financial institutions (who have international focused businesses) would choose to adopt the guidelines voluntarily. Compliance costs would arise where businesses choose to follow the guidelines and implement the procedures considered ‘best practice’. This choice will depend on the business and their existing CDD procedures. Compliance costs, should major Australian and foreign financial institutions choose to adopt best practice in Australia could range, over a **10 year period,** from an indicative upper bound of **$223.3 million** (lower than the cost of Option C) to an indicative lower bound of **$74.4 million**, with the median cost being **$148.9 million** (in net present value terms).

However, the uncertainty of the degree of industry adoption of the guidelines may result in some businesses bearing more cost than others – i.e. those who choose to ‘free ride’. Costs may also arise from the need for government to develop additional guidance materials, conduct ongoing maintenance and assess the expected increased number of transaction reports. Customers may incur costs passed on from business, though again this level will depend on the level of uptake of the guidelines. In addition, the majority of larger organisations saw the uncertainty that guidelines create as potentially costly and instead favoured the prescription offered by Option C.

The benefits of Option B would be lower than those expected under Option C. This option will achieve a portion of the benefits expected under Option C, but the benefits realised relative to the costs incurred will be lower than for Option C. This is because money launderers would be expected to gravitate towards the entities that do not follow the guidelines, therefore potentially increasing costs further and reducing the level of benefit realisation. This option has a greater risk of entities disregarding the guidelines and therefore fails to achieve policy objectives.

In addition, while this approach may address some of the underlying problems if there is a high uptake, it will not address the risks to reputational damage or any other actions which may be taken at an international level as internationally agreed standards require these obligations to be prescribed in law (rather than issued as guidance only).

Option C – Regulatory Change

This option yields the highest level of benefits but imposes the greatest costs. Compliance costs for the industry is estimated to be **$281.3 million over a 10 year period** (net present value and include one off and ongoing costs). This represents an **average annualised cost of around $39.6 million** (undiscounted).

These estimates are broadly consistent with the limited high-level estimates obtained during consultation with regulated entities. The consultation provided indicative estimates for the upfront costs to implement the changes of around $20 million to $25 million for a ‘big 4’ bank. This implies an implementation cost of $80 million to $100 million for other large banks. These figures are broadly in line with the estimate of $281.3 million over 10 years, which included an upfront implementation cost of $137.6 million for the industry as a whole.

In addition to industry costs, there may be modest costs to government from additional suspicious matter reports and monitoring of new regulations. There may also be costs borne by consumers if business compliance costs are passed on. The costs that could potentially be borne by consumers are reflected in the industry cost estimates and would represent a transfer from industry to consumers, rather than additional costs.

This option would improve Australia's AML/CTF regime by substantially addressing the deficiencies identified by FATF, while taking into account Australia's existing circumstances, and decreasing the probability of ML/TF activity. The multiple benefits under this option include:

- government would benefit from an expected increase in tax compliance and the resulting benefits of increased taxation revenue, similar to that experienced through Project Wickenby
- government, businesses and society would benefit from reduced crime and money laundering, as well as increased deterrence and ease of prosecution of serious and organised crime, financial crimes and tax evasion
- avoiding increased compliance costs for businesses, or lost business opportunities, if Australia remains on the EU's equivalence list
- stronger risk management and increased information on customers to assist business in preventing fraud against their institution
- some businesses would benefit as the amendments would increase their ability to meet FATCA requirements for US source income, as well as potentially avoiding the need to have two different systems to deal with customers who are US citizens
- codify existing business practices to minimise any commercial risk where the business is required to assess beneficial ownership and control and the bona fides of a customer (eg lending money or providing credit)

In summary, this option directly responds to each of the problems identified and would provide the greatest level of benefits through reducing fraud on banks and other businesses, reducing serious and organised crime more generally, increasing tax recoveries, enabling more successful criminal prosecutions (with related criminal assets confiscations). In light of the scale of existing ATO tax assessments resulting from AUSTRAC information, this option has the potential for the total value of benefits to exceed the estimated costs of $39.6 million per annum or $281.3 million (in net present value terms) over the next ten years associated with the proposed reforms.

Regulatory Offsets

In parallel with the proposed reforms, AUSTRAC has also identified several specific measures to offset the regulatory burden imposed on business by the proposed AML/CTF rule amendments. The two offset measures being developed are:

- An exemption for the proposed mFund operation.
- Simplified collection and verification of a customer's identification.

mFund offset

The mFund settlement service will enable issuers of managed investment schemes to electronically process applications. Without the proposed exemption, the product issuer would need to identify and verify a customer, despite the fact that the agent of the customer has already undertaken the same checks.

The exemption provided by the AUSTRAC Chief Executive Officer (CEO) will remove an obligation under the AML/CTF Act for both the agent of a customer and the product issuer of a managed investment scheme (MIS) to identify the same customer and undertake various AML/CTF obligations in relation to the same customer. Under the current arrangements, the customer would need to complete forms provided by the product issuer as part of the KYC obligations.

Discussions with several financial institutions and the Australian Stock Exchange (ASX) indicate that undertaking these 'know your customer' checks cost the financial institutions around $40 per customer. On this basis, the proposed exemption would provide savings of around $22.8 million per annum (averaged over a 10 year period) to product issuers and around $3.2 million per annum to customers, with total **annualised savings of around $26.0 million**. This is based on the assumption that the mFund would attract approximately 510,000 new customers each year. This compares to an analysis commissioned by the ASX that estimated there were a total of 5,173,000 applications to MISs in 2011.[7] New customers to the mFund would represent only a proportion of the total applications. These savings estimates consider the KYC requirements only, as sufficient data was not available to estimate the additional savings related to the broader AML/CTF obligations. It is further noted that the exemption will also be applicable to other future managed investment schemes, and not just the mFund, but it is not possible at this time to quantify the future regulatory cost savings to new schemes.

It is understood that the mFund is anticipated to commence operation during 2014. Beyond the cost savings associated with this exemption, the mFund is designed to provide benefits through more efficient application and payments processing and enhanced product distribution. Those benefits have not been included in this analysis as they are not direct regulatory cost offsets.

Customer identification

The second offset being considered by AUSTRAC related to the collection and verification of a customer's identification (Chapter 4 of the Rules). Currently, reporting entities are required to collect information from a customer and verify it from a reliable and independent source. Under the proposed change, the reporting entity would have flexibility in its approach to collection and verification of customer information including obtaining initial information from an independent source, pre-fill parts of the customer application form and then check the information with the customer for verification purposes. The key cost savings would relate to:

- reducing manual data entry of customer information by reporting entity employees
- reducing customer time needed to complete application forms (due to the reporting entity pre-filling information from an independent source).

Based on discussions with financial institutions, it is estimated that the proposed change would reduce manual data entry time by around 4 minutes per customer and would reduce the time it takes the average new customer to complete an application form by around 12.5 minutes. Some financial institutions indicated that the proposed change would not provide cost savings to their customer on-boarding process due to technology constraints and practical issues around existing processes. Therefore, it is assumed that around half of the financial institutions[8] would adapt their processes to leverage the flexibility of the proposed requirements over the 10 year period. The estimated annualised savings represent $7.2 million to financial institutions and $7.9 million to customers (individuals), with a total saving of around **$15.1 million per annum** from this offset.

Combined, these offsets provide annualised future savings of around **$41.1 million**. These savings estimates are highly sensitive to the underlying assumptions used. For example, the mFund savings estimates are driven by the assumed take-up rate of MISs by ASX share market participants. The customer verification offset savings are highly sensitive to the assumed proportion of financial institutions that would likely modify their existing customer on-boarding processes to take advantage of the more flexible verification requirements. Section 8 of the RIS provides further details on the offset costings and assumptions used.

7 Rice Warner Actuaries Report, Managed Funds Transaction Cost Research, July 2012.

8 Comprises major domestic banks, other domestic banks, foreign subsidiary banks, foreign branch banks, credit unions, building societies and mutual ADIS.

Average Annual Compliance Costs (from Business as usual)*				
Costs ($m)	**Business**	**Community Organisations**	**Individuals**	**Total Cost**
Undiscounted	$39.6 m	n/a	n/a	$39.6 m
Cost offset ($m)	**Business**	**Community Organisations**	**Individuals**	**Total by Source**
Agency				
a) mFund	$22.8m	n/a	$3.2m	$26.0m
b) Chapter 4	$7.2m	n/a	$7.9m	$15.1m
Within portfolio	n/a	n/a	n/a	n/a
Outside portfolio	n/a	n/a	n/a	n/a
Total by Sector	$30.0m		$11.1m	$41.1m
Proposal Cost neutral?		Yes		
Proposal deregulatory		Yes		
Balance of cost offsets		$1.5m		

* - Figures may not sum due to rounding.

Implementation and Review considerations

In terms of implementation timing, it is anticipated that the AUSTRAC CEO would make the AML/CTF Rules during May 2014, with the Rules to take effect from 1 June 2014. The AUSTRAC CEO has indicated the adoption of an assisted supervisory approach or alternatively incorporation of this approach into Policy principles issued under section 213 of the AML/CTF Act to operate from the period of the commencement of the Rules through to 1 January 2016. During this period business would be required to take actions to bring themselves into full compliance with the additional requirements. Furthermore, AUSTRAC will continue engagement with business prior to the Rules taking effect to develop guidance material and provide practical advice to support the implementation of the Rules.

There are two primary review processes that are relevant to this proposed regulatory change. On 4 December 2013, a legislative review was commenced by the Government of the AML/CTF Act, Rules and Regulations. A report will be presented in 2015. In parallel, Australia's regime is being reviewed against the revised 'International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation'. This process will result in a Mutual Evaluation Report being considered by the February 2015 Plenary meeting of the FATF. One of the impacts of these separate reviews is that there will be regular updates to government and to the FATF on Australia's AML/CTF regime.

Contents

1 About this RIS

1.1 Purpose

This single-stage details Regulation Impact Statement (RIS) examines options to address deficiencies found in Australia's anti-money laundering and counter-terrorism financing (AML/CTF) regime in respect of Australia's customer due diligence (CDD) obligations. It has been prepared in response to AUSTRAC proposals which are in response to the following two core drivers:

- the Financial Action Task Force (FATF) evaluation of Australia's implementation of the international AML/CTF standards (the FATF standards) in 2005

- the revised international standards on AML/CTF that clarify existing CDD obligations released by the FATF in February 2012

The decision was taken by the AUSTRAC Chief Executive Officer (CEO) to produce a single-stage details RIS due to the importance to Australia of responding to the problems discussed in this RIS, the drivers leading to the proposed reform and the urgency to address deficiencies. In making this decision the AUSTRAC CEO heavily took into account the extended consultation and discussions that have been conducted with business and stakeholders. This single-stage details RIS is one element which will be taken into account by the CEO before making a final decision in relation to any regulatory reform.

Prior to, and in parallel with the development of, this RIS, AUSTRAC engaged with industry and reporting entities to understand current business practices and options that may be considered in respect to enhancing customer due diligence requirements. This engagement has been through a workshop with stakeholders in April 2012, liaison and discussion through supervisory activities and consultative committee meetings, and three written public consultations which commenced in May 2013, December 2013 and March 2014 respectively.

AUSTRAC developed and publically released a discussion paper in May 2013 titled 'Consideration of possible enhancements to the requirements for customer due diligence'. The purpose of this paper was to seek formal stakeholder views on current industry practice and the need for, and costs and benefits of, amendments to Australia's AML/CTF CDD regime. Submissions were received from 29 industry participants, organisations and peak bodies from the period May through September 2013. Following this process, and in consideration of the submissions received, AUSTRAC released draft AML/CTF Rules on 9 December 2013 for additional industry comment. The public consultation period for the draft AML/CTF Rules was open to 24 January 2014. Submissions were received from 37 industry participants, organisations, peak bodies and government agencies. Consultation continued throughout February 2014 directly with industry participants and peak industry bodies and two further versions of the draft Rules were issued. A second consultative draft was used as a basis for discussions with parties who made substantive submissions to the first published draft of the Rules, and a third consultative draft was published for general public consultation on AUSTRAC's website on 5 March 2014 for a 2 week consultation period.

It is important to note that a statutory review of the AML/CTF regime (which encompasses the AML/CTF Act and Regulations made under that Act and the AML/CTF Rules) commenced on 4 December 2013. However, given the significance of CDD measures to the effectiveness of Australia's AML/CTF regime and international concern regarding Australia's current approach, it is appropriate that reforms to amend existing CDD obligations be considered in advance of the wider review of the operation of the legislative framework. Examining and applying changes now will leverage implementation (including systems, processes and procedures) by reporting entities and businesses in Australia subject to the United States Foreign Account Tax Compliance Act (FATCA) and developments associated with the OECD Automatic Exchange of Information (AEOI). The FATCA, commercially driven risk management strategies, and proposed CDD reforms all seek to identify beneficial ownership and controlling interests. It will also avoid many of the adverse impacts of reputational damage outlined in this RIS.

Further background information on Australia's AML/CTF regime is provided in Appendix A.

This RIS follows the OBPR *Best Practice Regulation Guidelines* for regulatory proposals.

1.2 RIS structure

This RIS is structured as follows:

- **Section 2** describes the problem that government is seeking to address
- **Section 3** establishes the objective of government action
- **Section 4** describes the policy options being considered in this RIS
- **Section 5** outlines the impact analysis that has been undertaken on each of the options
- **Section 6** outlines the consultation process and the stakeholders engaged
- **Section 7** summarises the conclusions of the RIS
- **Section 8** describes the regulatory offsets

Detailed information about our analysis, assumptions and supporting evidence is provided in the appendices.

2 Identified problems

2.1 Adverse impacts on Australia's national security

Money laundering is the lifeblood of organised crime. It is a transnational crime that:

- threatens the integrity and stability of the financial system
- is a source of funds for criminal activity, including serious and organised crime and terrorism, which impacts on community safety and wellbeing

The 2011 Australian Crime Commission (ACC) Organised Crime Threat Assessment identified money laundering as one of the three critical risks facing Australia given its potential impact to Australia's national security and prosperity with the potential to undermine the integrity of the Australian financial system.[9] Organised crime is conservatively estimated to cost Australia $10-15 billion each year.

The ACC's *Organised Crime in Australia 2013* report identifies the exploitation of business structures, including the infiltration of legitimate businesses by organised crime, as a key enabler of serious and organised crime. In particular, the report notes that complex business structures, for example, those composed of multiple layers and having international connections, are used to hide criminal ownership and control, and to move and obscure illicit funds, and that this is becoming increasingly common in Australia.[10]

To combat money laundering and terrorism financing activities and protect Australia, its institutions and its people, the Australian Government has sought to implement a robust AML/CTF regime within Australia. Australia has not acted in isolation with the enactment of laws throughout the majority of jurisdictions in the world aimed at consistency against an agreed global framework. The AML/CTF Act and Rules set a minimum baseline for reporting entities to know their customers and beneficial owners. Currently reporting entities must have in place AML/CTF programs to identify, mitigate and manage risks that a designated service it provides may involve or facilitate money laundering or terrorism financing.

AUSTRAC is Australia's combined AML/CTF regulator and financial intelligence unit (FIU). It receives financial transaction reports from regulated businesses. Of the 84 million financial transaction reports received by AUSTRAC from Australian businesses during 2012-13, just under 80 million were of international fund transfers into and out of Australia, with a total value of more than $3.5 trillion.[11] In addition, AUSTRAC received over 40,000 reports of suspicious matters from Australian businesses.

These reports and the information they contain provide AUSTRAC with the ability to disseminate intelligence to the broader law enforcement network regarding suspicious transactions and potential money launderers.

The three underlying problems that warrant additional government intervention in the AML/CTF regime are:

- reduction in Australia's revenue base due to information failure
- adverse societal consequences (i.e. negative externalities)
- regulatory failure to meet Australia's international obligations

9 Australian Crime Commission (2011) *Organised Crime in Australia 2011*. Available at: http://www.crimecommission.gov.au

10 http://crimecommission.gov.au/publications/organised-crime-australia/2013-report/enabler-activities#4

11 AUSTRAC (2013) *Annual Report 2012-13*.

2.2 Reduction in Australia's revenue base due to information failure

As highlighted previously, the 2011 ACC Organised Crime Threat Assessment identified money laundering as one of the three critical risks facing Australia given its potential to undermine the integrity of the Australian financial system.

The ACC reports that organised crime is conservatively estimated to cost Australia $10-15 billion each year, which includes illicit drug markets, money laundering, fraud, firearms trafficking, intellectual property crime and cyber-crime.[12] These costs go far beyond the direct harm caused by individual offences, and extend to the redirection of resources that would otherwise have been invested in legitimate business, foregone tax revenue, and increasing law enforcement costs. They also include the costs to the community associated with social harm and health. Broader impacts on community functions and social cohesion, including loss of public confidence in the rule of law and the administration of justice, are considered to be unquantifiable.

Empirical evidence suggests that between 70 and 80 percent of total criminal proceeds are laundered through the legitimate financial system. By way of illustration, in 2011 the World Bank – UN Office for Drugs and Crime Stolen Asset Recovery Initiative reported that 150 of the 213 grand corruption cases investigated involved the use of at least one corporate vehicle to hide beneficial ownership and the true source of funds. In these 150 cases, the total proceeds of corruption were approximately $USD56.4 billion.[13]

Information asymmetry – Due to current gaps in the Australia's AML/CTF regime, there are examples where a lack of accurate or verified information has enabled organised crime, terrorist and other organisations to hide or misrepresent core information from financial institutions and, ultimately, government agencies. The information gaps resulting from inadequate customer due diligence (CDD) include:

- No requirement for a financial institution (i.e. reporting entity) to understand the control structures of a customer, meaning that control structures can sometimes be hidden.
- No requirement for a financial institution to identify and verify the beneficial ownership and control of its customers, resulting in transactions taking place where the beneficial owner is not always evident.
- Limited requirement for reporting entities to identify politically exposed persons (presently only considered in terms of broad application of risk and related to foreign PEPs) who may be susceptible to coercion and corrupt conduct.

These information asymmetries have resulted in law enforcement agencies being inadequately supplied with the necessary information to perform their duties.

Table 1 provides a summary of the information gaps and the nature of the problems observed by AUSTRAC in relation to each gap.

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12 Australian Crime Commission (2011) *Organised Crime in Australia 2011*. Available at: http://www.crimecommission.gov.au

13 http://star.worldbank.org/star/publication/barriers-asset-recovery

Table 1: Nature of existing AML/CTF information gaps

Area	Problems experienced in Australia
Requirements for beneficial ownership and control	In Australia the investigations associated with Project Wickenby are a direct example of instances in which the obfuscation of ownership has been involved. To date additional tax liabilities raised exceeds $1.8 billion. Intelligence assessments and investigation by law enforcement and tax authorities highlight the substantial exploitation by individuals misusing corporate structures as vehicles to conceal the spectrum of serious and organised criminal activity. The existing limitation in identification requirements allows current weaknesses in Australia's regime to be exploited.
Situations where a customer is acting on behalf of a person	The ability to conceal a controlling person's identity and / or to place assets and property at arm's length has historically and continues to be a principal approach adopted by criminals to insulate themselves from law enforcement and frustrate confiscation efforts. Each year transactions amounting to billions of dollars in cash are reported to AUSTRAC. Criminals continue to exploit the opportunity to have another individual operate an account, in instances referred to as a 'front person' or 'front company' to act as a veneer of legitimacy.
Enhanced customer due diligence and politically exposed persons (PEPs)	Allegations of corruption at all levels of government has exposed the power and influence of politically exposed persons which can significantly impact economic development, political stability and the transnational nature of crime. The abuse of such power can lead to broader mistrust by the community in the legitimacy of government. Anecdotal evidence has suggested foreign PEPs may have invested embezzled or corrupt funds in Australia. Australia's National Threat Assessment on Money Laundering 2011 reported that given the potential attractiveness of Australia's financial, real estate and casino sectors to foreign PEPs, and reported corruption in some regional countries, the financial activity of foreign PEPs warrants scrutiny. A range of recent media articles has highlighted the ongoing vulnerabilities of when to apply enhanced customer due diligence measures regarding PEPs.
Purpose of business relationship	The discretion to consider and understand the nature of the business relationship with the customer has allowed individuals to operate businesses that have links to serious and organised crime exposing a reporting entity to ML/TF risk.

Box 1 and Box 2 provide specific examples of the practical implications of these information failures.

Box 1: Examples of CDD deficiencies identified during Project Wickenby

The flexibility in the existing rules has, in some cases, meant that law enforcement agencies are left with minimal information and thus reduced ability to prosecute money launderers. This is due to the use of legal entities and complex legal structures to hide the true ownership and control of those entities. For example, here in Australia, recent cases demonstrating the abuse of legal structures for illicit purposes have highlighted gaps in the system which need to be addressed.

Project Wickenby[14] has provided numerous examples of the abuse of complex legal structures for tax evasion purposes. PW uncovered the abuse of complex legal structures involving chains of company ownership, trusts and other corporate entities to hide the true ownership of funds for tax evasion purposes.

