



The draft Anti-Money Laundering and Counter-Terrorist Financing Bill 2005

Analysis and impact assessment



The draft Anti-Money Laundering and Counter-Terrorist Financing Bill 2005

Executive summary

About the draft Bill

The draft Bill represents the first step of the Government's Anti-Money Laundering and Counter-Terrorist Financing (AML/CTF) regime. A sample set of Rules and guidelines accompany the draft Bill and more will be released in 2006.

The draft Bill covers anyone providing one of 64 designated financial or gambling services.

The draft Bill requires Reporting Entities to:

- Develop a risk based program to knowing your customer (KYC)
- Expand customer due diligence when trigger events occur
- Put in place systems to monitor customers and their transactions
- Report suspicious matters and transactions within specified, and short timeframes
- Implement training for affected staff
- Implement monitoring processes for the AML/CTF program

There is a four month consultation period on the draft Bill, ending 13 April 2006. The draft Bill does not specify a date for commencement or implementation.

How will this affect your business?

This legislation will affect your relationship with your customers. Some of the key impacts are considered below.

Competitiveness abroad

Overseas operations of Australian organisations are captured by the draft Bill. Where these requirements exceed local regulations, implementation will create a competitive disadvantage for Australian business overseas.

Remediation of existing data

The draft Bill does not require remediation of existing customer data. However, the Rules outline a range of re-verification triggers that will result in progressive data remediation.

Correspondent banks

Due diligence requirements in respect of correspondent banks are onerous.

Accountability

The draft Bill does not require a Money Laundering Reporting Officer (MLRO). However, overseas we have seen improved effectiveness and compliance when organisations appointed an MLRO at a senior level.

Risk assessment of customers

You will need to assign a risk classification to each of your customers. This could be an onerous activity depending upon how this requirement is interpreted.

Material mitigation of AML/CTF risk

Materiality in this context has yet to be defined and measurement may prove difficult as few organisations capture data that will allow this to be assessed.

Where are the costs?

The risk based approach and absence of retrospectivity will help contain the cost of implementation. However, these costs may reappear as operating expenditure during the early years of implementation. The quantum of these costs will be influenced by the interpretation of risk based and the definition of trigger events.

Implementation will require spending on data, processes, technology and people. Compliance will have an impact upon all customer channels and will be complex for large organisations. Where transaction volumes are high, technology will be a key component of the solution.

Our experience overseas has shown that organisations which have been pro-active have experienced better cost outcomes.

Immediate next steps

You now have four months to influence the final content of the legislation.

The consultation period provides an opportunity for industry and the regulator to work together towards effective and commercial outcomes. Our experience overseas has been that the regulation has been most easily implemented under a joint and co-operative approach.

In respect of the draft Bill the particular areas of focus include:

- Understanding expectations of a risk based approach
- Definition of trigger events
- Implications for overseas operations
- Requirements for correspondent banks

Engagement and sponsorship of the AML/CTF program should be taken up at a senior executive level. This will help ensure that the consultation period is effectively used and that the AML/CTF program is effectively implemented and workable.



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Glossary

FATF - Financial Action Taskforce on Money Laundering

AML – Anti-Money Laundering

CTF – Counter-Terrorist Financing

KYC - Know Your Customer

PEP - Politically Exposed Person

What is the draft Bill?

The draft of the Anti-Money Laundering (AML) and Counter-Terrorist Financing (CTF) Bill 2005 (the draft Bill), represents the first tranche of the Government's reform of Australia's AML/CTF regime. Some draft Rules and guidelines have been released by the Australian Transaction Reports and Analysis Centre (AUSTRAC).

Who does the draft Bill cover?

Any business or person that supplies any of the 64 designated services described in the draft Bill.

The designated services are listed in Table 1 (financial services) and Table 2 (gambling services), of Section 6 of the draft Bill. In addition to the more traditional kinds of services supplied by banks and other financial institutions (such as the opening and operating of bank accounts, providing loans and transferring funds), the draft Bill also covers certain activities normally carried out by securities dealers, financial planners, insurers and accountants.