For example, the case of *Leighton v Commission of Taxation* illustrates the loss of revenue to the Australian government facilitated/enabled by the current CDD regime. Leighton's clients were able to avoid taxation on $10 million in taxable income from shares purchased through an Australian stockbroker. Although the money was earned in Australia, it was not able to be taxed because the beneficial owners were not able to be identified. Under enhanced CDD provisions, the beneficial owners must be identified.

A case study included in AUSTRAC's Typologies Report[15] gives another example where an individual was able to sell ASX shares to a company of which he was the beneficial owner. This allowed the individual to sell shares overseas and not pay Australian tax. Had the true beneficial owner of these accounts been known, these transactions, totalling $4.7 million, would not have been able to be disguised.

It is not only the government that can be negatively impacted. Individual investors can also be hurt in investments where funds are hidden offshore and unable to be recovered, such as in the Firepower case.

14 Project Wickenby was established in 2006 and is a cross agency taskforce established to protect the integrity of Australia's financial and regulatory systems by preventing people from promoting or participating in illegal offshore schemes.

15 AUSTRAC (2013) *AUSTRAC Typologie*s and case studies report 2013, available at http://www.austrac.gov.au/files/typ13_full.pdf

Box 2: Example of information asymmetries arising from hidden beneficial ownership

A key vulnerability in the Australian listed securities market is the common use of nominee/omnibus accounts in the custodial service provider (CSP) industry. Due to this feature, and lack of information on ultimate beneficial ownership as part of Australia's AML/CTF regime, it is not possible to identify securities held by CSPs on behalf of offshore entities.

The ATO is aware that in a number of offshore countries, with lower tax standards, investors are using CSPs to create companies which subsequently purchase shares on the Australian Stock Exchange (ASX). As the beneficial owners are not disclosed such investors are not reporting:

- capital gains to the ATO
- acquisitions that, if the beneficial ownership were known, would trigger a disclosure to the ASX and the broader investment community. In this way, 'control' can be acquired stealthily and market transparency undermined.

This risk could potentially be significant. The total value of Australian listed securities held by CSPs as at 30 June 2009 was $520 billion (approximately 47 per cent of the total value of the market). The value of directly held Australian listed securities offshore was $36.6 billion (as at 31 December 2008). With 41.9 per cent of the Australian listed securities market held by overseas investors, it is possible that a portion of this flow of capital into Australia from overseas is a vehicle for misconduct. Further, given their opacity, this sort of international transaction may facilitate misconduct in the Australian listed securities market as well as tax evasion.[16]

As the examples above illustrate, organised crime and activities associated with money laundering through complicated corporate and trust structures, can result in a decline in the level of revenue expected to be received by the Australian government.

This also affects the broader Australian community as less revenue received by the government due to tax evasion leads to either increased taxes on the Australian community to recover the lost revenue or otherwise reduced expenditure on social programs such as health and education.

The extent of this lost revenue is unknown; however it is likely to be significant. To provide an indication of the orders of magnitude involved, we note that the Australian Taxation Office (ATO) used AUSTRAC data to identify suspected tax avoidance, including abuse of overseas tax and secrecy havens in 1,428 ATO cases in 2012-13, resulting in $572 million in taxation assessments being raised.'[17]

2.2.1 Adverse societal consequences (negative externalities)

A closely related problem to that outlined above is that the financial institutions that may inadvertently facilitate transactions that result in tax evasion, money laundering or terrorism financing do not bear the full costs associated with these financial transactions. That is, the business arrangements between financial institutions and particular customers can lead to significant **negative externalities** for the broader community. The flow on effects of money laundering and terrorism financing are felt by other Australian businesses, the Australian Government, and the population at large. For example:

- the loss in revenue to the Australian Government from ML activities (such as evading taxes) harms the population at large, rather than the institutions responsible for conducting the CDD

16 Comments received from government stakeholder consultations.

17 *AUSTRAC Annual Report 2012-13*, page 60.

- the criminal activities associated with money laundering and terrorism financing have negative impacts on the community through violent crime and other offences. As mentioned earlier, organised crime is conservatively estimated to cost Australia $10-15 billion each year.

Financial institutions would incur additional costs to reduce the risk of these activities occurring, but would not directly benefit from the resultant lower levels of money laundering and terrorism financing activities. Therefore, financial institutions are unlikely to choose to bear the costs to mitigate these risks to a level that is optimal from a societal perspective.

2.2.2 Regulatory failure to meet Australia's international obligations

Aside from the indicative estimates of the cost of crime and the associated market failures, Australia's deficiencies in this area may also be viewed as a regulatory failure as Australia's regulatory approach is considered to be inconsistent with international standards.

International reputation about the strength of AML/CTF safeguards is important as it can guide investment decisions, but also opinions about the attitude the government of a country has towards making real steps to prevent money laundering and terrorism financing.[18] Australia has historically and continues to take a significant role in fostering global cooperation in the fight against transnational organised crime and related harms. As it relates to these specific problems Australia has made a direct commitment as a G20 country in the 2013 Declaration to tackle the risks raised by opacity of legal persons and legal arrangements, and commit to take measures to ensure that the FATF standards regarding the identification of the beneficial owners of companies and other legal arrangements such as trusts that are also relevant for tax purposes are met.[19]

The consequence of regulatory failure is that Australia's financial system remains vulnerable to serious and organised crime, and criminals are not deterred from pursuing illicit profits through drug trafficking, fraud, tax evasion and other criminal and corrupt activities.

The deficiencies which remain in Australia's AML/CTF framework and which are core to the amendments being considered in this RIS are outlined in Table 2.

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18 An indication of both these sides is the EU equivalence list. This 'whitelist' contains the countries that are regarded as having AML/CTF safeguards that are equivalent to the EU and as such safer to do business with under more simplified due diligence. The list also has a national reputation element for the countries contained on it.

19 G20, 2013,Leader's Declaration https://www.g20.org/sites/default/files/g20_resources/library/Saint_Petersburg_Declaration_ENG.pdf

Table 2: Summary of Australia's deficiencies

Area	Deficiency
Requirements for beneficial ownership and control	The obligation on reporting entities to determine the beneficial ownership and control structures of customers is inadequate and inconsistent with the FATF standards because there is no: • provision for a reporting entity to understand the 'control structures' of a customer • requirement for a reporting entity to collect information on the powers that bind the legal person (e.g. company) or legal arrangement (e.g. trust).
Requirements for beneficial ownership and control	There is no explicit requirement for a reporting entity to identify and take reasonable measures to verify the beneficial ownership and control of its customers
Situations where a customer is acting on behalf of a person	The AML/CTF regime does not require a reporting entity to determine whether a customer, who is a natural person, is acting on behalf of another person and, if so, to take reasonable steps and apply adequate measures to verify the identity of that other person.
Settlor of a trust	Where a reporting entity is dealing with a customer that falls under a legal arrangement (e.g. trust), there is no explicit requirement under the AML/CTF regime to identify and verify the settlor of a trust.
Enhanced customer due diligence and politically exposed persons (PEPs)	The AML/CTF regime does not provide sufficient clarity on the application of enhanced customer due diligence measures where a reporting entity has a high-risk situation. The AML/CTF regime does not contain an obligation for a reporting entity to apply enhanced customer due diligence measures where a customer is classified as a politically exposed person (PEP).
Purpose of business relationship	There is no explicit requirement for a reporting entity to consider and understand the nature of the business relationship with the customer.
CDD records	The AML/CTF Act does not place a general obligation on reporting entities to keep CDD information up to date, regardless of the ML/TF risk assessed for a customer.

The issue of this non-conformance with international standards and an AML/CTF regime that is out of step with our trading partners can result in a number of repercussions on government, business and society.

If Australia does not continue with its ongoing efforts to improve its AML/CTF framework, Australia's reputation in the eyes of its friends and allies could be adversely affected. Such judgments can have adverse commercial, political and reputational implications, including the potential to:

- undermine Australia's standing and influence on the global stage (i.e. G8, G20, UN Sanctions Committee, etc.)
- undermine Australia's influence with respect to wider foreign policy efforts (e.g. trade negotiations, AML/CTF and anti-corruption technical assistance to key developing countries and regional neighbours etc)
- undermine the reputation of its financial institutions
- discourage legitimate foreign investment
- distort capital flows or otherwise increase the cost of doing business
- increase Australia's vulnerability to serious and organised crime, corruption and terrorism

Non-conformance with international standards will continue to tarnish Australia's reputation and may have a more damaging effect in light of Australia assuming the G20 Presidency in 2014. The G20 agenda items include transparency of company ownership and combating corruption. Australia will also hold the FATF Presidency from July 2014.

As discussed previously, organised crime and activities associated with money laundering through complicated corporate and trust structures, can result in a decline in the level of revenue expected to be received by the Australian government, with adverse impacts on the broader Australian community.

From a business perspective, increased levels of money laundering and terrorism financing abuse also have the potential to distort markets creating illegitimate competitive advantage. This can be particularly damaging for smaller businesses trying to compete in these markets. Increased money laundering and terrorism financing abuse also damages Australia's international reputation and increases the cost of business.

Businesses may be likely to see an increase in compliance costs if Australia remains unaligned with international standards, particularly if Australia is included on one of the FATF's three 'watch lists' (the grey, dark grey and black lists). Inclusion on these lists is currently based on technical compliance with the FATF standards and movement between lists is based on progress made to address identified deficiencies. Other developed countries and FATF members have previously been included on the FATF grey list, and there is a possibility that the FATF may publish a list of member countries with remaining key/core deficiencies as the third round of mutual evaluations comes to an end in 2014.

Should a country be included and remain on the black list for a year, the country and its businesses may be subject to a call by the FATF for other countries to apply countermeasures, which could include any of the following:[20]

- Requiring financial institutions to apply specific elements of enhanced CDD.
- Introducing enhanced relevant reporting mechanisms or systematic reporting of financial transactions.
- Refusing the establishment of subsidiaries or branches or representative offices of financial institutions from the country concerned, or otherwise taking into account the fact that the relevant financial institution is from a country that does not have adequate AML/CTF systems.
- Prohibiting financial institutions from establishing branches or representative offices in the country concerned, or otherwise taking into account the fact that the relevant branch or representative office would be in a country that does not have adequate AML/CTF systems.

20 FATF (2013) *Interpretive note to recommendation 19. Available at*: http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf

- Limiting business relationships or financial transactions with the identified country or persons in that country.
- Prohibiting financial institutions from relying on third parties located in the country concerned to conduct elements of the CDD process.
- Requiring financial institutions to review and amend, or if necessary terminate, correspondent relationships with financial institutions in the country concerned.
- Requiring increased supervisory examination and/or external audit requirements for branches and subsidiaries of financial institutions based in the country concerned.
- Requiring increased external audit requirements for financial groups with respect to any of their branches and subsidiaries located in the country concerned.

The probability of Australia being subject to these countermeasures, though, is considered unlikely given that only Iran and North Korea are currently subject to these measures, and Australia's current AML/CTF regime is not considered to be analogous with the frameworks within these countries.

A tangible example of the risk to business is that if Australia remains non-compliant with international standards there is the potential for Australia to be removed from the European Union (EU) equivalence list. Australia is currently one of twelve countries on the list. This list enables EU regulated entities to apply simplified due diligence measures when dealing with industry in listed countries as the EU considers countries' compliance with the FATF standards in maintaining the list. Removal from this list would mean that Australian businesses operating in the EU or dealing with EU regulated entities would be subject to more stringent due diligence measures and therefore increased transaction costs.

In consultations a number of government and industry stakeholders specifically pointed to the circumstances in which New Zealand was removed from the European Union (EU) equivalence list. Similar deficiencies in relation to CDD, as currently faced by Australia, were at the core of New Zealand's removal. The impact of removal of New Zealand from this list meant that New Zealand businesses operating in the EU were subject to more stringent due diligence measures and therefore suffered from increased transaction costs (principally delay) as foreign banks seeking to deal with NZ businesses were required to undertake additional inquiries. Stakeholders were not able to quantify the costs of such delay but considered it material.

3 Objectives of government action

The overarching objective of government action is to protect the Australian people and economy against money laundering and terrorism financing activities that could severely damage the economy and Australian businesses. It aims to do so by increasing the transparency and improving the effectiveness of CDD activities in regards to the AML/CTF regime.

Namely, the government is seeking to ensure that the AML/CTF framework:

- supports domestic and international efforts to combat organised crime, corruption and terrorism
- protects Australia's tax revenue base through more transparent financial market transactions
- provides Australian law enforcement agencies with better evidence based on more detailed information about beneficial ownership
- ensures sufficient transparency surrounding the full range of high risk financial transactions
- is consistent with internationally agreed standards which promote effective prevention, deterrence, detection and prosecution of money laundering and the financing of terrorism

In meeting the above objectives the Attorney-General's Department and AUSTRAC have undertaken an extended policy development process which has included ongoing engagement in relation to the problems discussed in Section 2 across government at the Commonwealth, State and Territory level. This engagement has extended to international jurisdictions which have implemented similar reforms or are on the cusp of implementing reforms.

Beyond government, the most intensive component in this process has been public consultation which is detailed in Section 6. As a summary of this engagement, in May 2013, Ministerial approval was provided to conduct a public consultation seeking submissions on a discussion paper which outlined reasons for reform, the nature of possible reforms and sought responses to questions on those topics and on ways to minimise the impact of any reforms. Following consideration of the submissions, in November 2013, further Ministerial approval was provided to continue the consultation in relation to the policy development process. This led to the release of draft AML/CTF Rules on 9 December 2013 which provided a public opportunity for stakeholders to consider the possible policy changes as well as the detailed impact. The public release of the discussion paper and draft AML/CTF Rules also enabled the international community through the FATF to monitor the efforts being made by Australia, at its October 2013 and February 2014 meetings.

Between January and March 2014, AUSTRAC has been involved in targeted consultation with stakeholders who made submissions to the draft AML/CTF Rules and further public consultation on a revised set of draft AML/CTF Rules. At each stage of consultation further refinement has been made to the policy and draft Rules. The AUSTRAC CEO has provided in-principle support to changes that have been made during the consultation process, including in relation to the timing of the implementation of reforms and the expectations of AUSTRAC as the regulator during the implementation.

4 Statement of options

This section outlines the options that were considered to improve the effectiveness of CDD and corresponding risk management activities. It is expected that the implementation of the considered options could be achieved through modification of the existing AML/CTF Rules, and/or creation and dissemination of supporting guidance and material from AUSTRAC.

Options for government intervention can be broadly categorised along a spectrum ranging from non-regulatory to regulatory. The differentiating feature is the degree of direction, coercion or penalties to ensure compliance.

- *Non-regulatory* options are preferred where they are capable of achieving desired behavioural change. There are many advantages to non-regulatory approaches, including flexibility, cooperation and minimal costs to industry. However, for many problems such as those noted in Section 2 above, non-regulatory options may not provide sufficient force or consistency to produce change on a scale needed to solve the problem.

- *Regulation* and supporting rules and instruments are generally justified where market forces or voluntary initiatives are not effective in driving the desired behavioural change or outcome. Examples include public goods and services, market failure, externalities or information asymmetries. CDD and associated activities (in relation to AML/CTF) have elements of externalities and information asymmetry as noted in Section 2.

To assess the most effective and appropriate course of action for government to take to achieve the objectives set out in Section 3, three options were developed and are subject to analysis in this report. The options considered (in ascending order of intervention) are:

- **Option A:** *Status quo* — current regulatory approach maintained.

- **Option B:** Code of best practice — current regulations and rules are supplemented with additional guidance and material provided to reporting entities.

- **Option C:** Regulatory change —additional requirements incorporated into the existing AML/CTF Rules.

The following sections describe each option in greater detail.

4.1 Option A: Status quo

The first option for consideration is *status quo*, or the ‘do nothing’ option. The *status quo* assumes that the government will maintain the existing regulatory arrangements, and assumes that there will be no external driver that would cause the Government to change its existing approach.

The purpose of this option is to act as the baseline for analysing the costs and benefits of each subsequent option where changes occur. The base case is assumed to maintain the following specific elements in place:

- current approach to AML/CTF, allowing reporting entities to continue to use their discretion as to whether to identify beneficial owners

- current legislative framework and/or supporting instruments to address CDD risks (as found by the FATF)

- current CDD obligations

- existing domestic and international law enforcement approach towards combating money laundering and terrorism financing
- existing levels of expenditure with respect to compliance, particularly with respect to any investments in infrastructure

4.2 Option B: Code of best practice

Option B entails a light-handed approach to implementing the desired behavioural change of reporting entities as compared to pursuing regulatory change. It would entail the current AML/CTF regime remaining as is (i.e. current AML/CTF regulations and supporting rules) but with additional guidance and material provided to reporting entities by AUSTRAC. The guidance and material would provide clarity around the following:

- definitions of core terms such as 'control' and 'PEP'
- definitions of what constitutes specifically a low risk situation/customer through to a high risk situation/customer
- guidelines as to specific CDD and/or enhanced CDD requirements and activities under each of the low, medium and high risk situations
- guidelines as to what activities should be undertaken when identifying and verifying ownership structures and beneficial owners, particularly of corporate structures and trust arrangements
- guidelines as to appropriate timelines and activities for ensuring relevant and important pieces of customer data are kept up-to-date

Under this approach, there would be no automatic repercussions for reporting entities failing to meet objectives as outlined within the guidelines. Guidance materials could likely be developed jointly between industry and government stakeholders. Ideally, over time, reporting entities would develop an industry consensus — or best practice — with respect to AML/CTF risk management where those 'out of step' with industry practice may be subject to market pressures to ensure rectification of deficiencies. For example, firms found to have lax AML/CTF practices would incur increased regulatory attention from AUSTRAC and from other regulators and see both domestic and international pressures to conform.

4.3 Option C: Regulatory change

Option C reflects the regulatory approach identified by AUSTRAC on 9 December 2013 in the document titled *Explanatory statement: draft amendments to the AML/CTF Rules relating to customer due diligence* and subsequent drafts. The primary objective of Option C is to substantially address deficiencies as assessed by the FATF by amending/supplementing the existing AML/CTF Rules with additional regulatory obligations. Option C would bring Australia further into compliance with the FATF standards. It would create the obligations in a legally enforceable way, and provides the regulated population with clarity and certainty. Option C also has the advantage of avoiding competitive distortion through variable implementation of CDD requirements.

4.3.1 Proposed amendments

The proposed rules build on the existing risk-based AML/CTF framework, and aim to develop greater precision and consistency in the application of CDD preventative measures across the regulated population and mandate a single standard with respect to AML/CTF compliance.

Section 5 summarises the proposed regulatory changes and the expected impact of each change on the regulated population.

Proposed mechanisms to reduce burden

Option C also includes an expanded approach to the existing **Disclosure Certificate** facility contained in Chapter 30 of the AML/CTF Rules. Under the amended Rules a reporting entity, in certain circumstances, would be able to use a Disclosure Certificate from a customer to verify the identity of a beneficial owner of a company, trust, partnership, association or registered co-operative. Reporting entities would have to be satisfied when using this approach that relevant information could not be reasonably obtained or verified from normal sources. [21] The onus would thus fall on the customer to provide information that is true and correct, and could be subject to penalties if it is later proven that the information provided was false or misleading.

Target Population — Reporting entities impacted

Australia's reporting population is far from homogenous, with reporting entities ranging from local family-owned or sole-trader businesses to major banks with an international presence. Experience and familiarity with Australia's AML/CTF regulations varies, as does the sophistication of AML/CTF programs and their supporting infrastructure. This is an important consideration because the current operational arrangements of the target population ultimately drive the associated impact of the rules.

Currently, there are 13,762 reporting entities enrolled with AUSTRAC on the Reporting Entities Roll (in accordance with post 1 November 2011 enrolment requirements). A portion of these however, will not be subject or have limited exposure to the proposed changes. This is due to the continuation of existing exemptions for certain reporting entities (approximately 10 per cent of total number of reporting entities) together with categories of businesses which would normally not engage with customers who are legal entities or PEPs.

Table 3 provides a breakdown of the total regulated population and the anticipated impact for each entity within a given sector. It indicates that 28 per cent of reporting entities (2,147 micro business and 1,652 larger businesses including banks and large institutions) will be impacted by Option C provided all existing and proposed exemptions are maintained moving forward.

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21 Stakeholder indicated that disclosure certificates are not commonly used by industry as the circumstances in which they can be used are quite narrow. Potentially this could be only a minor 'mechanism to reduce burden'; however additional research would be required to more accurately qualify this comment.

Table 3: Summary of regulatory impact on reporting entities

Option C	Number	Description of reporting entities impacted
Reporting entities with negligible or no impact		
No impact	1,376	Of the total number of reporting entities, approximately 10 per cent will not be affected due to existing exemptions which will remain in force.
Negligible impact	8,587	There are currently 10,734 micro-businesses who are regarded as reporting entities. It is expected that 80 per cent of these businesses (which represent around 78 per cent of the total reporting population) will not incur any significant regulatory impact given they do not have a large legal entity customer base and their business models mean they largely offer fewer services that would be impacted by these reforms. These businesses include: • remittance dealers - affiliates and independents • gambling businesses - betting agencies, bookmakers, pubs and clubs) • non-bank lenders and financiers – ie small lenders • financial planners.
Reporting entities impacted		
Potentially affected	2,147	It is expected that 20 per cent of micro-businesses would potentially be affected by the proposed changes due to their customer base.
Most affected	1,652	The remaining reporting entities that will be most affected by the proposed reforms are generally large, sophisticated entities such as banks and major financial institutions given the size and nature of their customers. These entities have significant AML/CTF programs, systems and processes in place that may be more readily adapted to meet new requirements, and are also more likely to be subject to FATCA requirements.

4.4 Options not considered

This RIS relates to certain components (largely those concerning CDD) of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (AML/CTF Act) and AML/CTF Rules. For this reason, this RIS has not considered an option which would involve self-regulation (i.e. repeal of current AML/CTF regulations and subordinate instruments).

Further, the following two options were raised but also deemed to be insufficient to meet present Government objectives and thus were not considered further in the RIS.

1. Regulatory enforcement with automatic exemptions

Given the problems identified and the repercussions of not ensuring effective CDD measures across all reporting entities, the option of partial regulatory enforcement (automatic exemptions provided to sector specific reporting entities such as remittance dealers, gambling businesses, non-bank lenders and financiers and financial planners) was not considered feasible. By providing automatic exemptions it would potentially create gaps in the system and provide easy avenues for launderers to take advantage of certain financial service providers. This is an important consideration within a dynamic environment where new products, services and money laundering/terrorism financing opportunities can quickly emerge.

2. Extending the application of the AML/CTF Framework (Tranche II) and ASIC support

A portion of submissions from financial service providers noted that the expansion of the AML/CTF framework to include designated non-financial businesses and professions (DNFBPs) would aid in the strengthening of the AML/CTF regime as this would mean that additional sectors and thus entities (i.e. real estate agents, jewellers, accountants and lawyers) would be subject to the AML/CTF Act and its requirements.

In addition, the notion of ASIC providing supporting infrastructure was also raised to enable and facilitate the checking and sharing of CDD information relating to beneficial ownership. AUSTRAC found that given the inherent complexities associated with extending the AML/CTF regime to include DNFBPs and enhancing ASIC infrastructure support, extending regulatory coverage at this stage requires further consideration and was not considered as an option within this RIS. Further, while the existence of supporting infrastructure such as ASIC databases would assist in the transfer of regulatory burden, such infrastructure would still need to be supported by CDD measures for non-Australian companies and trusts.

5 Impact Analysis

Given the 'hidden' nature of money laundering and terrorism financing, it is difficult to robustly quantify the costs of this type of criminal activity and quantify the benefits to society of deterring, disrupting and detecting this activity. At a macro environment level estimates generated by the Australian Crime Commission or international bodies such as the United Nations link the estimate of crime as a percentage (often 2 per cent – 5 per cent) of a jurisdiction's GDP. The analysis below attempts to quantify impacts wherever possible but in doing so, in some cases, relies on adopting a large number of assumptions or relies on qualitative discussion.

While Options B and C outlined in Section 4 aim to address both the market and regulatory failures, they will ultimately do so in different ways. Broadly, the potential impact of each option falls into four broad categories:

- **Reputation impacts** – this category considers the impacts of being 'named and shamed' (or otherwise singled out) in the eyes of international companies, international institutions, and Australia's friends and allies.
- **Litigation impacts** – this category considers the impact of money laundering, crime and loss of revenue in terms of law enforcement agencies having better evidence based on the availability of more detailed information about beneficial ownership to be able to investigate and prosecute crimes and reclaim lost taxation revenue.
- **Compliance impacts** – this category considers the impact of the proposed option in terms of the direct costs faced by business in implementing the proposed solution.
- **Social/economic impacts** – this category considers the impact of the proposed solution on the broader society and economy, particularly with respect to its effectiveness in reducing money laundering, terrorism financing and other serious and organised crime.

Additionally, as will be discussed further in Section 6, key feedback from stakeholders concerning the draft rules highlights that an important cost driver of these rules could be subsequent decisions (i.e. AUSTRAC, court decisions, international commitments, etc) concerning the precise:

- definition (i.e. scope, coverage, etc) of beneficial ownership
- nature of ongoing CDD requirements.

This section summarises the assessment of the costs and benefits of implementing the options described in section 4. More detailed analysis and explanation of methodology (including assumptions) is provided in Appendix A. Additionally, comparison of the options is presented in Appendix E.

5.1 Option A: Status quo

As was discussed in Chapter 4, the first option for consideration is *status quo*, or the 'do nothing' option. This option assumes the following by maintaining:

- the current legislative framework and/or supporting instruments to address CDD requirements
- the existing domestic law enforcement approach towards combating money laundering and terrorism financing
- existing levels of expenditure with respect to compliance, particularly with respect to any investments in infrastructure

5.1.1 Cost Impacts

The primary cost impacts of Option A relate to the implications for Australia's international reputation and the social and economic impacts of remaining vulnerable to serious and organised crime. These issues are in many respects intricately intertwined.

Money laundering is a transnational crime. Continued weaknesses in Australia's CDD requirements in an environment where other comparable international jurisdictions have already addressed these shortcomings are likely to result in Australia becoming a more attractive destination for international money laundering operations.

This will lead to increased costs to Australia in the form of the negative externalities considered in section 2 above.

A consequence of continuing weaknesses in Australia's CDD requirements relative to other international jurisdictions, is that it is likely that international bodies such as the FATF will make a public statement declaring that Australia does not meet international standards and warns other members about the risk in interacting with Australia. Such a statement may lead to an immediate response. The FATF form of 'naming and shaming' classifies jurisdictions as being at three levels of deficiency (jurisdictions having strategic deficiencies and that have not made sufficient progress – the black list; jurisdictions that have not made sufficient progress against their action plan – the dark grey list; and jurisdictions that have given high-level commitment to addressing their strategic deficiencies – the grey list) and generally calls for countermeasures to be in place at the most serious level.

The likelihood of Australia being subject to a call for countermeasures is low. Currently only Iran and the Democratic People's Republic of Korea are subject to countermeasures. Further, countries on the 'non-cooperative' and progressing lists have systemic AML/CTF deficiencies not found in Australia.[22] Despite this, it is possible that Australia may be subject to further action by the FATF, including a public 'name and shame' mechanism (which may or may not be through the existing grey or black lists), if it continues to remain deficient against the CDD standard.

If Australia were to maintain the status quo, there is a risk that Australia could otherwise be viewed unfavourably by the international community. If this were to occur, there could be a number of cost implications for government, industry and individual Australians alike. This is particularly relevant given the duration since 2005 in which Australia's deficiencies have not been rectified, and during which other countries have rectified similar deficiencies.

Business

In the event that Australia is viewed unfavourably by the international community businesses could be negatively impacted.

For example, when Thailand was cited as having strategic AML/CTF deficiencies in 2012, Deputy Prime Minister Kittiratt Na-Ranong stated 'this will definitely affect foreign investor confidence and Thailand as a whole'.[23] Possible costs to Thailand businesses as a consequence of being cited were identified as:

- an increase in costs of capital investments and financial transactions between Thailand and other jurisdictions
- impediment of international trading, including the opening of accounts with international financial institutions and remittances, as additional documents would be needed.

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22 FATF, 'FATF Public Statement, 18 October 2013', available at http://www.fatf-gafi.org/documents/documents/fatf-public-statement-oct-2013.html

23 Bangkok Post, 'Anti-money laundering blacklist spells trouble', 22 May 2012, available at: http://www.bangkokpost.com/learning/learning-from-news/294602/anti-money-laundering-blacklist-spells-trouble

In addition to 'blacklisting' by FATF, the EU publishes its own list which, rather than acting as a 'naming and shaming' of countries that have deficiencies, recognises those countries where the standards are comparable to the EU. This is called the 'Third country equivalence list', [24] or can be referred to as a 'whitelist'.[25] Because this list recognises conformity with international standards, it is more likely that deficiencies not rectified will lead to Australia's removal. Although the whitelist has no legal status, and the EU states that being recognised on the whitelist does not overrule taking a risk based approach towards dealings with other countries, it does set up a refutable presumption towards simplified CDD.[26] It generally means that the EU can accept and acknowledge CDD analysis performed in the listed country. Being listed reduces costs for Australian consumers and businesses in dealings with EU financial institutions.

While it is more likely that Australia would be removed from 'whitelists' than be 'blacklisted', this removal could also increase transaction costs for Australia businesses. The reputational risks to government can also taint businesses by association with the country. When New Zealand was removed from the whitelist, costs to business were described as being 'of the detriment to every New Zealand company which operates in Europe and has dealings with the European financial institutions that now have to be satisfied with more information being provided by the New Zealand corporate, which no doubt increase their compliance costs as a consequence of this problem not being remedied earlier'.[27]

In addition, there are risks to business' own reputations and the potential for legal consequences and penalties for not adequately knowing their customer, if they are linked to, or found to have been providing services to, money launderers, terrorists, corrupt officials, etc. High-profile international examples in recent years include US regulatory action (including significant financial penalties) against HSBC and JP Morgan Chase, for the failure of their AML/CTF systems to detect and prevent money laundering by Mexican drug cartels, sanctions violations, and the embezzlement of investor funds by Bernie Madoff.

Government

To the extent that negative externalities arise from increased crime in Australia as a result of our relative weaknesses in CDD, government agencies will incur additional costs in the fight against serious and organised crime. In addition, agencies which rely on AUSTRAC information will be less efficient than could otherwise be the case where reports provided to AUSTRAC do not contain sufficient information related to the beneficial owners underlying particular transactions or where that information cannot be obtained readily from AUSTRAC's regulated entities.

From a government perspective, even if no specific consequences flow from being on any international 'watch list', the simple act of being named, inherently, could negatively impact on Australia's reputation, particularly in situations where reputation may serve as leverage in other areas of Australia's foreign policy.[28]

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24 European Union, 'Common understanding between Member States on third country equivalence under the Anti-Money Laundering Directive', June 2012, available at http://ec.europa.eu/internal_market/company/docs/financial-crime/3rd-country-equivalence-list_en.pdf

25 Baker Platt, 'White Paper, EU White list omits the Diamond for the Dirt', available at http://www.legal500.com/assets/firmdevs/bakerplatt/whitepaper.pdf

26 European Union, 'Common understanding between Member States on third country equivalence under the Anti-Money Laundering Directive', June 2012, available at http://ec.europa.eu/internal_market/company/docs/financial-crime/3rd-country-equivalence-list_en.pdf

27 New Zealand House of Representatives Hansard, 'Companies and Limited Partnerships Amendment Bill – First Reading', 24 July 2012, Volume 682, Page 3852, per Hon David Parker available at http://www.parliament.nz/en-nz/pb/debates/debates/50HansD_20120724_00000024/companies-and-limited-partnerships-amendment-bill-%E2%80%94-first

28 Jason Sharman, 'The bark is the bite: International organizations and blacklisting', paper presented at the American Political Science Association meeting Chicago, September 2004, available at http://macha.itc.griffith.edu.au/dspace/bitstream/handle/10072/30215/61832_1.pdf?sequence=1

For example, the FATF is a well-established international body, which has 'observer' membership comprised of most other major international economic or regulatory institutions, such as the World Bank and IMF. The FATF and G20 Anti-Corruption Working Group contain 15 of these organisations.[29] Australia's status amongst these organisations is important, especially given Australia's Presidency of the G20 and FATF in 2014, in a year in which a key identified agenda issue is anticorruption.[30]

Additionally, the FATF is also not the only body that can 'blacklist' Australia and institute accompanying reputational risk. In the past, FATF blacklisting has led to member countries issuing advisory statements against the blacklisted economy, which may continue independently of blacklisting. For instance, when St Kitts and Nevis, the Cayman Islands, the Cook Islands and Liechtenstein were FATF blacklisted in 2000, the US based FinCEN issued advisories against them and did not remove these advisory against all jurisdictions even when they were removed from the FATF blacklist.[31] In this way the FATF announcements can have a compounding effect.

New Zealand was removed from the EU whitelist in 2012. The EU does not have to publish their reasons for removal of a jurisdiction from the list, though public statements were made by some members regarding New Zealand's removal. A factor in the removal may have been a report made to the EU's Committee on the Prevention of Money Laundering and Terrorist Financing, or a high-profile case involving a New Zealand-based shell company washing money through a Latvian bank account.[32] This removal from the whitelist was described in the New Zealand Parliament as a 'black mark against our name'.[33]

Lastly, a consequence of loss of reputation and confidence in Australia's systems could lead to a decline in the national credit or finance rating. These ratings can consider FATF opinions and as FATF gains more visibility through its prominence in G20 and OECD, it is possible Australia's deficiencies will be highlighted. It is important to note that the IMF's Financial Sector Assessment Program (FSAP) explicitly considers countries' compliance with the FATF standards as a key indicator of financial stability; while Australia's assessment occurred in 2012, the IMF Board will consider the results of Australia's upcoming 2014 FATF mutual evaluation once it has been finalised.[34] However, given this is one of many considerations in establishing credit and financial ratings, it is difficult to quantify the extent of this risk.

It is noted that the G20 and the OECD are leading the global push toward increased corporate transparency through the identification of beneficial ownership and control of corporate vehicles and combating the misuse of tax havens and tax avoidance. Non-compliance with the FATF standards may be perceived by the international community and Australia's trading partners as undermining these efforts.

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29 FATF, 'President's Summary of Outcomes from the Experts' Meeting on Corruption', 12 October 2013, available at http://www.fatf-gafi.org/media/fatf/documents/statements/Corruption-Expert-meeting-Oct-2013.pdf. Members of this Working Group include the Asia Pacific Group on Money Laundering, the Council of Europe Group of States Against Corruption, the International Monetary Fund, the Organisation for Economic Co-operation and Development, the United Nations Office on Drugs and Crime, the World Bank and the World Customs Organization, amongst others.

30 G20, 'G20 2014: Overview of Australia's Presidency', December 2013, available at https://www.g20.org/sites/default/files/g20_resources/library/G20Australia2014conceptpaper.pdf

31 Jason Sharman, 'The bark is the bite: International organizations and blacklisting', paper presented at the American Political Science Association meeting Chicago, September 2004, available at http://macha.itc.griffith.edu.au/dspace/bitstream/handle/10072/30215/61832_1.pdf?sequence=1

32 Asia-Pacific International Relations Study Centre, 'New Zealand's reputation to rescue – blame Russian Mafia connections?', July 2012, available at http://apircenter.org/south-pacific/new-zealands-reputation-to-rescue-blame-russian-mafia-connections/

33 New Zealand House of Representatives Hansard, 'Companies and Limited Partnerships Amendment Bill – First Reading', 24 July 2012, Volume 682, Page 3852, per Hon Clayton Cosgrove, available at http://www.parliament.nz/en-nz/pb/debates/debates/50HansD_20120724_00000024/companies-and-limited-partnerships-amendment-bill-%E2%80%94-first

34 International Monetary Fund, Australia: Financial System Stability Assessment (IMF Country Report No. 12/308), November 2012, http://www.imf.org/external/pubs/ft/scr/2012/cr12308.pdf

Society

Increased criminal activity in Australia impacts all Australians through lost revenue to Government, the reallocation of Government resources toward fighting crime and away from other priorities such as health and education.

Blacklisting or removal from a whitelist may result in some financial institutions not offering services to Australian customers, meaning reduced choice, or higher prices for Australians either from lack of competition or costs passed on from higher transaction costs. There is also the possibility of general reduced economic output which will affect the whole society. However, we have not identified any research, quantitative or qualitative, that has explored this in detail.

5.1.2 Potential benefits

The *status quo* has no additional incremental benefits to government. Law enforcement efforts will continue to be limited by what can reasonably be achieved with the existing tools at its disposal, while facing potentially increased levels of crime. With respect to industry, the benefit of maintaining the status quo would be to not incur the implementation costs associated with the other options. For society and consumers more generally, both groups could potentially benefit in the short term from maintaining current arrangements by avoiding any costs 'passed on' from industry as well as avoiding any increasing administrative or documentary requirements.

5.2 Option B: Code of best practice

Under this option, no additional regulatory requirements are imposed on businesses; rather, the existing rules would be supplemented with unenforceable guidance material issued by AUSTRAC. The intention is that businesses could respond to the issues regarding the ML/TF risks posed by lack of transparency surrounding beneficial ownership, without prescriptive regulatory directives.

As this option is non-prescriptive, it is likely that not all the businesses will adopt guidelines provided by AUSTRAC. If all businesses choose to disregard the guidelines, the impact will be the same as the situation under the status quo option set out above.

5.2.1 Potential costs

Business

The absence of enforceable regulation means that business will only incur compliance costs if it chooses to follow the guidelines. Compliance costs arise when businesses decide to act according to the guidelines. For example, business may undertake activities identifying and verifying ownership structures according to the guidelines which incur more administrative burden and require additional training for staff. The extent to which the level of costs vary depend on how closely business adopt the guidelines as well as their existing practices. If all entities adopt best practice as suggested in the guidance materials, the costs will be close to the compliance costs under full regulatory requirements.

In consultations business representatives voiced mixed views about the attractiveness of this option. While some welcomed the flexibility that guidelines may provide and felt that AUSTRAC guidelines would be viewed by industry as being almost mandatory to implement, the majority of larger organisations saw the uncertainty that guidelines create as potentially costly and instead favoured prescription offered by Option C.

Businesses will incur additional compliance costs if they choose to follow the guidelines. Costs could be passed onto consumers through increased banking fees and other mechanisms, depending on the prevailing market conditions. This potentially places those businesses that adopt the guidelines in a relatively less competitive position compared with businesses that do not follow the guidelines. Incentive for entities to adopt best practice is therefore likely to be reduced and adds to the risk of this option failing to achieve government objectives.

As was noted above, compliance costs under this option depend on the current state of industry / firm level practices, as well as firms choosing to adopt the guidelines. AUSTRAC's compliance activities indicate that entities subject to its regulation have variable approaches to current requirements. AUSTRAC sees a range of approaches, from entities which comply with both the intent and spirit of the obligations, to those that take a minimalist approach to compliance and those which are subject to remedial or enforcement action. Given that this experience relates to mandatory obligations, it is reasonable to expect that some significant proportion of the regulated population would choose not to comply with guidelines.

Given the uncertainty related to the level of non-compliance, it is only possible to estimate a range of compliance costs. Compliance costs, should major Australian and foreign financial institutions (both of whom have international focused businesses), choose to adopt best practice in Australia could range, over a **10 year period,** from an upper bound of **$223.3 million** (lower than the cost of Option C) to a lower bound of **$74.4 million**, with the median cost being **$148.9 million** (in net present value terms).[35]

Government

To the extent that industry does not comply with the guidelines, the costs associated with lost revenue and fighting additional and potentially increasing crime levels in Australia would still be incurred.

Additional costs to government are minimal for the preparation of material and costs to supervise entities in relation to their compliance with the guidelines. Other additional costs may be due to a potential increase in suspicious matter reports (SMRs) filed by businesses. The extent to which additional costs are incurred depends on how active businesses are in following the guidelines. More reports may be filed if business chooses to adopt best practice. The costs will, however, be minimised as not all businesses are expected to adopt the guidelines.

The true cost to government of this option may be that it will not avoid the risk to reputational harm, as FATF International Standards require obligations to be in law, and would not be addressed by a non-binding guidance based approach.

Society

Similar to government, the extent to which society will be affected will depend on how closely business practice aligns with the guidelines. If businesses choose to adopt good practice, it is likely that the additional costs will be passed onto consumers. If most businesses choose to disregard the guidelines, consumers may not bear the costs directly from increased fees or other ways in which business pass down costs. This situation will, however, create inconsistency in the market in which those customers of business that follow the guidelines will face more administrative burden than the other customers. To the extent that businesses choose to comply with the guidelines, the negative externalities for society associated with additional crime will be mitigated.

5.2.2 Potential benefits

The level of additional benefits under this option is highly dependent on the ability to develop expert guidance on a range of designated services, and the extent to which businesses adopt best practice according to the guidelines. The benefits of Option B would likely be lower than those expected under

35 This range assumes that only major Australian and foreign financial institutions (both of whom have international focused businesses) choose to implement changes over a 10 year period (two year implementation period and ongoing costs over the remaining years). This also does not include any assumptions or adjustments concerning the current state of the industry, or ongoing productivity benefits resulting from the implementation of new systems and processes. The assumed discount rate is 7%. The lower bound assumes that 25 per cent of these institutions apply the guidelines and the upper bound assumes that 75 per cent apply the guidelines.

Option C. This option will achieve a portion of the benefits expected under Option C, but the benefits realised, relative to the costs incurred, will be lower than for Option C. This is partially because money launderers would likely gravitate towards the entities that do not follow the guidelines, therefore potentially increasing costs further and reducing the level of benefit realisation. This option has a greater risk of entities disregarding the guidelines and therefore fails to achieve policy objectives. Finally, as this option is not legally binding, it does not generate the benefits associated with addressing the FATF identified deficiencies and achieving a compliant rating for Australia's CDD regime.

Business

While it is unknown to what extent businesses will follow the guidelines, businesses will still benefit from an improved clarity of the information associated with AML/CTF. For example, definitions of low risk situation/customer to high risk situation/customer may assist business to make decisions on the level of precaution that they should take. Guidelines will also benefit businesses in the context of providing directions as to what activities should be undertaken when identifying and verifying ownership structure and beneficial owners. It is expected that businesses will choose to follow those elements of the guidelines where they consider the benefits (in terms of reduction in risks to their business) will be greater than the costs will be. It will, however, not be on the same scale as the entities that choose to follow a 'business as usual' approach and can free ride the benefits from those that are complying with best practice.

Government/Society

The benefits to government and society will depend on the level of business practice conducted in accordance with the guidelines. If, for example, most entities retain 'business as usual' operations, the code of best practice option will not provide any benefits for government or society. To the extent that some entities adopt the code of best practice, this option will provide a subset of the benefits under the full regulatory change option. More importantly, this non-prescriptive approach could result in money laundering activities being channelled through those entities that have less strict CDD requirements due to their non-adoption of the code of best practice.

In addition, while this approach may address some of the underlying risk if there is a high uptake, it will not address the risks to reputational damage as the FATF requires these obligations to be in law (rather than issued as guidance only).

5.3 Option C: Regulatory Change

The proposed rules create additional requirements to existing CDD obligations and advance Australia's AML/CTF legal framework in areas which were previously silent, for example politically exposed persons. This will develop greater certainty and consistency in the application of CDD preventative measures across the regulated population and mandate a single standard with respect to AML/CTF compliance.

As was outlined in Section 4.3 in Table 3, the proposed rules are expected to impact up to 28 per cent of reporting entities whilst approximately 72 per cent of reporting entities would see either no or negligible change to the current impact on their business from the AML/CTF regime with all existing and proposed exemptions maintained moving forward.

The rules have been developed to ensure that certain reporting entities, such as those in the gambling and alternative remittance sectors, are not significantly affected by the possible reforms outlined in this paper. Namely, designated services provided by sectors that cater primarily to individual clients should not, as a matter of course, give rise to additional regulatory impact.

However, to the extent that these sectors do have corporate clients, customers who are PEPs or account-based activity as opposed to occasional transactions these reforms could entail a regulatory impact. Table 4 provides information on the practical steps that reporting entities would need to take to comply with the proposed changes. As previously noted, reporting entities are not homogenous and the practical steps taken by one reporting entity or one industry sector to comply with individual requirements may be quite different to another. This reflects the flexibility within the application of the risk based approach allowing compliance in a manner best understood and implemented by the reporting entity itself.

Table 4: Practical steps for reporting entities to comply with Option C

Area	Practical steps to comply with proposed requirements
Requirements for beneficial ownership and control	**Description:** Reporting entities must identify and take reasonable measures to verify the identity of beneficial owners, if any, of individuals, trusts, partnerships, incorporated and unincorporated associations, and registered co-operatives. The existing Rules only provide a requirement for a reporting entity to consider beneficial ownership in the context of certain companies. As reporting entities range in size and complexity such implementation may occur through a range of mechanisms not limited to: simple systems involving questions and answers, customer forms, online data collection, use of third party providers to obtain information, IT system changes. For major institutions all mechanisms may be used at differing points of the customer experience with the institution. None of these practices or processes of themselves are new but additional effort will be applied to respond to the new measure. The Rules include a provision which will allow reporting entities to assume that a customer who is an individual and the beneficial owner are one and the same, unless there are reasonable grounds to consider otherwise. This will substantially reduce impact which may have otherwise required a question of each new customer as to whether another person owned or controlled the service purported to be provided to the customer. For other types of non- individual entities, particular business entities which may include partnerships, trusts or corporations, the new measure will require seeking information from the business in relation to the structure associated with the business. This may be sourced through documents including certificate of association, registration or incorporation, company extracts, trust deeds, partnership agreements. **Categories of business most affected:** Banks and other financial institutions are most affected given the size and nature of their customer base which includes significant corporate and business customers. **Relative significance of impact :** The relative impact of this requirement is expected to be high as the requirement will apply to the significant customer base that comprises business entities. **Incremental or new requirement:** This is significant incremental change to a requirement that currently exists to collect beneficial owner information of certain companies.

Area	Practical steps to comply with proposed requirements
Situations where a customer is acting on behalf of a person	**Description:** As outlined against the previous requirement, due to a provision allowing reporting entities to assume that a customer who is an individual and the beneficial owner are one and the same, unless there are reasonable grounds to consider otherwise, the practical steps are those contained in a reporting entities' current ongoing customer due diligence program. That is, entities are required to collect and verify information in relation to the customer to enable it to be reasonably satisfied, where a customer is an individual, and that the customer is the individual that he or she claims to be. At present reporting entities consider various instances in which a customer is acting on behalf of another person, for example, signatory to an account, power of attorney, employees undertaking daily banking activities. Circumstances which may arise in which a reporting entity may consider it necessary to consider beneficial owner / controlling interests include where there is some indication of coercion, intimidation or standover which may indicate the customer is a victim of fraud or extortion or other criminal activity. **Categories of business most affected:** Banks and other financial institutions are most affected given the size and nature of their customer base and number of individuals they have as customers. **Relative significance of impact :** The relative impact of this requirement is expected to be low as it applies to a sub-set of customers only – that is, those where there are reasonable grounds that the customer is acting on behalf of a person. **Incremental or new requirement:** This is an incremental change to a requirement that currently exists in some form.

Area	Practical steps to comply with proposed requirements
Settlor of a trust	**Description:** The proposed amendments to the Rules will require reporting entities to collect information about the settlor of a trust. This is not currently required. In the majority of instances in the Australian context, the role of the Settlor is one of administration. Provisions of the draft rules seek to reduce the burden on reporting entities from these new obligations in those instances where a settlor contributes less than $10,000 at the time the trust is established. As Australian institutions operate in a global market place, the settlor plays a far more significant role in foreign jurisdictions. The practical steps for a reporting entity may include asking specific questions of the customer, sighting the Trust Deed which in most circumstances will contain details of the Settlor and the amount settled. The Trust Deed is presently sighted to meet existing requirements of the AML/CTF Rules. The new requirement will increase time in reviewing of documentation where it is not clear who is the settlor of the trust. In the international context, trust or related documents may be required to be sighted. Where available, public source information could be utilised. **Categories of business most affected:** Banks and other financial institutions are most affected given the size and nature of their customer base. Those entities that only deal with individuals will not be affected – for example gambling entities. **Relative significance of impact :** The relative impact of this requirement is expected to be medium as the requirement is restricted to identification of information relating to trusts. **Incremental or new requirement:** This is a new requirement in terms of collecting information about a different person involved in the trust

Area	Practical steps to comply with proposed requirements
Enhanced customer due diligence and politically exposed persons (PEPs)	**Description:** Reporting entities will be required to identify PEPs who fit the definition included in Chapter One of the AML/CTF Rules. That includes domestic based PEPs, foreign PEPs and PEPs of international organisations. Self-declaration of PEPs reduces the onus on a reporting entity to ask questions of a customer but it is a process that may be supported by additional inquiries. Reporting entities may undertake searches on databases such as World Check and also use third party verification services. The use of forms has been a common method used in initial collection of information which may then be verified through additional searches. Many businesses currently screen new customers against PEPs lists generated by commercial operators such as World Check. Foreign PEPs have historically and continue to be treated as high risk customers. **Categories of business most affected:** Banks and other financial institutions are most affected given the size and nature of their operations which bring those reporting entities into contact with foreign, domestic or international organisation PEPs. Other reporting entities may offer services to individuals who are PEPs. **Relative significance of impact:** The relative impact of this requirement is expected to be medium. While the proportion of customers that are PEPs is low, businesses have advised that meeting the requirements relating to PEPs will be time-consuming (relative to the standard CDD requirements). **Incremental or new requirement:** This is an incremental change to a requirement that currently exists in some form.

Area	Practical steps to comply with proposed requirements
Purpose of business relationship	**Description:** The underlying tenor of CDD is 'know your customer'. The new measure places an obligation on reporting entities to consider the risk associated with its customers in the context of the purpose and nature of the business relationship. In the first instance this is relevant to understanding the various types of businesses that a reporting entity would have as customers. This closely aligns with understanding the control structures of non-individual customers. When reporting entities currently on-board a new customer it is highly likely for risk purposes beyond AML/CTF that questions are posed in relation to the nature of business and at times employment of a person. For example, in the case of providing superannuation services, the nature of the business relationship would be evident at the time of on-boarding the customer. The practical steps to understand purpose and nature of the relationship are likely to be those existing risk processes, transaction monitoring and where appropriate seeking updated information where business profile or engagement with the business changes. Changes to forms, whether paper or online, to build in additional data fields may be an option employed by business. Some reporting entities have provided advice that IT systems have been built which allows some level of intuitive learning based upon the nature of the transactions conducted inferring the nature and purpose of the relationship. **Categories of business most affected:** Banks and other financial institutions are most affected given the size of their customer base. **Relative significance of impact:** The relative impact of this requirement is expected to be medium. Some elements of the requirements are likely met through existing risk processes. **Incremental or new requirement:** This is a new requirement which may be supported through existing infrastructure and existing business arrangements.

Area	Practical steps to comply with proposed requirements
CDD records	**Description:** The AML/CTF Rules currently require the collection and verification of information from customers. Ongoing customer due diligence is an existing requirement of the legislation and at present outlines requirements for reporting entities to monitor transactions and apply enhanced due diligence measures in relation to high risk customers. The relationship between a reporting entity and customer may change by virtue of additional services being provided and other customer interactions. These changes in the relationship are relevant to the ML/TF risk profile of the customer and accordingly, it is appropriate for a reporting entity to update its records. The new measure does not stipulate specific timing or intervals or level of review and update which must be undertaken as reporting entities are best placed to consider what is appropriate, having particular regarding to risk. Practical steps to meet this new requirement may include a regular timed request for updated information from high risk customers through a written request, or requiring front-line staff to seek an update of information when a different service or engagement with a customer occurs. **Categories of business most affected:** Banks and other financial institutions are most affected given the size of their customer base. **Relative significance of impact:** The relative impact of this requirement is expected to be high as it potentially applies to all customers, although there is no specified frequency at which this requirement should occur. **Incremental or new requirement:** This is an incremental change to a requirement that currently exists in some form.

5.3.1 Potential compliance costs

Business

There are two significant limitations with respect to estimating compliance costs of this option:

- Data – it is impossible to estimate (with any certainty) the cost drivers of detecting or preventing money laundering or terrorism financing given its ‘hidden’ nature.
- Current operational arrangements – due to commercial confidentiality, it is very difficult to develop a baseline comparing reporting entities and their current operational costs and the impacts related to the deficiency in meeting new requirements. Further, this is compounded by the fact that the regulated population is not homogenous.

The best information available that provides a starting point for the cost analysis is drawn from a recent EU study relating to the impact of the third directive of the European Commission concerning

AML/CTF.[36] To develop its estimate, the EU undertook a survey of financial institutions asking them to estimate the cost of compliance, specifically distinguishing between implementation costs and ongoing compliance costs. From this data we have developed operational ratios (expressed as a percentage of operational costs) and applied them to the Australian financial sector to estimate an ‘upper bound’ with respect to the impact if the current AUSTRAC proposal is pursued.[37] From this upper bound we have further refined our estimate based on stakeholder feedback and secondary research. Further details of the assumptions on costs estimation can be found in Appendix C.

A limitation of the approach is that it is ‘point in time’ and does not necessarily reflect the progress that has been made in the interim period by jurisdictions all over the world. As such, in our view, this cost estimate represents a ‘theoretical upper bound’ with respect to additional marginal compliance costs imposed by this option. Further, while stakeholders provided important qualitative input to further refine our estimates, quantitative data was not always available or inconsistent across industry. In some cases adjustments are based on professional judgements with respect to reasonableness.

We believe this approach is reasonable because:

- Changes proposed in Australia are a sub-set of the ones in the EU and similar jurisdictions who have also implemented similar reforms (e.g. New Zealand).

- We have triangulated this top down approach with ‘bottom up’ inputs from industry through selected stakeholder engagement and the results yielded a comparable ‘ballpark’ number which was viewed by many stakeholders as reasonable.

Using this approach, we have estimated the maximum upper boundary compliance costs to have a net present value of **$463.5 million** over 10 years. A large portion of this cost would be borne in the immediate implementation period once the new rules are in force. However, based on feedback from industry stakeholders, there are a number of mitigating factors that would warrant revisions to the figure.

- PwC’s adopted approach is based on a retrospective study undertaken in the EU in 2009 of the implementation of the Third AMLD. Reviewing this methodology in more detail reveals that many of the underlying cost assumptions were dependent on the degree of technological innovation and automation that could be incorporated into operational practices. Given the time gap between 2007 and 2014, it may be that current technology solutions available to business could ease the overall compliance costs on business. Additionally, today there are a number of new firms that have emerged or grown since 2007 who specialise in data services thereby potentially providing a more cost effective solution to compliance than if businesses were to ‘go it alone’.

- Consultations with PwC personnel indicate that major systems and process change programs regular occur over a 5 to 7 year cycle. This means that any changes to systems and processes resulting from these rule changes could be replaced after seven years, limiting the ongoing cost resulting from the proposed changes. Further, assuming alignment with existing change and capital expenditure programs, business could likely see additional efficiencies over time as new technologies are integrated into their operations.

- Many Australian banks have significant operations in NZ and elsewhere in the world including the UK (a major financial centre) and throughout Asia. As such, portions of their existing Australian operations (which may be segregated from the Australian operations) may already have adopted more stringent CDD and risk management practices. This aligns with information provided during AUSTRAC’s consultations on the proposed reforms – refer to Box 4 for details. Further, those

36 Europe Economics (2009), *Study on the Cost of Compliance with Selected FSAP Measure*, available at: http://ec.europa.eu/internal_market/finances/docs/actionplan/index/090707_cost_of_compliance_en.pdf

37 The EU impact assessment estimated compliance costs to adopt Third Anti Money Laundering Directive in light of the FATF’s recommendations. While the changes in Third AMLD are not identical to the proposed changes in Australia, many of the changes are common as it aims to meets the FATF’s standards.

reporting entities and businesses in Australia which are subject to FATCA will have strict obligations to be aware of the beneficial ownership and control where it involves a US taxpayer.

- It is highly likely that many entities already adopt good practices that meet international standards. Additionally, a reporting entity which is a subsidiary or affiliate of an international group may be required by its parent company (or umbrella group) to have in place a more stringent CDD program to meet the requirements of its parent company's global AML/CTF program, consistent with national laws and FATF requirements. Box 4 provides examples of relevant information obtained during AUSTRAC's consultation with reporting entities.

Based on the factors discussed below, on balance, we estimate that the compliance costs are approximately **$281.3 million (net present value) over a 10 year period**, or annualised average of **$39.6 million (undiscounted, simple average**). We have estimated that the ''up front' cost would be approximately $137.6 million. This cost estimate is composed of items such as the initial implementation costs which primarily reflect systems and process improvement, project management, consultancy fees, etc. On an ongoing basis we have estimated costs to be $143.7 million over a 10 year period. This cost estimate is composed of items such as ongoing training, internal audit, system maintenance, etc. attributable to the proposed rules. The cost estimates and associated assumptions are further detailed in Appendix B Table 9.

Table 14 and Table 15 in Appendix D provide details on the distribution of the cost categories across each group of entities. As discussed earlier, the distribution of costs across the identified categories is based on the recent EU study relating to the impact of the third directive of the European Commission concerning AML/CTF.

Distribution impact analysis for businesses

The burden of compliance varies across entities because of a difference in the nature and size of operations and customer base. Major banks in Australia have the highest compliance costs, for both one-off and ongoing costs. It is however, relatively low compared to most other entities when expressed as proportion of revenue and profits. Small entities such as other domestic banks, credit unions, building societies and mutual authorised deposit takers bear proportionately more compliance costs than the large entities. Overall, the total level of compliance costs for all entities are relatively insignificant, with one-off costs of less than 0.03 per cent of total revenue and ongoing costs of less than 0.06 per cent of profit. The results of distribution impact analysis are further detailed in tables in Appendix D.

Bottom up approach

As a validation exercise, an indicative bottom up calculation was conducted to test whether the comprehensive estimate calculated above using the EU approach was broadly aligned with the high-level feedback provided by regulated entities during the business consultation. Namely, indicative figures of implementation costs for the 'Big 4'were used as a lower bound and compared with the result above.

Given this methodology, this calculation should be treated with caution. Due to market sensitivity, confidentiality issues and lack of implementation studies, no accurate or detailed estimate of costs associated with the proposed changes were put forward by business during the consultations. Consequently, only two indicative figures have been able to be gathered and used from consultations and thus this figure is for validation purposes only (see Box 3).

Box 3: Indicative estimates obtained through stakeholder consultations

- Informal discussions with key industry players suggest that a ballpark figure of implementation costs would be in the region of $25 million per big bank.
- One stakeholder loosely suggested that implementation costs could be anywhere in the vicinity of $10 to $30 million for the business units in each of the 'Big 4' banks.

Using these figures as a rough indication from business provides us with a range of approximately $20 to $25 million for each of the Big 4 to implement the proposed changes. This provides a rough bottom up estimate of approximately $80 to $100 million for the Big 4 sector. This figure is in line with the top down figure calculated of $137.6 million for industry as a whole (for one-off implementation costs) given other banks and financial providers would still need to be considered.

In addition to the few cost estimates loosely suggested by stakeholders, a few also suggested the extent to which customers would be impacted, or the number of accounts affected which would be indicative of the level of 'cost' to industry. For example, the more customers and/or accounts impacted from the changes of keeping information updated and of determining beneficial ownership would result in a greater level of cost. Box 4 outlines the information provided by stakeholders during consultations regarding the level of impact on current business processes and practices, although it is noted that the new measures insofar as the identification of beneficial owners and PEPs will apply only to new customers following enactment of the Rules.

Box 4: Level of customers/practices impacted suggested by stakeholders

Virtual based businesses

1. An online based business suggested the impact would be high as specific outreach would be required to gather information from customers given they do not have the opportunity to conduct face to face business with customers.

2. However, at the same time they noted given their global business practices, some processes were already implemented, in particular regarding PEPs.

Australian based banks/service providers

3. Significant number of customer accounts impacted by need to keep information updated. Existing processes and practices may overlap to some degree with the required changes but would not fully comply.

4. A proportion noted that KYC actions are already conducted on customers for the purpose of credit provision/lending. The impact would thus be the extension of these activities to other business units.

Foreign affiliated banks/service providers

5. Additional costs imposed by the proposed CDD requirements would be negligible as foreign owned firms already address some of the proposed changes – for example requirements regarding Beneficial Ownership and the new PEP definition and requirements are consistent with existing internal bank policy.

6. In some instances, some entities noted they already comply with higher standards. For example, the 25 per cent level for determining beneficial ownership is out of step with some overseas policies which mandate identification to the 10 percent level regardless of risk level.

7. For some entities, there would be impact under the requirement to periodically update customer information. However one noted that the business as a whole was already considering this as part of wider firm standards.

Australian based banks/service providers with foreign operations

8. Businesses with operations overseas noted that none of the requirements are 'new' at a global level and that they are largely already considering the implementation of the Rules due to requirements in other jurisdictions.

9. A significant number of customer accounts are expected to be impacted that are not currently subject to ongoing due diligence. Namely, all individual retail customers are expected to be affected due to the OCDD requirement however, it is noted that these are mostly low risk clients and would only be affected to a small degree.

Overall, the limited figures obtained through the business consultations are broadly in line with the detailed top down calculation for the cost to industry of the proposed changes.

Government

The additional cost imposed on the government is likely to be minimal and is likely to be absorbed through efficiencies gained by better targeted intelligence and investigative actions. While potentially more transaction reports will be submitted to AUSTRAC, prosecutions could be made easier with improved customer data being retained by reporting entities and therefore more readily available to law enforcement. Fewer investigations may be required to track down the details of beneficial owners, and may result in more successful prosecutions and penalties/forfeitures. Overall, it is likely that more effective law enforcement will offset the additional costs to the government.

Society

Compliance costs of businesses are likely to be passed down to consumers in this option. There is incentive for businesses to increase fees in order to recover compliance costs because the competitors are likely to do so, given that all businesses are subject to the requirements. While consumers bear the costs, it should be noted that the results achieved such as reduction of crimes rates and illicit drug trade, ultimately benefit society. Further, some customers may face additional burdens resulting from additional requirements to provide documentation and other evidence that they normally would not have to provide under the existing arrangements. However, this cost is extremely difficult to quantify given that it would require knowing the current state (including common deficiencies, delays and bottlenecks) in order to establish a base line which is currently unknown.

5.3.2 Potential benefits

Existing research concerning the quantifiable benefits of implementing an effective AML/CTF regime are limited. As such, the following discussion will be limited to a qualitative evaluation supported by secondary research where appropriate.

Business

The first key benefit for businesses will be the strengthening of their risk management processes. Stronger risk management processes will protect businesses against costs associated with regulatory action for AML/CTF deficiencies, which have resulted in large penalties in overseas markets such as the US and the UK. The improvement of information gained through stronger CDD will flow on to assist businesses in fraud prevention and detection. This is an important benefit for financial institutions as many forms of fraud, including identity fraud, remain prevalent and pose substantial financial costs to Australia.[38] A secondary benefit could be more favourable insurance arrangements as well as reduced legal costs in pursuing fraud that does occur.

Risk management is also important to maintain a financial institution's reputation. Banks can be especially vulnerable to reputational risk, as a customer using them as a vehicle for illegal activities can impact poorly on them, particularly when such associations result in large penalties being imposed by regulators. Reliance on trust and reputation are essential for financial institutions, as the nature of a

38 Australian Crime Commission. *Organised Crime in Australia 2011 – 2013.*

bank's business requires maintaining the confidence of the shareholders, rating agencies, creditors and the general marketplace.[39]

The second benefit for businesses is avoidance of additional compliance costs by remaining on the EU's equivalence whitelist. For countries, appearance on this list is a reputational benefit but for businesses it translates to a direct saving of costs. This is because parties are able to use simplified due diligence or rely completely on the diligence done in the third country, reducing these investigation costs.[40] For example, when New Zealand was removed from the whitelist, it was described as 'of detriment to every New Zealand company that operates in Europe and has dealings with these European financial institutions' and that it would 'no doubt increase their compliance costs'.[41]

We estimate that over 550 regulated businesses have clients based in the European Union, and will thus directly benefit from FATF compliance and remaining on the equivalence list. With a substantial proportion of financial institutions benefiting, the entire business community will indirectly be affected.

Enhanced CDD directly aligns with many of the core requirements sought under the United States Foreign Account Tax Compliance Act (FATCA). FATCA will require Australian financial institutions to report information to the US Internal Revenue Service (IRS) about customer accounts held by US taxpayers, or expose themselves to a 30 per cent withholding tax on their US source income. The Australian Government is currently negotiating an intergovernmental agreement (IGA) with the US Government to facilitate Australian financial institutions' compliance with FATCA in a manner consistent with Australian law.[42] It is expected that financial institutions would be able to leverage the enhanced CDD practices to assist in complying with their FATCA obligations under the proposed Australia-US IGA.[43]

Lastly, and related to the previous point, another benefit of these enhancements may be to assist Australian reporting entities as Australia progress toward the Automatic Exchange of Information. The intention of this exchange will be to facilitate worldwide tax transparency and exchange of information (with a focus on Automatic Exchange of Information (AEOI) / Common Reporting Standard (CRS)). More specifically:

- The Australian government is committed to early adoption of AEOI/CRS.
- Australia will shortly sign the Intergovernmental Agreement for FATCA.
- There is a need for FATCA/AEOI to work together to minimise disruption and impact on financial institutions.
- The Global Forum on Transparency and Exchange of Information for Tax Purposes has been tasked with developing an implementation and monitoring plan.[44]

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39 ECO Trade and Development Bank, 'Anti-Fraud, Corruption, Money-Laundering', April 2008, available at http://www.etdb.org/content/anti-fraudcorruptionmoney-laundering.

40 European Union, 'Common understanding between Member States on third country equivalence under the Anti-Money Laundering Directive', June 2012, available at http://ec.europa.eu/internal_market/company/docs/financial-crime/3rd-country-equivalence-list_en.pdf.

41 New Zealand House of Representatives Hansard, 'Companies and Limited Partnerships Amendment Bill – First Reading', 24 July 2012, Volume 682, Page 3852, available at http://www.parliament.nz/en-nz/pb/debates/debates/50HansD_20120724_00000024/companies-and-limited-partnerships-amendment-bill-%E2%80%94-first.

42 The proposed IGA will allow Australian institutions' FATCA obligations to be met by reporting the required information to the Australian Taxation Office (ATO), which will pass on the information to the IRS under existing tax information sharing arrangements. To fulfil FATCA obligations, Australian institutions will need to identify their US customers, including beneficial owners.

43 The institution must, as part of the processes of confirming whether the customer is a US taxpayer, rely on its AML procedures to identify and verify the beneficial ownership and, in certain cases, the control structures of its US customers.

44 Information received via email from government stakeholder consultations.

Government

From a government perspective, the first benefit of Option C is to further strengthen Australia's legal framework with respect to AML/CTF thereby deterring and detecting serious and organised crime and providing law enforcement with more accurate, detailed information and intelligence to combat illicit activities. In short, the primary benefit to government is that the proposed rules will make it harder for criminals 'to do business' and reduce the incentive of illegal profits.

Further, in the context of AML/CTF, benefits can be measured not only in terms of prosecutions for money laundering *per se* but in prosecutions for the underlying criminal offences as well. The first benefit to government is saved costs from the reduction of crime, and in turn, costs associated with combating it. Government could also expect increased tax compliance as well as resulting benefits of increased taxation revenue or recovery of the proceeds of crime, similar to that experienced through Project Wickenby.

White collar crimes including fraud, misappropriation, together with money laundering are often complex and costly in terms of investigation, prosecution and punishment. This equally applies to terrorism financing. The harder it becomes for criminals to launder the proceeds of their crime, the less attractive they become. 'As long as criminals are able to launder money with little risk of discovery, the rewards from criminal activities will continue to appear attractive'.[45]

For example, in the case of *Leighton* outlined previously in Box 2, taxes owing to the Australian Government could not be recovered because the beneficial owners were unknown. If, when *Leighton* had originally opened the Australian bank account, these owners had to be identified, this might have changed the 'cost benefit calculation'.[46] Project Wickenby described one of their key learnings with regard to these problems as 'if appropriate frontline measures are not in place to prevent abuse of the system, it will often be too late when regulators undertake follow-up compliance action'.[47] Other high-profile examples include the funnelling of the proceeds of fraud from Bernie Madoff's Ponzi scheme and the Firepower scandal into overseas shell companies with opaque beneficial ownership. With enhanced CDD these problems will be reduced and may even be able to be avoided.

The second benefit of the proposed regulation will be protection of reputation. International business relationships often depend on the assessment of the strength and effectiveness of Australia's AML/CTF regime by the international community and business counterparts. Global corporations and foreign investors, when looking to establish operations in Australia, pay close attention to Australia's approach to meeting international regulatory standards, as do institutions such as the IMF in their assessment of the safety and stability of Australia's financial system. Knowing that the AML/CTF standards in Australia meet international requirements provides increased certainty as to the integrity, stability and security of doing business with Australian institutions. The EU equivalence list is an indicator of this. In fact it has been argued that the act of declaring deficiencies is punitive in itself without anything else, because of the resulting loss of reputation.[48]

The international community, including the G20 and the United Nations, are increasingly focused on improving the transparency of legal entities in order to combat crime and corruption.[49] Cases involving the international transfer of assets by corrupt political leaders have highlighted vulnerabilities in the financial

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45 John Walker, AUSTRAC and RMIT University, 'The extent of money laundering in and through Australia in 2004', September 2007, available at http://www.criminologyresearchcouncil.gov.au/reports/200304-33.html

46 Project Wickenby. Submission to the consultation on possible enhancements to the requirements for customer due diligence'

47 Project Wickenby. Submission to the consultation on possible enhancements to the requirements for customer due diligence'

48 Jason Sharman, 'The bark is the bite: International organizations and blacklisting', paper presented at the American Political Science Association meeting Chicago, September 2004, available at http://macha.itc.griffith.edu.au/dspace/bitstream/handle/10072/30215/61832_1.pdf?sequence=1

49 As evidenced in their participation in the G20-FATF Working Group, as well as their identified objectives

system where legal entities have been used to obscure beneficial ownership. It is widely recognised that strong and effective CDD measures are an integral element to addressing beneficial ownership vulnerabilities. On 1 December 2013, Australia officially commenced its 2014 presidency of the G20, succeeding 2013 host Russia.[50] These priorities will be in the foreground of Australia's Presidency.

Society

In terms of impacting a society in total, it has been said that 'money laundering has a more direct negative effect on economic growth in the real sector by diverting resources to less productive activity, and by facilitating domestic corruption and crime, which in turn depress economic growth'.[51] Money laundering can have other negative impacts on an economy by:

- causing unpredictable changes in money demand, distortion of markets, and distortion of economic data
- posing risks to the soundness of financial institutions and financial systems
- contaminating legal financial transactions, and increasing the volatility of international capital flows and exchange rates due to unanticipated cross-border transfers.[52]

The extent of money laundering and terrorism financing activities occurring within Australia's borders is difficult to accurately quantify, but the broader cost of organised crime to the Australian community has been conservatively estimated to be between $10-15 billion each year.[53]

Moreover, the ability of criminals to infiltrate legitimate businesses and the formal financial system significantly increases the scale and impact of crime on society, by allowing criminals to gain a foothold within the community, finance their illicit activities and enjoy their illegal profits. As the ACC has noted, this is an increasingly common phenomenon in Australia and it is well-known that organised criminals including outlaw motorcycle gangs have used legitimate businesses to gain opportunities to launder money and put a façade of legitimacy over their activities.

Crime affects society at large, as well as imposing cost on government, whether personally or through distortion of the economy. As discussed above, the proposed changes have the ability to reduce crime through making the proceeds harder to legitimise.

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51 B L Bartlett, 'Money laundering countermeasures with primary focus upon terrorism and the USA Patriot Act 2012', presented at the Seminar on Current Developments in Monetary and Financial Law Washington DC, May 2002.

52 John Walker, AUSTRAC and RMIT University, 'The extent of money laundering in and through Australia in 2004', September 2007, available at http://www.criminologyresearchcouncil.gov.au/reports/200304-33.html

53 Australian Crime Commission (2011) *Organised Crime in Australia 2011.* Available at: http://www.crimecommission.gov.au

6 Consultations

In determining the need for government intervention and the need to amend the current AML/CTF regime, an extensive consultation process was undertaken. The consultation process continues concurrently with the development of this RIS.

Consultations have been conducted with a wide range of stakeholders from both AUSTRAC and PwC and are further discussed below.

6.1 AUSTRAC consultations

The Australian AML/CTF regime saw a significant transformation by the introduction of the AML/CTF Act in 2006. The deficiencies in relation to beneficial ownership under the Australian AML/CTF regime were comprehensively identified in the 2009 FATF Mutual Evaluation – third follow-up report. Given the global financial crisis and the anticipated impact on industry, it was not considered appropriate to amend or extend regulation at this time.

The sixth follow-up report in October 2011 detailed the outstanding deficiencies and sought expedited action by Australia to address these matters. The National Threat Assessment, completed by AUSTRAC in November 2011 identified a key threat in Australia to be the misuse of corporate vehicles. Consultation with industry participants and associations on options for reform has taken place since this time.

In response to increasing international pressure and priority focus on beneficial ownership and corruption, AUSTRAC escalated its efforts in considering options for reform of the CDD obligations. In April 2012, AUSTRAC conducted a targeted consultation, and subsequently convened a roundtable forum with industry participants and associations to discuss current practices on identification of beneficial ownership and options for reform.

The roundtable, held on 18 April 2012, set out to engage with industry to determine to what extent, under the current regime, participants were already meeting voluntarily what might be imposed as a regulatory requirement. In addition, wherever there were efficiencies in codification of existing practice, either for other risk drivers internally, or to meet regulatory requirements in international jurisdictions, then that would present a preferred way forward for regulatory reform. Most participants noted that this was not an unexpected development, and many describing existing practices that identified beneficial ownership of some customers. There was support for clarification of definitions, such as in relation to beneficial ownership and politically exposed persons, to support compliance efforts. There were challenges identified in relation to existing infrastructure, in terms of availability (such as the lack of a trust register) and reliability of up to date information (contained in the ASIC company register). There were also calls for extending the AML/CTF regime to capture non-financial businesses and professions, as an additional way to address some of the risks identified. Finally, there was widespread support for harmonisation of requirements in line with other regulatory changes, such as FATCA requirements, which would be requiring system changes.

These themes informed the continued intra-Government consultation, taking into account measures to minimise regulatory burden while balancing the need to address the deficiencies and avoid possible international repercussions, including sanctions for failure to act. Broad proposals were then outlined in a discussion paper titled *Consideration for possible enhancements to the requirements for customer due diligence*, which provided a formal public consultation on the options being considered. Industry participants, industry associations and other stakeholders had more than four months to assess the potential reforms and provide feedback on the best way forward. In total, 29 submissions (including several peak industry bodies) were received with the majority being published on the AUSTRAC website.

The submissions identified many areas where businesses were already undertaking similar practices which achieved many of the goals of the reforms. They also identified areas of concern, including the utility in identifying the settlor of many Australian trusts. Many submissions indicated support for the clarification of definitions such as beneficial ownership and politically exposed person. There was some concern about the regulatory impact of the requirement to keep customer information up to date in the manner in which it had been expressed. In addition, privacy issues are being considered in a privacy impact assessment. AUSTRAC advises that many of these comments informed the draft changes to the AML/CTF Rules, published on 9 December 2013.

Box 5 outlines the general positions from industry gathered from the submission documents.

Box 5: General positions and commentary obtained from industry

- Industry supports any proposal to further protect the integrity of the financial system, but additional reforms are required to address the following: full implementation of Recommendations 22 and 23 (2012 FATF Recommendations) on designated non-financial business and professions; and full compliance with Recommendation 25 on transparency and beneficial ownership of legal arrangements.

- Generally, where banks operate internationally, policy standards are set at a higher standard at the group level. In the event that local legislative requirements represent lower standards, compliance to the group standard is required.

- It should be noted that these proposals, if adopted, will be very resource intensive and add a significant regulatory cost burden to Australian business. Specifically, there will be a need to expend significant IT resources as the approach suggested in the consultation paper relies heavily upon the collection, retention and analysis of significant amounts of data that is not currently required to be employed in undertaking CDD processes. All of which, from a cost perspective, has the potential to act as a deterrent to new market entrants, while at the same time it is unclear how these additional requirements will actually reduce the risk of AML/CTF activities taking place.

- The Australian standards need to be practical and avoid applying a ‘one size fits all’ approach across entire reporting population. The warning about adverse impact of not rectifying deficiencies identified by FATF is directly relevant for large, internationally active institutions. However care must be taken to ensure the response does not adversely affect institutions serving the domestic consumer market. Any enhancements – if justified – should be carefully measured and targeted to specific danger areas.

- Greater efforts are also needed to address the laundering of funds stolen through corruption and other illicit activities, due to the greater use of company formation agents, lawyers, accountants and financial advisers to create and manage a PEP customer’s affairs making it harder for reporting entities to identify PEP beneficial owners.

In addition, the following tables outline the key positions and commentary from industry gathered from the submission documents for each of the core proposed changes.

Key positions regarding changes to beneficial ownership and control	
Areas of similarity	Currently information on beneficial ownership (BO) is already collected at the 25 per cent threshold as part of the application process for certain entity types (generally business accounts). Information collected on individuals is verified on a risk-based approach. In industry's view, BO and signatories are the only reliable means of identifying control. There is no additional benefit in introducing a different concept of 'control', nor is there a mechanism for complying with an additional concept. If the Government was minded to introduce such a concept, then the information should be recorded in ASIC. To add in the collection of a further document, the suggested additional document gathering requirements would not achieve any substantive enhancement over and above existing processes.
Areas of difference	Concept of 'control' varies. Further clarification of the concept of control is required as contractual definitions can be technical and difficult to understand in practice. Industry submits that if this proposed reform is to proceed, implementation of Tranche 2 legislation is required for the reform to be effective, together with robust publically available registers against which an RE can test the veracity of any information provided by the customer.

Key positions regarding changes to customers acting on behalf of another person	
Areas of similarity	[Stakeholder] does not believe the potential reforms to address Deficiency 3 will materially impact the operations of superannuation funds. [Stakeholders] expressed concerns that they would be unable to obtain a meaningful response beyond being able to 'tick a box' to indicate that they had made enquiries along these lines. That would do nothing more than protect the institution rather than obtain any data that would either refute or confirm any suspicions held.
Areas of difference	This would impose a significant compliance burden and require changes to both front end and back end systems, without a significant reduction in ML/TF risk. If unlawful activity is being undertaken, information regarding any third party arrangements is less likely to be disclosed even if the proposed reforms were to be adopted. Fund managers are regulated and will have their own obligations to verify the subscribers to their funds/managed investment schemes. In order to minimise the risk of duplication of existing regulatory obligations, any changes to the AML/CTF Rules should have regard to the kind of business that is conducted by institutions and the level of regulation that already applies to that business.

Key positions regarding changes to settlor of a trust	
Areas of similarity	Settlor information is not currently collected at on boarding. REs firmly believe that legal professionals are far better placed in the value chain to readily satisfy this requirement as part of the activities that they currently undertake in establishing trusts. This deficiency could be remedied through the implementation of the Tranche 2 reforms.

Key positions regarding changes to enhanced due diligence and PEPs	
Areas of similarity	Currently banks screen foreign PEPs only. It is accepted that industry needs to give further consideration to the possible risk presented by domestic PEPs, but in keeping with the risk-based approach, REs need to retain the flexibility to determine what constitutes a domestic PEP and how that associated risk should be treated. Industry would welcome guidance from AUSTRAC as to what constitutes a domestic PEP. Full ECDD is already performed on foreign PEPs – they are all treated as high risk customers. As all bank members conduct ECDD on foreign PEPs, a change in the rules to require enhanced due diligence to be conducted would not have a significant impact, unless prescription on the type of due diligence was included.

Key positions regarding changes to purpose of business relationship	
Areas of similarity	Industry supports a requirement to consider and understand the purpose and nature of the business relationship with the customer using a risk-based approach; that is, not for all customers, but for higher risk customers or customers with a risk trigger. In relation to a customer's business or occupation, industry also supports a requirement to collect the customer's occupation or industry type, on a risk-based approach. [Stakeholder] believes that making it mandatory to establish risk based processes to fully understand the 'purpose' behind the establishment of the account could be a valuable tool in gaining a better understanding of the account, the account holder and the nature of the transactions being undertaken. We would support making this a mandatory requirement as it would make it easier to assess the level of risk associated with the account holder and the source of funds. Most financiers already collect information about this, so provided any new requirement is risk based and allows financiers to determine the appropriate level of enquiry, our members would not oppose a requirement to have a reasonable understanding of the nature of the customer's business or occupation.
Areas of difference	We would argue that the nature of the business relationship is self-evident and the need to collect a member's occupation has no bearing on this relationship. The reform would not lead to any practical change.

Key positions regarding changes to CDD records	
Areas of similarity	Currently customer identification relies on a 'pull' model. This will work better if the requirements are amended to make it more of a 'push' model, that is, where customers must 'push' information changes to the FI. There is currently no requirement for a customer to update their details with an FI when changes occur. Banks rely on risk triggers being activated and may conduct enhanced CDD when an existing customer applies for a higher risk product, a trigger event occurs such as lodgement of an SMR, or they receive a transaction monitoring alert. Industry accepts that there is a general obligation to conduct CDD, but not necessarily an obligation to retain (and keep current) copies of ID credentials, which brings additional privacy obligations. Industry accepts the importance of managing high risk customers through ongoing due diligence, including the requirement to keep KYC data up to date, but does not believe that this should be prescribed by rules, and that a risk-based approach should be maintained. The requirement for reporting entities to keep CDD information 'up to date and relevant, regardless of the assessed risk' potentially imposes a very onerous obligation on reporting entities. The requirement to update and verify CDD information should only apply where there is a customer touch point or upon the occurrence of specific 'trigger events'.
Areas of difference	REs already have in place adequate systems and controls, such as periodic review processes and trigger event reviews which provide for CDD information to be updated at appropriate intervals which effectively addresses the money laundering risk. Any increased requirements to update records should be balanced with a reduction in the seven years currently required for record keeping to five years in line with FATF Recommendation 11 and Australian taxation laws.

Draft AML/CTF Rules were published on the AUSTRAC website from 9 December 2013 with a consultation period until 24 January 2014. AUSTRAC contacted all reporting entities on the Reporting Entities Roll in order to alert them to this publication and also wrote directly to industry associations, members of its Privacy Consultative Committee and other government stakeholders. AUSTRAC received 37 submissions on the draft AML/CTF Rules. During the consultation period, AUSTRAC held meetings with a number of peak industry bodies.

During February 2014, AUSTRAC held targeted consultation meetings with 16 industry bodies and reporting entities that made a substantive submission to the first Draft of the AML/CTF Rules. AUSTRAC discussed in these meeting the proposed changes to the Rules to address comments made in submissions. On 24 February 2014, AUSTRAC held an Industry Forum which was attended by 32 representatives of Industry Associations and the major financial institutions and reporting entities in Australia. Industry were largely satisfied with the further amendments made to the Rules. The following are areas in which AUSTRAC has made amendments to the draft AML/CTF Rules in response to industry comments:

- The new provisions in relation to identifying the settlor of a trust, identifying the beneficial owner of a customer and determining if a customer or beneficial owner is a politically exposed person will only apply to persons who become customers after the date of commencement.

- Existing exemptions in legislation will continue and therefore new obligations will not apply in instances where a reporting entity accepts payment of the purchase price for a new pension or annuity, accepts a superannuation contribution, roll-over or transfer or accepts a retirement saving account contribution, roll-over or transfer.

- The risk assessment processes currently in operation by reporting entities have been extended to include factors including beneficial owners and PEPs, its customers' sources of funds and wealth, understanding the nature and purpose of the business relationship, and control structures of its non-individual customers (e.g. companies, trusts, etc). These factors are to be considered at the broad customer/product/service level as opposed to each individual customer.
- The definition of beneficial owner has been slightly reworded to focus on the 'ultimate' individual who owns or controls (directly or indirectly) the customer.
- In respect to the requirements associated with identifying the beneficial owner and determining whether the customer or beneficial owner is a politically exposed person, entities will be able to undertake this identification either before the provision of a designated service or as soon as practicable after the service has been provided.
- Reporting entities have also been allowed to assume that in the case of a customer who is an individual the customer and beneficial owner are one and the same, unless they have reasonable grounds to consider otherwise.
- AUSTRAC has included flexibility in verification options to assist reporting entities – the inclusion of date of birth which is supported by wider access to data.
- AUSTRAC has included modified procedures which exclude entities from having to identify the beneficial owner where the customer is an Australian Government Entity (Commonwealth, state, territory or local government) or where simplified company or trust procedures exist or in the case of a foreign listed public company that is subject to disclosure requirements to ensure transparency of beneficial ownership which are, or are comparable to the requirements in Australia.

The primary comments raised at the Industry Forum related to timing of the implementation and AUSTRAC's approach to the implementation, with Industry acknowledging the balance between meeting international obligations and providing appropriate support for the implementation.

A further version of draft AML/CTF Rules was published on the AUSTRAC website from 5 March 2014 with a consultation period until 19 March 2014. At this same time AUSTRAC issued a draft of the supervisory approach to the reforms. A total of 8 submissions were received with the primary comments in relation to the draft supervisory approach. In response to those submissions AUSTRAC has determined that it would be appropriate to consider placing the proposed Supervisory Approach onto a more formal statutory footing rather than relying on the CEO's implied powers under the AML/CTF Act. Further targeted consultation will occur.

6.2 PwC consultations

In preparing this RIS, PwC has undertaken consultation with a range of service providers, including banks, other financial institutions and third party service providers.

Key messages heard from these consultations have included:

- There is a widespread belief that the largest impact to industry from a change in AML/CTF rules would flow from those regarding the change to determining beneficial ownership and the requirement to keep customer information up to date. This additional information collection and storage would require additional processes and supporting infrastructure to be built. Onboarding in particular will require more time and staff resources.

- A concern with the current lack of clarity and a desire for a reduction in ambiguity to ensure a level playing field. This lack of clarity includes the expected implementation period, as quicker required compliance will involve larger upfront costs.
- Some service providers and reporting entities already have the processes for PEP policies in place.
- There is a possibility that a ‘free rider’ problem may ensue if the proposed changes are not prescriptive but rather optional (i.e. for instance Option B as assessed in this RIS).
- Burden could, to a degree, be partly transferred to other entities, for example a company register of beneficial ownership built within ASIC.
- The level of impact and cost of the proposed changes will depend on the type of business, particularly whether they are customer facing as compared to online products. If a business currently has no face to face interactions over the course of normal business, more outreach may be required to obtain the information specifically needed for these CDD changes.
- The impact of changes will also depend on the type of customer serviced by a business. Providers consulted ranged from entirely domestic, for whom a lot of the procedures would be new; domestic with overseas clients, who already have some systems in place that will require expansion; and international providers, for which a lot of these procedures will be in place already. This difference was especially reflected in differing beliefs about the costs of PEP policies.
- Some providers considered an Option B scenario to be quite similar to Option C, as they would still come in to compliance with enhanced CDD. Other providers noted that Option B may not have the key characteristic of bringing Australia to be FATF compliant.
- Some providers noted that the proposed regulations would bring Australia in to line with international jurisdictions, and as such would not act as a competitive disadvantage.

PwC also consulted with government stakeholders including the ATO and AUSTRAC.

Overall, many of the comments received from industry have been acknowledged throughout the course of AUSTRAC’s consultations and are reflected in the analysis within this RIS and in the development of the draft AML/CTF Rules and policy. In particular:

- Section 4 of this RIS analyses how the level of impact and cost of the proposed changes will depend on the type of business and their types of customers.
- Observations that some businesses will already have in place some policies and procedures, including in relation to PEPs, is consistent with AUSTRAC’s understanding of the current regulatory environment and expectations.
- Option B (where the proposed changes are optional rather than prescriptive) may result in a situation where some industry players may resort to ‘free riding’ and will not bring Australia into compliance with the FATF requirements.

AUSTRAC also agrees with, and has endeavoured to address, the following points throughout this consultation process:

- The largest impact to industry would flow from the proposed changes regarding determining beneficial ownership; amendments have been made to the draft Rules to aid their application by business in the most efficient manner. Several measures have been introduced, including the assumption that an individual customer and beneficial owner are one and the same, exemptions from determining the beneficial owner where other simplified procedures currently exist within the Rules, or where there was an appropriate case to provide a new carve out from the procedure, for example an Australian Government Entity.

- Clarity surrounding regulatory requirements, including implementation timeframes, is needed to ensure a level playing field amongst the regulated population; implementing the proposed Rule changes over a transitional period balances and taking into account these considerations with other concerns in an appropriate manner.
- The proposed changes will not act as a competitive disadvantage; by bringing Australia into line with international standards, businesses which operate overseas will be able to remain competitive (eg through Australia maintaining its listing on the EU equivalency whitelist).
- There are a range of other measures which would assist in transferring the burden to other entities, eg a company register of beneficial ownership and regulation of designated non-financial businesses and professions, and these issues will be considered as part of the ongoing statutory review of the AML/CTF Act as they relate to broader issues surrounding the AML/CTF regime.

However, it is acknowledged that there are a range of views on the proposed changes, particularly due to the highly heterogeneous nature of the regulated population and the variance in current practices. As with any regulatory change, systems and processes will need to be adjusted, and this will impact on reporting entities differently depending on their existing levels of experience and infrastructure. It is believed that a number of residual issues, including surrounding the collection and storage of customer information, will be able to be resolved once additional clarity is provided to industry. To facilitate this, AUSTRAC is committed to supporting reporting entities' compliance by clarifying regulatory expectations through ongoing engagement.

7 Preferred option

This assessment illustrates the anticipated costs and benefits of the proposed changes to the AML/CTF regime regarding revised CDD activities. Further, it demonstrates the potential for improved protection for business and the broader Australian economy against criminal abuse, associated commercial fraud and reputational risk. By meeting FATF requirements, Australia's integrity, stability and security is also upheld within the international community, deterring criminal activity and maintaining a sound reputation with global organisations and foreign investors.

Based on the analysis, the preferred option is Option C. The proposed AML/CTF rules changes represent an improvement over the status quo and are the preferred option for government consideration.

While Options B and C impose additional regulatory costs, there is reputational risk such that failure to take concerted action in addressing legal deficiencies in Australia's AML/CTF framework will put Australia 'out of step' with major trading partners and allies.

The estimated cost of Option C is in the order of $281.3 million (net present value) over 10 years.

Organised crime is conservatively estimated to cost Australia $10-15 billion each year. AUSTRAC and other law enforcement agencies would only have to disrupt, prevent, detect or recover at least 3 per cent of this amount per annum in order to cover the compliance costs associated with these rules. To further put this into perspective, in 2012-13 AUSTRAC information contributed to 1,428 Australian Taxation Office (ATO) cases which resulted in $572 million in tax assessments being raised,[54] that is, the current value of AUSTRAC information in one year already well exceeds the estimated cost of Option C over 10 years.

Considering the potential combined impact of the proposed reforms on reducing fraud on banks and other businesses, increasing tax recoveries, more successful criminal prosecutions (with related criminal assets confiscations) not to mention the more intangible benefits of industry/national reputation preservation, it is possible that the total value of these benefits could exceed the estimated costs of $39.6 million per annum or $281.3 million (in net present value terms) over the next ten years associated with the proposed reforms.

AUSTRAC has also identified a range of measures to offset the regulatory burden imposed on business by the proposed AML/CTF rule amendments. Section 8 provides further information on AUSTRAC's proposed offsets.

7.1 Implementation and review

AUSTRAC is proposing that the obligations would take effect from 1 June 2014 and that reporting entities would be supported with a transition period to extend to 1 January 2016, during which time reporting entities will be required to establish a transition plan containing actions and timeframes to achieve full compliance by 1 January 2016, including ensuring that any high money laundering or terrorism financing risk customers identified during the transition period are subject to the additional customer due diligence obligations. AUSTRAC will work directly with reporting entities and industry associations to develop guidance in relation to aspects of the reform.

Table 5 provides the key dates for the implementation of the proposed AML/CTF rules.

54 *AUSTRAC Annual Report 2012-13*, page 60

Table 5: Key implementation dates

Date	Key implementation step
May 2014	AUSTRAC CEO makes the AML/CTF Rules
Second Quarter 2014	AUSTRAC will develop additional guidance material to assist with implementation and to provide practical advice to support the Rules.
1 June 2014	AML/CTF Rules will come into effect.
Date of effect to 1 January 2016	Period whereby reporting entities will be required to undertake actions to bring themselves into full compliance including developing a transition plan. The current review of Australia's AML/CTF regime includes the review of the AML/CTF Act, Regulations and Rules. Australia's regime enables the consideration by the AUSTRAC CEO of general exemptions by virtue of s247 of the AML/CTF or individual consideration of exemptions or modifications by virtue of s248.

There are two significant review processes that are relevant to these changes. The first is the legislative review of the AML/CTF Act, Rules and Regulations which was commenced by Government on 4 December 2013. A public consultation has occurred seeking initial submissions in relation to the regime. The review process will culminate in a report to Government in 2015. In parallel, Australia's regime is being reviewed against the revised '*International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation*'. This process which assesses Australia's technical compliance against the international standards, and its effectiveness in implementation of those standards, will result in a Mutual Evaluation Report being considered by the February 2015 Plenary meeting of the FATF.

One of the impacts of these separate reviews is that there will be regular updates to government and to the FATF on Australia's AML/CTF regime.

8 Compliance Cost Offsets

In parallel with the proposed reforms relating to customer due diligence, AUSTRAC is progressing measures to minimise regulatory burden.

8.1 Exemption - mFund

The AUSTRAC CEO has decided to provide the Australian Stock Exchange (ASX) with an exemption in relation to its proposed mFund operations. The effect of this exemption is that it would remove an obligation under the AML/CTF Act for both the agent of a customer and the product issuer of a managed investment scheme to identify the same customer and undertake various AML/CTF obligations in relation to the same customer.

Section 6 of the AML/CTF Act specifies designated services. Entities that provide those designated services are reporting entities under the AML/CTF Act and must comply with obligations under that Act and the AML/CTF Rules.

Item 35 of table 1 in section 6 of the AML/CTF Act, specifies that issuing or selling a security or a derivative to a person in particular circumstances is a designated service.

Item 33 of table 1 of section 6 also specifies that it is a designated service to acquire or dispose of a security or derivative in the capacity of agent of a person.

As a result of these provisions, where a person purchases securities or derivatives through an agent, both the agent of the person and the issuer of the security will be required to undertake parallel activities to identify that person for the same transaction and undertake AML/CTF obligations including monitoring transactions, reporting transactions, keeping and updating records. This duplication is proposed to be addressed by providing an exemption to the issuer of the security in certain circumstances, which relate to the issue of an interest in a managed investment scheme (MIS).

The exemption will amend Chapter 21 of the AML/CTF Rules (issuing or selling a security or derivative), and will exempt issues of interests in managed investment schemes via the mFund settlement service from being a designated service under the AML/CTF Act. The new exemption will apply specifically to the issue of new interests in an MIS registered under section 601EB of the *Corporations Act 2001*.

Under the exemption only the reporting entity providing the item 33 designated service will need to identify and verify a customer and undertake various AML/CTF obligations, whereas the item 35 reporting entity will be exempt from this, and other, AML/CTF obligations.

The mFund settlement service will enable issuers of managed investment schemes to electronically process applications. Without the proposed exemption, the product issuer would need to identify and verify a customer and implement other AML/CTF obligations in respect to the customer, despite the fact that the agent of the customer has already undertaken the same checks, particularly with respect to identification.

Discussions with several financial institutions and the Australian Stock Exchange (ASX) indicate that undertaking these 'know your customer' checks cost around $40 per customer. On this basis, the exemption would provide savings of around **$22.8 million per annum** (averaged over a 10 year period) to product issuers and around **$3.2 million per annum** to customers, with total **annualised savings of around $26.0 million**. This is based on the assumption that the mFund will attract 510,000 new customers each year. This compares to an analysis commissioned by the ASX that estimated there were a total of 5,173,000 applications to MISs in 2011.[55] New customers to the mFund would represent only a

55 Rice Warner Actuaries Report, Managed Funds Transaction Cost Research, July 2012.

proportion of the total applications. These savings estimates consider the KYC requirements only, as sufficient data was not available to estimate the additional savings related to the broader AML/CTF obligations. Table 6 details the cost estimates and the underlying assumptions.

It is understood that the mFund is anticipated to commence operation during 2014. Beyond the cost savings associated with this exemption, the mFund is designed to provide benefits through more efficient application and payments processing and enhanced product distribution. Those benefits have not been included in this analysis as they are not direct regulatory cost offsets.

Table 6: Estimates of potential impacts - mFund

mFund savings estimate	Value	Index	Annualised value over 10 years	Source and explanation
Business Savings (from SMSFs)				
Know your customer (cost estimate per customer)	$40	2.5%	$45	Cost estimate provided via consultation and escalated by CPI in line with general inflation.
New SMSF parties	210,000	0%	210,000	AUSTRAC estimates that there are around 70,000 new SMSFs per annum, and an average of 3 parties per SMSF.
Know your customer savings (New SMSFs)	**$9,410,841**	Calculation		
Business Savings (from Individuals)				
Know your customer (cost per customer)	$40	2.5%	$45	Cost estimate provided via consultation and escalated by CPI in line with general inflation.
New customers for Managed Investment Schemes (via mFund)	299,000	0%	299,000	Assume 5 per cent of existing ASX participants use mFund each year. Source: Stockbroking business advised that around 10 per cent of retail customers enquire about managed investment schemes. Assume half of these would purchase through mFund each year.
Know your customer savings (Retail customers)	**$13,399,245**	Calculation		
Savings to customers				
Time saving from not completing product issuer form	0.21 hours	0%	0.21 hours	10-15 mins per customer from filling in product issuer form. Source: Business consultation.
Cost savings per customer	$5.63		$6.30	Calculation (Time savings x hours rate) Hourly leisure time rate of $27.00 (provided by AUSTRAC)
Number of mFund customers	509,000	0%	509,000	Customers = new SMSF parties and new customers for Managed Investment Schemes (via mFund). Refer details above.
Savings to customers	**$3,207,668**	Calculation		
Know your customer savings (Total)	**$26,017,754**	Calculation		

8.2 Collection and Verification of a Customer's Identification

The current AML/CTF Rules require collection of identification information from a customer. Whether the customer is an individual, a company, a trust or another entity type, the particular types of information to form part of CDD are specified in Chapter 4 of the Rules.

AUSTRAC has been advised by industry that the need to verify information from an independent and reliable source may be overly burdensome in circumstances where the entity has collected the information from such a source in the first place. For instance, an entity may collect information about a company from the ASIC company registry. It is not then possible for the entity to verify this information using the ASIC registry as this is not independent from the collection process. As a result, the entity would need to ask the customer to provide other information such as the articles of incorporation.

An alternative to this approach would be to amend the collection and verification requirements so that either the information is collected or it is verified from an independent and reliable source. This would enable the entity to check information with the customer for verification purposes if it had already collected the information from ASIC or other similar sources.

Under the proposed change, the reporting entity would have the flexibility to be able to collect the customer information from an independent source, pre-fill parts of the customer application form and then check the information with the customer for verification purposes. The key cost savings would relate to:

- reducing manual data entry of customer information by reporting entity employees
- reducing customer time needed to complete application forms (due to the reporting entity pre-filling information from an independent source).

Based on discussions with several financial institutions, it is estimated that the proposed change would reduce manual data entry time by around 4 minutes per customer and would reduce the time it takes the average new customer to complete an application form by around 12.5 minutes. Some financial institutions indicated that the proposed change would not provide cost savings to their customer on-boarding process due to technology constraints and practical issues around existing processes. Therefore, it is assumed that around half of the financial institutions[56] would adapt their processes to leverage the flexibility of the proposed changes over the 10 year period. This assumption reflects the varied responses received from financial institutions on this offset. The different approaches applied by reporting entities to meet the current requirements affect the extent to which particular reporting entities are expected to benefit from the changes to verifying customer information. The estimated annualised savings to financial institutions are $7.2 million, with a further $7.9 million of annualised savings provided to customers (individuals). Table 7 details the cost estimates and the underlying assumptions.

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56 Comprises major domestic banks, other domestic banks, foreign subsidiary banks, foreign branch banks, credit unions, building societies and mutual ADIS.

Table 7: Estimates of potential impacts – Customer identification

Chapter 4 offset	Value	Index	Annualised value over 10 years	Source and explanation
Savings to financial institutions (business)				
Data entry time saving (per customer) (hours)	0.07 hours		0.05 hours	4 minute saving per customer between years 4 and 10 only based on information that IT system upgrade/redesign every 7 years (average is 3.5 years from now). Assume businesses only adopt change as part of broader IT/process upgrades.
Cost savings per new customer	$5.53	2.5%	$4.17	Figure based on average weekly earnings (ABS Catalogue 6302. Average weekly earnings - ordinary time (Financial & Insurance Services), November 2013) and converted to hourly rates using 37.5 hour assumption. Assume on-costs and overheads are 1.75x wage rate (VCEC guidance material - Victorian Guide to Regulation Appendix C). Figure multiplied by the data entry time saving per customer above.
Number of new customers for 50% of financial institutions applying new process	2,005,200	0%	2,005,200	Based on information that there are around 600,000 new customers per year for each of the major banks (Source: AUSTRAC) and that the major banks make up 69.8 per cent of industry expenses and therefore the same percentage of customers. It has then been assumed that half of financial institutions adopt based on feedback provided by industry.
Savings to financial institutions (business)	***10,289,615***		**7,202,731**	
Savings to new customers (individuals)				
Reduction in time to complete application forms per customer (hours)	0.21 hours		0.15 hours	12.5 minute saving per customer (source: business consultation) between years 4 and 10 only based on information the IT system upgrade/redesign every 7 years.
Cost saving per new customer	$6.06	2.5%	$4.57	Based on the default hourly leisure rate (cost of time) ($27) for individuals obtained by AUSTRAC from deregulation program advice.
Number of new customers to benefit (each year) - based on 50% of financial institutions applying new process	2,005,200	0%	2,005,200	Based on information that there are around 600,000 new customers per year for each of the major banks (Source: AUSTRAC) and that the major banks make up 69.8 per cent of industry expenses and therefore the same percentage of customers. It has then been assumed that half of financial institutions adopt the changes.
Savings to customers (individuals)	***$11,279,248***		**$7,895,474**	
Chapter 4 offset savings (Total)			**$15,098,208**	

Combined, these two offset measures provide **annualised future savings of around $41.1 million**. These savings estimates are highly sensitive to the underlying assumptions used. For instance, the mFund savings estimates are driven by the assumed take-up rate of MISs by ASX share market participants. The customer verification offset savings are highly sensitive to the assumed proportion of financial institutions that would likely modify their existing customer on-boarding processes to take advantage of the more flexible verification requirements.

Appendices

Appendix A: Background on AML and CTF

This appendix provides an overview of the current Anti-Money Laundering/Counter-Terrorism Financing (AML/CTF) regime within Australia and its place within the global context including current regulatory arrangements and the current framework for CDD obligations.

AML/CTF in Australia

The AML/CTF Act and AML/CTF Rules generally reflect the global standards agreed to by 36 member countries of the FATF. Australia as a founding member of the FATF plays a leading role in developing these standards, promoting and assessing global compliance, and is committed to implementing them fully. The FATF has, however, identified a number of deficiencies around customer due diligence obligations which require amendments to the AML/CTF Rules. The aim of the AML/CTF Act and AML/CTF Rules is to protect Australia and the global financial system from criminal and terrorism financing through effective and proportionate compliance with the FATF global standards.

The flexibility and adaptability of corporate vehicles to accommodate the financial and organisational needs of entrepreneurs and investors have arguably contributed to the deepening of financial markets. Irrespective of how effective these forms might be for meeting the needs of a broad range of businesses and investors, there have been increasing concerns about the degree to which these legal forms are used for tax evasion, money laundering, and other illegal or abusive transactions. The ACC's *Organised Crime in Australia 2013* report identifies the exploitation of business structures, including the infiltration of legitimate businesses by organised crime, as a key enabler of serious and organised crime. In particular, the report notes that complex business structures, for example, those composed of multiple layers and having international connections, are used to hide criminal ownership and control, and to move and obscure illicit funds, and that this is becoming increasingly common in Australia.[57]

Globally, governments have responded to these threats and challenges through a range of international bodies and forums to identify and implement strategies to combat and address these threats including the FATF, the G-20 (which is being chaired in Australia in 2014), the OECD, the United National, the World Bank just to name a few.

Given the harm that money laundering causes to financial markets and the effect that it has in undermining confidence in government and business, AUSTRAC considers that strengthening the weak links in the AML/CTF Rules is needed.

Money laundering is the lifeblood of organised crime. It is a transnational crime that:

- threatens the integrity and stability of the financial system
- is a source of funds for criminal activity, including serious and organised crime and terrorism, which impacts on community safety and wellbeing.

[57] http://crimecommission.gov.au/publications/organised-crime-australia/2013-report/enabler-activities#4

The 2011 Australian Crime Commission (ACC) Organised Crime Threat Assessment identified money laundering as one of the three critical risks facing Australia given its potential impact to Australia's national security and prosperity with the potential to undermine the integrity of the Australian financial system.[58] Organised crime is conservatively estimated to cost Australia $10-15 billion each year.

Increased levels of money laundering and terrorism financing abuse have the potential to distort markets creating illegitimate competitive advantage. This can be particularly damaging for smaller businesses trying to compete in these markets. Increased money laundering and terrorism financing abuse also damages Australia's international reputation and increases the cost of business.

To combat money laundering and terrorism financing activities and protect Australia, its institutions and its people, the Australian Government has sought to implement a robust AML/CTF regime within Australia.

The Financial Action Task Force (FATF)

Australia is a founding member of the FATF, the inter-governmental body which develops and promotes the implementation of standards for combating ML/TF and other related threats to the integrity of the international financial system. The international standards are contained in the FATF's 40 Recommendations. FATF assesses compliance with the recommendations through a country peer review evaluation (called a 'mutual evaluation') and monitoring (follow-up) process. The 2005 FATF mutual evaluation of Australia was a primary factor which shaped the development of the AML/CTF Act.

In February 2012, the FATF released revised international standards on AML/CTF that clarify existing CDD obligations and transparency of beneficial ownership. The revised FATF Standards were a direct response to a call by the G20 to address the increasing number of high profile cases involving the use of legal entities and complex legal structures to hide the true ownership and control of those entities. The G20 Finance Ministers in April 2012 endorsed the revised standards which included a declaration calling on all countries to fully implement measures in line with the Standards.[59]

The FATF Recommendations (2012) are expected to significantly improve transparency regarding beneficial ownership structures. Under Recommendation 10, 'customer due diligence' (CDD) for legal persons (eg companies) and arrangements (eg trusts), the FATF Recommendations state that:

> *When performing CDD measures in relation to customers that are legal persons or legal arrangements, financial institutions should be required to identify and verify the customer, and understand the nature of its business, and its ownership and control structure. The purpose of the requirements [...] regarding the identification and verification of the customer and the beneficial owner, is twofold: first, to prevent the unlawful use of legal persons and arrangements, by gaining a sufficient understanding of the customer to be able to properly assess the potential money laundering and terrorist financing risks associated with the business relationship; and, second, to take appropriate steps to mitigate the risks. As two aspects of one process, these requirements are likely to interact and complement each other naturally.*

The FATF performs a critical role in ensuring that an internationally coordinated approach prevents criminals from exploiting vulnerabilities arising from differences between the laws of different jurisdictions. It does so by setting international standards on combating money laundering, countering the financing of terrorism and the financing of proliferation of weapons of mass destruction through the FATF Standards.

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58 Australian Crime Commission (2011) *Organised Crime in Australia 2011*. Available at: http://www.crimecommission.gov.au

59 http://www.fatf-gafi.org/documents/documents/ministersrenewthemandateofthefinancialactiontaskforceuntil2020.html

The FATF has developed and published 40 recommendations which establish the international standard for domestic AML/CTF regimes. These standards are endorsed internationally by bodies such as the G8, G20, United Nations, the Organisation for Economic Cooperation and Development (OECD), the Financial Stability Forum, the IMF and the World Bank, who encourage and support their implementation.

If a country fails to meet the FATF standards, the actions available to the FATF in response include high level delegations to the country, public naming of the country as having AML/CTF deficiencies (otherwise referred to as grey and black lists), suspension and ultimate cancellation of the country's membership of the FATF and countermeasures such as those imposed on Iran and North Korea.[60]

The public naming action occurs through one of two FATF public documents (issued three times a year) and is based on the results of the jurisdiction's review by the International Co-operation Review Group (ICRG).[61]

1. *FATF's Public Statement* – the first public document identifies jurisdictions that have strategic AML/CTF deficiencies and to which countermeasures apply as well as those jurisdictions with strategic AML/CTF deficiencies that have not made progress in addressing those deficiencies or have not committed to an action plan to address the deficiencies.

2. *Improving Global AML/CTF Compliance: On-going Process* – the second public document identifies jurisdictions that have high level political commitment to address the deficiencies through implementation of an action plan that has been developed in partnership with the FATF.

In the *FATF Public Statement 18 October 2013* document, two countries were identified as being deficient and thus subject to 'a FATF call on its members to apply countermeasures' to the jurisdictions due to the level of ML/TF risk. Further, eleven countries were identified as having strategic AML/CTF deficiencies with inadequate progress in addressing those deficiencies or having not committed to an action plan and thus 'FATF calls on members to consider the risks arising from the deficiencies associated with each jurisdiction.'[62] In the *Improving Global AML/CTF Compliance: On-going Process 18 October 2013* document, 19 jurisdictions were identified as being called upon by the FATF to complete the implementation of action plans and subject to close monitoring by the FATF. Australia has not been publicly listed at any of these levels.

Further, the FATF Standards include a requirement for countries to consider the level of risk posed by other jurisdictions. Regulated entities are to apply a higher level of due diligence when dealing with businesses from countries which have been identified by the FATF as having deficiencies in their AML/CTF regimes. For example, to be considered as having equivalent AML/CTF systems to the European Union (EU) and thus be considered as a third country and named on the EU equivalence list, a jurisdiction would have to continue be deemed sufficiently compliant with the FATF standards. Currently, Australia is one of twelve countries with Third Country Equivalence status.[63] These countries are:

- Australia
- Brazil
- Canada
- Hong Kong

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60 Countermeasures are framed as protection for the individual or country dealing with these risky jurisdictions, rather than punitive.

61 FATF (2013) *High-risk and non-cooperative jurisdictions*. Available at: http://www.fatf-gafi.org/topics/high-riskandnon-cooperativejurisdictions/

62 Ibid

63 European Commission (2013) *Member States list of equivalent third countries – June 2012*. Available at: http://ec.europa.eu/internal_market/company/docs/financial-crime/3rd-country-equivalence-list_en.pdf

- India
- Japan
- South Korea
- Mexico
- Singapore
- Switzerland
- South Africa
- The United States of America.

The role of AUSTRAC

AUSTRAC is Australia's combined AML/CTF regulator and financial intelligence unit (FIU) and has the objective of maintaining an effective AML/CTF regime in Australia. As Australia's AML/CTF regulator, AUSTRAC oversees industry's compliance with the requirements of the AML/CTF Act and the FTR Act and works with reporting entities to ensure that the regulatory measures in place are effective and proportionate to the risks they face. Where AUSTRAC detects cases of serious non-compliance under the AML/CTF regime, it may take appropriate and measured enforcement action to secure a regulated entity's compliance.

AUSTRAC's partner agencies include Australian Government law enforcement, national and border security, revenue, regulatory and human services agencies, as well as state and territory law enforcement and revenue agencies. It also works closely with international counterparts under memorandums of understanding (MoUs).

As part of its financial intelligence responsibilities, AUSTRAC receives financial transaction reports from regulated businesses. AUSTRAC's annual report indicates that during 2012-13 there was a substantial increase in the number of international funds transfers. Whilst 2011-12 saw AUSTRAC receiving 59 million individual reports of financial transactions, in 2012-13 this figure increased to more than 84 million – an increase in volume of nearly 43 per cent. Further, of the 84 million financial transaction reports received by AUSTRAC from Australian businesses during 2012-13, just under 80 million were of international fund transfers into and out of Australia, with a total value of more than $3.5 trillion.[64] In addition, AUSTRAC received over 40,000 reports of suspicious matters from Australian businesses.

These reports and the information they contain provide AUSTRAC with the ability to disseminate intelligence to the broader law enforcement network regarding suspicious transactions and potential money launderers. For example, the Australian Taxation Office (ATO) used 'AUSTRAC data to identify suspected tax avoidance, including abuse of overseas tax and secrecy havens. AUSTRAC information contributed to 1,428 ATO cases during the year, resulting in $572 million in taxation assessments being raised.'[65]

Current regulatory arrangements in Australia

Australia is recognised internationally as having a (generally) robust AML/CTF regime. The AML/CTF regime provides a comprehensive legal framework designed to ensure that Australia's financial system is

64 AUSTRAC (2013) *Annual Report 2012-13*.

65 Ibid.

hostile to money laundering and terrorism financing, and aims to protect Australia, its people and financial institutions against abuse from criminal activity.

The legislative authority and direction is provided by:

- the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (the AML/CTF Act)
- the *Anti-Money Laundering and Counter-Terrorism Financing Rules Instrument 2007 (No.1)* (the AML/CTF Rules)
- the *Financial Transaction Reports Act 1988* (the FTR Act).

The AML/CTF Act sets out a principles-based framework, encouraging a risk based approach to AML/CTF compliance. The AML/CTF Rules set out specific requirements that underpin the broader obligations provided for in the AML/CTF Act. Under section 229 of the AML/CTF Act, the AUSTRAC Chief Executive Officer (CEO) may, in writing, make AML/CTF Rules. AML/CTF Rules are binding legislative instruments. AUSTRAC develops the AML/CTF Rules in consultation with relevant government agencies, industry and other stakeholders.

The AML/CTF Act imposes obligations on any business that provides a 'designated service', which are known as reporting entities. Broadly speaking, the Act applies to the services provided by:

- financial institutions
- gambling service providers
- bullion dealers
- money remittance dealers.

Currently, there are 13,762 reporting entities enrolled with AUSTRAC on the Reporting Entities Roll (in accordance with post-1 November 2011 enrolment requirements).

In addition, some reporting entities (ie those with US citizen customers) are already subject to the United States *Foreign Account Tax Compliance Act* (FATCA), which will soon be subject to an intergovernmental agreement (IGA). The IGA will allow centralised reporting to the ATO to enable FATCA obligations to be met.

Current CDD Policy

CDD and reporting by businesses, including small businesses, is a fundamental part of an effective AML/CTF regime. It is critical to enabling the detection, investigation and prosecution of serious and organised crime and protecting the Australian financial system, revenue base and national security interests.

The AML/CTF regime recognises that regulated businesses are best placed to assess the money laundering risks of their customers. To properly assess these risks posed by each customer, as well as whether to proceed with the business relationship or transaction, and the level of future monitoring required, reporting entities must know and understand their customers if they are to be sufficiently informed.

The FATF Standards (as mentioned above) require reporting entities to:

1. understand who is the customer
2. understand who owns and controls the customer – this includes the beneficial ownership and control structures
3. understand the purpose and intended business relationship of the customer

4. conduct ongoing due diligence of the business relationship – including scrutiny of transactions involving that customer (on the basis of the risk assessed).

In Australia, the AML/CTF Act and Rules set a minimum baseline for reporting entities to know their customers and beneficial owners. Currently reporting entities must have in place AML/CTF programs to identify, mitigate and manage risks that a designated service it provides may involve or facilitate money laundering or terrorism financing. Before providing a service, reporting entities are required to have appropriate CDD programs in place to:

- enable them to 'know your customer' (KYC)
- perform ongoing customer due diligence
- monitor transactions
- report suspicious matters to AUSTRAC.

The AML/CTF Act and AML/CTF Rules enable reporting entities to apply a risk-based approach to AML/CTF and to CDD, in accordance with FATF principles. The risk-based approach requires a reporting entity to assess and determine the level of money laundering and terrorism financing risk associated with each customer before providing them with a designated service. The risk is assessed having regard to factors including the customer type, the potential designated service and product being offered, the method of delivery (eg over-the-counter or on-line), the nature of the customer's business and the geographic location of the customer.

The risk-based approach enables reporting entities to effectively and efficiently target their resources on a risk-sensitive basis and to address the risks in a manner which is cost-effective and proportionate to the level of perceived risk.

Accordingly, Australia's current regulatory CDD obligations in some instances do not require — and in others are not sufficiently explicit in obliging — reporting entities to undertake certain core CDD measures. For example, it is left to the discretion of reporting entities whether to undertake further checks in order to understand the beneficial ownership of a non-corporate customer. In such circumstances, reporting entities may not have sufficient information to properly assess their ML/TF risks.

The proposed regulatory amendments represent a range of incremental steps to further clarify support and reinforce Australia's existing AML/CTF legal framework. The incremental steps may vary widely from slight changes to current business-as-usual operations to systems process changes. As discussed in section 5 this largely reflects the codification of current expectations of industry in completing their CDD activities and 'maintenance' of current Australian statute to ensure that the legal tools available to AUSTRAC continue to be 'in step' with contemporary AML/CTF trends. Further, the proposed amendments reflect Australia's ongoing political commitments to its friends and allies with respect to combating international money laundering and terrorism financing.

Appendix B: Proposed regulatory change and expected impact

Table 8 summarises the proposed regulatory changes and the expected impact of each change on the regulated population.

Table 8: Expected impact on reporting entities to comply with proposed changes

Deficiency	Proposed Change	Amendment to AML/CTF Rules
No explicit requirement to take reasonable measures to understand the ownership and control structure of a customer that is a legal person or arrangement.	Extend definition in the AML/CTF Rules of beneficial ownership of all customers to explicitly introduce the concept of 'control'.	A definition of beneficial owner has been included in Chapter 1 of the Rules. Chapters 4, 8 and 9 have been amended to require that reporting entities **must** consider the beneficial ownership and control structure of customers. Chapter 4 outlines the obligations upon a reporting entity to determine each beneficial owner of the customer and collect and take reasonable measures to verify information.
No comprehensive requirement to identify and verify beneficial owners	Amend the Rules to explicitly require reporting entities to: • identify and take reasonable steps to verify the identity of beneficial owners for all categories of customer that are legal persons or legal arrangements • clarify that the term 'beneficial owner' means the natural person(s) (individual(s)) who ultimately owns or controls a customer.	
No requirement for reporting entities to determine whether the customer is acting on behalf of another person and, if so, to take reasonable steps to verify the identity of that other person.	Amend the AML/CTF Rules to explicitly require reporting entity to: • determine whether the customer is conducting a transaction on behalf of another person or third party, and accordingly • identify the beneficiaries and the destination of the transaction.	Amendments to chapter 4 recognise that circumstances where the customer is acting on behalf of the beneficial owner will be limited and therefore reporting entities may assume a customer who is an individual and the beneficial owner of that individual are one in the same.

Deficiency	Proposed Change	Amendment to AML/CTF Rules
No specific requirement for reporting entities to identify and verify the settlor of a trust	Amend the AML/CTF Rules to explicitly require a reporting entity to identify and verify the settlor of a trust.	Chapter 4 now requires reporting entities to collect and verify the full name of the settlor of the trust, except when the settlor has made a material asset contribution to the trust of less than $10,000 where the settlor is deceased or where simplified trustee procedures are applicable to the trust
No specific requirement to apply a range of CDD measures in high risk situations. Some enhanced due diligence measures are not clearly distinguishable from normal CDD measures. Reporting entities are not required to take specific additional measures for customers who are PEPs.	Amend the AML/CTF Rules to: • define the meaning of PEP • require reporting entities to introduce risk-based controls to identify whether their customer (and beneficial owners) may be a foreign, domestic or international organisation PEP • include provision for the conduct of explicit enhanced CDD measures where the customer is a PEP • prescribe specific measures to be taken to perform a range of enhanced CDD measures for high-risk situations.	Chapter 1 now includes a definition of PEP and Chapter 4 has been amended to require a reporting entity to have in place appropriate risk-management systems to determine whether the customer or beneficial owner of a customer is a PEP. Amendments to Chapter 15 specify actions which **must** be undertaken where the reporting entity has ascertained that ML/TF risk is high, a suspicion has arisen under section 41 or where customers is in a prescribed foreign country. Chapter 15 also now contains requirements which are in addition to normal CDD processes where the amendments now require that certain ECDD measures must be applied where customer or beneficial owner is a foreign PEP.
No requirement to collect information on the purpose and intended nature of the business relationship.	Amend the AML/CTF Rules to include an explicit requirement that Part A of a reporting entity's AML/CTF program must include appropriate risk-based systems and controls to ensure that the reporting entity has a reasonable understanding of the nature of the customer's business or occupation.	Chapters 4, 8 and 9 have been amended to require that reporting entities **must** consider among other money laundering and terrorism financing risks factors the nature and purpose of the business relationship with its customers.
Obligations on reporting entities regarding documents collected as part of the processes of identification, verification and updating of customers are inadequate.	Introduce a general obligation for reporting entities to keep CDD information up to date and relevant, and that risk-based systems be used to determine what CDD information should updated or verified and at what intervals.	Chapter 15 now requires that reporting entities must undertake reasonable measures to keep, update and review their records, both in regard to customers and beneficial owners.

The table below summarises the estimated impacts of Option C on the costs of businesses and the assumptions which the calculation were based on.

Table 9: Revised cost estimates and associated assumptions[66]

NPV Calculation 10 year period ($ million)	NPV	Assumptions
All entities		
On-going	$295.4	Reflects upper cost boundary based on EU methodology.
One off	$168.1	
Total NPV	**$463.5**	
Avg. annual offset req.' (undiscounted)	$70.3	
LESS adjustment in ongoing staff and IT costs		
On-going	$194.9	Stakeholder feedback did not cite significant additional ongoing staffing or IT costs as a primary concern. Further, investments in these sorts of technologies could potentially be leveraged by other parts of the business. Additionally, the EU methodology appears somewhat dated given advances in technology since the initial report was published. Further, EU methodology highlighted that cost savings could likely be achieved given potential automation and/or advanced digital technology. As such, ongoing IT and staffing costs have been reduced by an average of 50% to account for these considerations. [67]
One off	$168.1	
Total NPV	**$363.0**	
Avg. annual offset req.' (undiscounted)	$52.3	
AND LESS a reduction of life span to seven years		
On-going	$171.2	Discussions with internal PwC IT specialists indicated large systems and process redevelopment are undertaken regularly (roughly 5 – 7 years). It is likely the changes required by these regulations would form part of a much larger systems and process change program. This would limit the ongoing cost attributable to this specific set of regulatory changes to an estimated 7 years.
One off	$168.1	
Total NPV	**$339.3**	
Avg. annual offset req.' (undiscounted)	$47.0	
AND LESS Australian major banks with compliant operations		
On-going	$149.0	Some Australian banking stakeholders indicated it is possible that portions of their international businesses would already be broadly compliant or have comparable practices lessening the impact of the proposed changes. Based on this information, we have assumed that 75% of Australian banks' domestic operations would be impacted by the changes.
One off	$143.9	
Total NPV	**$292.9**	
Avg. annual offset req.' (undiscounted)	$41.1	

66 Annual offset required reflects average cost to business expressed in nominal terms and is not a discounted figure. This reflects and average cash outlay by business resulting from the regulatory burden imposed by the proposed changes and would have to be offset by the reduction or elimination of other regulatory burdens.

67 The initial EU study was undertaken in 2009, retrospective of the Third AMLD. Technology has continued to advance and there is acknowledgement that these initial estimated may be somewhat dated. The EU methodology also highlights that IT expenditure is linked to access costs of various databases required to fulfil the CDD obligations. Some firms, generally larger banks, view automation as the way to provide necessary evidence and audit trail in the event that a problem arises. This also has the advantage of being more cost effective, as compared to the manual effort required to perform the same tasks. Small firms did highlight that they might be likely to require a larger number of personnel, and had limited ability to invest in systems. On balance, we view a downward adjustment in ongoing IT and staffing costs as reasonable given these factors.

NPV Calculation 10 year period ($ million)	NPV	Assumptions
AND LESS foreign banks with compliant operations		
On-going	$143.7	Some international stakeholders operating in Australia indicated that since they operate globally, and are governed by a global risk management framework, the impact of the proposed changes may not be as significant as those banks operating primarily in Australia. Based on this information, we have assumed that 50% of business operations will be impacted by the proposed changes.
One off	$137.6	
Total NPV	**$281.3**	
Avg. annual offset req.' (undiscounted)	$39.6	

Appendix C: Costing methodology

Methodology and assumptions

Business compliance costs have been estimated based on the costs identified in an external study conducted on behalf of the European Commission. The study assessed the costs of compliance on an ex post basis of a number of Financial Services Action Plan measures, including the Third Anti Money Laundering Directive (2005/60/EC). The Third AMLD updated the Second AMLD in light of the recommendations of FATF. Some of the changes are similar to the proposed changes in Australia's AML/CTF, examples of some of the changes are:

- identity checks must be carried out on customers opening accounts (i.e. accounts cannot be held anonymously)
- checks must be applied to any transaction over €15,000
- stricter checks must be carried out on 'politically exposed persons' (PEPs)
- penalties can be imposed for failure to report suspicious transactions to national financial institution[68]
- extended the preventive measures to the collection of money or property for terrorist purposes
- introduced more specific and detailed provisions relating to the identification of the customer and of any beneficial owner and the verification of their identity
- extended the scope of the Directive to cover life insurance intermediaries and trust and company service providers[69].

While the changes in AML/CTF in Australia are not identical to the Third AMLD in Europe, both involves updating the existing legislation and aiming to follow the FATF recommendations. The EU cost impact analysis related to the Third AMLD is currently the most readily available cost estimate. Taking both factors together, we've used this as a starting point for this analysis. It is therefore, assumed that, as a starting point, the costs identified in the EU study will be similar for Australia.

Briefly, the compliance costs in the EU study were estimated as a proportion of operating expenses across four financial services industry, banks and financial conglomerates, assets managers, investment banks and financial markets. The costs are further broken down into one-off and ongoing costs and by activities such as including IT updates, staff costs and internal and external reporting. Compliance costs in the impact analysis are estimated through applying the proportions of EU study to the operating expense of Australian entities that will be affected by the proposed changes. The following sub-sections outline key assumptions in developing our compliance costs estimates.

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68 Europe Economics (2009), *Study on the Cost of Compliance with Selected FSAP Measure*, available at: http://ec.europa.eu/internal_market/finances/docs/actionplan/index/090707_cost_of_compliance_en.pdf

69 European Commission, (2013), *Commission Staff Working Document Impact Assessment*, available at: http://ec.europa.eu/internal_market/company/docs/financial-crime/130205_impact-assessment_en.pdf

Population

First, given that the size and functions of entities differ between Australia and the EU, the four categories from the EU study are mapped for the Australian financial industry. This mapping was driven by data obtained from AUSTRAC, the Australian Prudential Regulation Authority70 and IBIS World industry reports. 7172 Where a 'perfect' mapping was not possible, or in cases of uncertainty (i.e. due to definitional uncertainty), our professional judgement has been applied. Table 10 provides a summary of the mapping of EU classifications applied to Australian entities.

Table 10: Classification of Australian entities by EU study

Compliance Costs of 3AMLD	Australian financial entities
Banks & Financial conglomerates	Major domestic banks Other domestic banks Foreign owned bank branches subsidiaries
Assets & Managers	Credit Unions Building society Mutual ADIs
Investment Banks	Foreign owned banks
Financial Markets	Other financial providers *Custodies, Trustee and Stock Exchange Services* *Other Deposit Taking Financiers in Australia*

Cost Break Down

Second, costs can be broken down into different activities. Businesses will need to undertake activities including IT system update, training for staff as well as recruiting and internal and external reporting.

Given qualitative feedback from stakeholders concerning key contextual factors, our cost estimate was further refined to account for the time discrepancy between the Third AMLD and the current proposed regulation. Broadly, these relate to ongoing and continuous improvements related to CDD as well as improvements in technology and productivity which would arguably serve to reduce the current compliance cost estimates. The assumptions we have used to further refine our cost estimate include:

- Operational baseline – Stakeholder feedback did not highlight significant additional ongoing staffing or IT costs as a main concern. Further, investments in these sorts of technologies could potentially be leveraged by other parts of the business. Additionally, the EU methodology appears somewhat dated given advances in technology since the initial report was published. Further, EU methodology highlighted that cost savings could likely be achieved given potential automation and/or advanced is digital technology. As such, ongoing IT and staffing costs have been reduced by 50 per cent to account for these considerations.

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70 Australian Prudential Regulation Authority (2013), *Quarterly ADI performance statistic.*

71 IBIS world (2013), Industry report:Custody Trustee and Stock Exchange Services in Australia.

72 IBIS world (2013), Industry report: Other Deposit Taking Financiers in Australia.

- Systems / process lifespan – Discussions with internal PwC IT specialists indicated large systems and process redevelopment are undertaken regularly (roughly 5 – 7 years). Likely the changes required by these regulations would form part of a much larger systems and process change program. This would limit the ongoing cost attributable to this specific set of regulatory changes to 7 years over the same period.

- Australian major banks with compliant operations – A few Australian banking stakeholders indicated it is possible that portions of their international businesses would already be broadly compliant or have comparable practices lessening in the impact of the proposed changes. We have assumed that 75 per cent of Australian banks' domestic operations would be impacted by the changes. In other words, 25 per cent of their existing operations (i.e. those with links to their international business) are assumed to be compliant. This is broadly consistent with submissions provided in response to AUSTRAC's discussion paper and ongoing consultation that has occurred with AUSTRAC. For example, an online based business indicated that given their global business practices, some processes proposed under the revised AML/CTF rules were already implemented, in particular regarding PEPs.

- Foreign banks with compliant operations – Some international stakeholders operating in Australia indicated that since they are operating globally, and are governed by a global risk management framework, the impact of the proposed changes may not be as significant as those operating primarily in Australia. We have assumed that 50 per cent of these banks' business operations will be impacted by the proposed changes. This is supported by the information received by AUSTRAC during the consultation process. For instance, some foreign-owned entities advised that they already comply with higher international standards, such as those relating to determining beneficial ownership. Whereas the proposed AML/CTF rules have a 25 per cent level for determining beneficial ownership, some overseas policies apply are more stringent identification to the 10 per cent level, regardless of risk level.

Table 11 summarises key cost elements for both one off and ongoing costs.

Table 11: Break down of costs by activities[73]

Break down of costs					
One off costs					
Administrative costs		**Substantive compliance costs**		**Delay costs**	
Project management	7%	Investment in/updating IT	54%	Familiarisation with Directive	3%
		Training	22%		
		Consultancy fees	11%		
		Staff recruitment costs	2%		
		Legal advice	1%		
Ongoing costs					
Internal reporting	4%	Additional staff	18.5%		
External reporting	5%	IT[74]	15.5%		
Audit	10%				

Finally, to calculate compliance costs, the previous EU study developed an estimate of compliance costs as a percentage of operating expenses (composed to the items highlighted in Table 11). Table 12 summarises key operational compliance cost ratios applied to operating costs in the Australian context.

Table 12: Compliance Cost Ratios

Australian financial entities	Mean one-off costs[75]	Mean ongoing costs[76]
Major domestic banks Other domestic banks Foreign owned bank branches subsidiaries	0.29%	0.08%
Credit Unions Building society Mutual ADIs	0.21%	0.07%
Foreign owned banks	0.23%	0.05%

73 Europe Economics (2009), *Study on the Cost of Compliance with Selected FSAP Measure*, available at: http://ec.europa.eu/internal_market/finances/docs/actionplan/index/090707_cost_of_compliance_en.pdf

74 Overall reduction of 34% to ongoing IT and staffing cost estimated. See foot note 35 for additional commentary.

75 Europe Economics (2009), *Study on the Cost of Compliance with Selected FSAP Measure*, available at: http://ec.europa.eu/internal_market/finances/docs/actionplan/index/090707_cost_of_compliance_en.pdf

76 Europe Economics (2009), *Study on the Cost of Compliance with Selected FSAP Measure*, available at: http://ec.europa.eu/internal_market/finances/docs/actionplan/index/090707_cost_of_compliance_en.pdf

Australian financial entities	Mean one-off costs[75]	Mean ongoing costs[76]
Other financial providers *Custodies, Trustee and Stock Exchange Services* *Other Deposit Taking Financiers in Australia*	0.16%	0.13%

Industry operating expenses were largely drawn from the statistics released by the Australian Prudential Regulation Authority.[77] To capture the rest of reporting entities that are not subject to APRA's reporting obligation, information on the number of enterprise and revenue are drawn from IBIS world industry reports. [78] [79]

Net Present Value and Sensitivity analysis

Net Present Values are calculated over a ten year period with sensitivity analysis conducted for different discount rates and scenarios of costs incurred by businesses. Only ongoing costs are included in the stream of net benefits as one-off costs is assumed to be a first year cost.

The extent to which businesses already comply with the proposed requirements is unknown; therefore values are calculated for different scenarios. Foreign banks and subsidiaries are likely to be compliant already because of its multi-national operations and customers. Some major banks in Australia may also already follow the requirements proposed for their international customers that have transactions in Europe and other countries that are within FATF's standards.

Different scenarios are also conducted along with a number of real discount rates which are subject to uncertainty. Discount rate of 3, 7 and 10 per cent are used as suggested in the OBPR cost-benefit analysis guidance notes.

Table 13: Net present value of total compliance costs over ten year period, $m

NPV	**Discount rate**		
Scenarios	**3%**	**7%**	**10%**
All entities	$532.0	$463.5	$422.6
LESS 50% reduction for ongoing and IT costs	$409.3	$363.1	$335.3
AND LESS costs ongoing costs after seven years	$373.4	$339.3	$318.2
AND LESS Australian banks with foreign operations	$322.6	$292.9	$274.6
AND LESS foreign banks	$309.9	$281.3	$263.6

77 Australian Prudential Regulation Authority (2013), *Quarterly ADI performance statistics.*

78 IBIS world (2013), Industry report: Custody Trustee and Stock Exchange Services in Australia.

79 IBIS world (2013), Industry report: Other Deposit Taking Financiers in Australia.

Appendix D: Distribution Analysis

The tables below provide distribution analysis of the cost impacts on businesses. The distribution of costs across the identified activity categories is informed by the findings of the recent EU study relating to the impact of the third directive of the European Commission concerning AML/CTF. As such, the tables provide an indicative distribution only.

Table 14: Compliance Cost Distribution by Categories of Activity – One-off costs ($m, discounted)[80]

	Familiarisation with changes	Consultancy fees	Legal advice	Training	Staff recruitment*	IT updates	Project management	Total
Major banks	2.18	7.99	0.73	15.98	1.45	39.22	5.08	**72.63**
Other domestic banks	0.55	2.02	0.18	4.03	0.37	9.90	1.28	**18.33**
Foreign owned bank subsidiaries	0.06	0.22	0.02	0.43	0.04	1.07	0.14	**1.98**
Foreign owned bank branches	0.13	0.47	0.04	0.94	0.09	2.31	0.30	**4.28**
Credit Unions	0.07	0.26	0.02	0.52	0.05	1.28	0.17	**2.37**
Building society	0.03	0.10	0.01	0.19	0.02	0.47	0.06	**0.87**
Mutual ADIs	0.12	0.44	0.04	0.88	0.08	2.16	0.28	**3.99**
Other financial providers								
Custodies, Trustee and Stock Exchange Services	0.46	1.67	0.15	3.34	0.30	8.19	1.06	**15.17**
Other Deposit Taking Financiers in Australia	0.54	1.98	0.18	3.96	0.36	9.73	1.26	**18.01**
Total	**4.13**	**15.14**	**1.38**	**30.28**	**2.75**	**74.32**	**9.63**	**137.63**

80 Values may not total due to rounding.

Table 15: Compliance Cost Distribution by Categories of Activity – Ongoing costs ($m, discounted)[81]

	Additional staff	Internal reporting	IT costs	External reporting	Training	Audit	Total
Major banks	18.64	4.03	15.62	5.04	13.10	10.07	**66.49**
Other domestic banks	4.70	1.02	3.94	1.27	3.31	2.54	**16.78**
Foreign owned bank subsidiaries	0.40	0.09	0.33	0.11	0.28	0.22	**1.43**
Foreign owned bank branches	1.10	0.24	0.92	0.30	0.77	0.59	**3.92**
Credit Unions	0.73	0.16	0.62	0.20	0.52	0.40	**2.62**
Building society	0.27	0.06	0.23	0.07	0.19	0.15	**0.97**
Mutual ADIs	1.24	0.27	1.04	0.33	0.87	0.67	**4.42**
Other financial providers							
Custodies, Trustee and Stock Exchange Services	11.47	2.48	9.61	3.10	8.06	6.20	**40.90**
Other Deposit Taking Financiers in Australia	1.72	0.37	1.44	0.47	1.21	0.93	**6.15**
Total	**40.27**	**8.71**	**33.74**	**10.88**	**28.30**	**21.77**	**143.68**

81 Values may not total due to rounding.

Table 16: Distribution Analysis Cost by entity type and cost per Impacted Business ($m, discounted)[82]

	One off	Ongoing	Total	Total population	Impacted population*	One off cost per impacted business	Ongoing cost per impacted business
Major banks	$72.6	$66.5	$139.1	4	4	$18.16	$16.62
Other domestic banks	$18.3	$16.8	$35.1	9	9	$2.04	$1.86
Foreign owned bank subsidiaries	$2.0	$1.4	$3.4	8	8	$0.25	$0.18
Foreign owned bank branches	$4.3	$3.9	$8.2	41	41	$0.10	$0.10
Credit Unions	$ 2.4	$2.6	$5.0	85	85	$0.03	$0.03
Building society	$0.9	$1.0	$1.8	9	9	$0.10	$0.11
Mutual ADIs	$4.0	$4.4	$8.4	20	20	$0.20	$0.22
Other financial providers							
Custodies, Trustee and Stock Exchange Services	$15.2	$40.9	$56.1	334	334	$0.05	$0.12
Other Deposit Taking Financiers in Australia	$18.0	$6.1	$24.2	13,428	3,289	$0.01	$0.00
Total	**$137.6**	**$143.7**	**$281.3**	**13,938**	**3,799**	**$20.92**	**$19.25**

82 Values may not total due to rounding.

Table 17: Distribution Analysis Average Annual Cost as a % of 2013 Impacted Revenue and Profit

	Impacted businesses	2013 impacted revenue	2013 impacted profits	2013 revenue per impacted entity	2013 profits per impacted entity	Avg Annual Cost (10 yr)	Avg Annual Cost as % of Impact Revenue	Avg Annual Cost as % of Impact Profit
Major domestic banks	4	$76,129.0	$36,482.0	$19,032.3	$9,120.5	$13.9	0.018%	0.038%
Other domestic banks	9	$9,531.0	$1,734.0	$1,059.0	$192.7	$3.5	0.037%	0.203%
Foreign Subsidiary banks	8	$3,440.0	$1,300.0	$ 430.0	$162.5	$0.3	0.010%	0.026%
Foreign Branch banks	41	$4,323.0	$745.0	$105.4	$18.2	$0.8	0.019%	0.110%
Credit Unions	85	$1,485.0	$216.0	$17.5	$2.5	$0.5	0.034%	0.231%
Building Society	9	$591.0	$156.0	$65.7	$17.3	$0.2	0.031%	0.118%
Mutual ADIS	20	$2,603.0	$618.0	$130.2	$30.9	$0.8	0.032%	0.136%
Custodies, Trustee and Stock Exchange Services	334	$3,889.9	$4,088.9	$41.6	$12.2	$5.6	0.040%	0.137%
Other Deposit Taking Financiers in Australia	3289	$2,489.1	$317.2	$ 0.8	$0.1	$2.4	0.097%	0.762%
Totals	**3799**	**$104,481.0**	**$45,657.1**	**$20,882.3**	**$9,557.0**	**$28.1**	**0.318%**	**1.761%**

Annualised impact for offset calculations

Under Commonwealth guidelines, regulatory impact statements are required to apply the Business Cost Calculator in the preparation of regulatory impact assessments. The Business Cost Calculator has been developed by the Australian Government to assist with the calculation and reporting of compliance costs of regulatory proposals. It quantifies compliance costs on business using an activity-based costing methodology and serves as a reporting mechanism to the Office of Best Practice Regulations (OBPR). Submission of cost estimates must be reported in undiscounted to assist with comparability between proposals across time. The following table summarises the average annual cost of the proposal and the distributional impact of applicable businesses, reflecting the data submitted to OBPR separate to this report.

Table 18: Distribution Analysis - Average Annualised Cost per Impacted Business ($m, undiscounted)[83]

	One off (over 2 yr)	Ongoing (over 8 yr)	Total (10 yr)	Avg annual cost	Impacted businesses*	One off per business	Ongoing per business
Major banks	$75.1	$119.1	$194.2	$19.4	4	$18.8	$29.8
Other domestic banks	$19.0	$29.0	$48.0	$4.8	9	$2.1	$3.2
Foreign owned bank subsidiaries	$2.0	$2.7	$4.8	$0.5	8	$0.26	$0.3
Foreign owned bank branches	$4.4	$7.5	$11.9	$1.2	41	$0.11	$0.2
Credit Unions	$2.4	$4.5	$7.0	$0.7	85	$0.03	$0.1
Building society	$0.9	$1.7	$2.6	$0.3	9	$0.10	$0.2
Mutual ADIs	$4.1	$7.6	$11.8	$1.2	20	$0.21	$0.4
Other financial providers							
Custodies, Trustee and Stock Exchange Services	$15.7	$70.7	$86.4	$8.6	334	$0.05	$0.2
Other Deposit Taking Financiers in Australia	$18.6	$11.2	$29.9	$3.0	3,289	$0.01	$0.01
Total	**$142.3**	**$254.1**	**$396.4**	**$39.6**	**3,799**	**$21.67**	**$34.41**

83 Values may not total due to rounding.

Appendix E: Comparison of options

Table 19 illustrates the overarching findings of the RIS. Largely, Option C regarding the implementation of the proposed amendments to the AML/CTF Rules would provide the greatest level of benefits. This option however, would also impose additional costs when compared to other options. Given there is currently no feasible method to quantify expected benefits, as agreed by stakeholders in consultations, the decision is one of judgement.

For Option C to be the preferred option for government to follow, the net present value of the benefits received by all stakeholders would need to exceed $313.1 million (in real terms) over the next ten years to balance the cost of its implementation. In addition to the benefits that will flow from the introduction of Option C, the costs of implementing the regulatory change will also be offset by means set out in section 8, resulting in a clear net benefit to business and society.

An important narrative throughout this analysis is that there are currently a number of industry stakeholders that are currently undertaking measures to be in compliance with broader global AML/CTF trends and best practice (i.e. US legislation, global parent company policies and procedures, financial institutions with a primary global business strategy, etc.).

Table 19: Comparison of benefits, costs of options and conclusions

	Option A: Status quo	Option B: Code of best practice	Option C: Regulatory change
Description	No amendment to current legislation	AUSTRAC best practice guidelines on how to respond to AML/CTF risks provided to all entities.	Clarify and codify the current expectations of how regulated entities undertake CDD to manage AML/CTF risks
Benefits	No additional benefit under the status quo.	The level of benefits realised depends on the extent to which businesses adopt the guidelines. • Businesses have clear instructions that enable them to make better decisions related to AML/CTF risks. • Government's benefits are that less enforcements or investigation are required if business adopt good practice. • Society benefits from reduced crimes associated with money laundering if businesses adopt good practice.	Australia's AML/CTF regime meets FATF standards. • Government is in a confident position that Australia is in line with the international standard • Government would see increased tax compliance and revenue recovery • Society benefits from reduction in crimes associated with money laundering • Stakeholders preferred this option as a means of ensuring competitive neutrality • Business transactions and trade with jurisdictions like the EU are possibly made easier; fraud detection and prevention are more frequent

	Option A: Status quo	Option B: Code of best practice	Option C: Regulatory change
Costs	Possibility of being 'named and shamed' by the FATF or to be removed from the whitelist which implies: • Businesses face impediments in international trade and incur additional transaction costs • Government may face scrutiny from its trading partners • Consumers may have limited choices of international financial institutions	The level of costs depends partially on the extent to which businesses adopt the guidelines. • Business incurs costs in following the practice suggested in the guidelines if it involves updating current system and practice. • Government costs are minimal in publishing guidelines but there is a risk that most entities choose not follow the guidelines. • Consumers bear costs if businesses pass down the additional cost incurred by businesses from following the guidelines The costs in relation to the status quo will still apply as Australia will remain non-compliant with the FATF standard. Compliance costs, should major Australian and foreign financial institutions (both of whom have international focused businesses), choose to adopt best practice in Australia could range, over a 10 year period, from an upper bound of $223.3 million (lower than the cost of Option C) to a lower bound of $74.4 million, with the median cost being $148.9 million (in net present value terms).	• Business compliance costs are $281.3 million (in one year, $137.6m one-off and $143.7 m ongoing costs) over a ten year period. • Government additional costs of handling more suspicious matter reports are offset by more effective prosecutions made on money laundering. • Consumers bear the compliance costs passed down by businesses through higher banking fees.
Conclusion	If Australia maintains status quo, it may create hurdles for businesses, government and society in international trade and transactions, as well as risk Australia's financial rating and credibility as a G20 country and regional leader. Serious and organised crime may gravitate to Australia to take advantage of relatively lax regulation, increasing the level and costs of crime on society.	This option will achieve partial benefits of Option C with much lower costs. It however, has a greater risk of entities disregarding the guidelines and therefore fails to achieve policy objectives, the outcomes will then be the same as the status quo. Money launderers would gravitate towards the entities that do not follow the guidelines, therefore the costs incurred may not fully realise the benefits.	This option yields the highest level of benefits but also incurs a greater cost. While benefits cannot be quantified, they must aim to prevent or recover at least $281.3 million over a ten year period.

Appendix F: Sources

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