Examples of Designated Services

Table 1



- Opening and allowing transactions on a bank account
- Issuing debit cards
- Issuing or cashing traveller's cheques
- Transfers of money
- Buying or selling shares on behalf of a person
- Issuing or selling shares to a person in the course of carrying out a business
- Providing personal advice as a licensed financial adviser in respect of buying or selling shares and other securities, life insurance policies or superannuation
- Issuing life insurance policies
- Accepting superannuation contributions
- Providing a custodial service
- Exchanging foreign currency in the course of carrying out a business
- Buying or selling bullion in the course of carrying out a business

Table 2



- Gambling services

In total, 63 financial services are listed in Table 1, although the Government is inviting public comment on the scope of the services covered.

If you provide one of the designated services described in the draft Bill you will be a Reporting Entity under the proposed legislation.

Does it apply outside Australia?

The draft Bill will apply not only where a designated service is provided in Australia, it will also impact the overseas operations of Australian resident companies.

If local competitors are able to make lesser demands of customers in overseas jurisdictions, the draft Bill may adversely impact the overseas operations of Australian companies.

What is the timeline for the draft Bill, Rules and guidelines?

There is a four month consultation period on the draft Bill, ending on 13 April 2006. Comments and submissions on the draft Bill and the draft AML/CTF Rules must be received by that date.

AUSTRAC has released some of the draft Rules which will support the draft Bill and expects to release further draft Rules and guidelines in 2006.

About the draft Bill



Some of the businesses that may provide services covered by the draft Bill

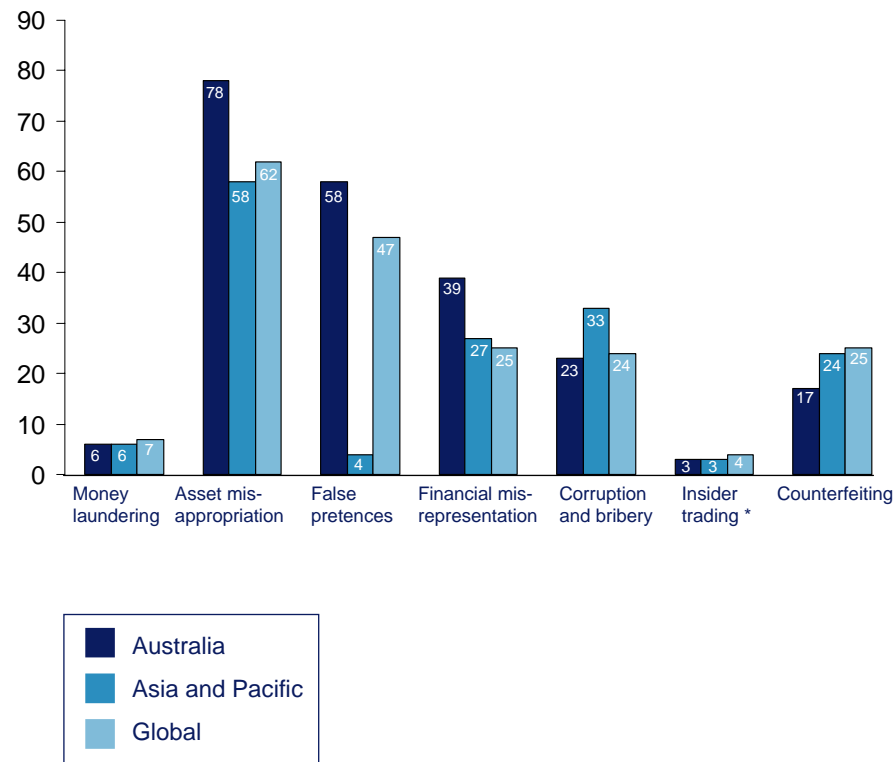
- Banks, building societies, credit unions and other financial institutions
- Fund managers
- Life insurers
- Financial planners
- Accountants
- Legal practitioners
- Securities and derivatives dealers
- Superannuation fund trustees
- Licensed financial advisers
- Remittance service providers
- Bureaux de change
- Gambling service providers
- Bullion dealers

Financial crime statistics

- Financial institutions have only recently started to incorporate AML/CFT into a broader financial crime model. The chart provides recent statistics on financial crime, many of which are predicate events to money laundering. The percentage for money laundering is relatively small but can be expected to increase as enhanced AML prevention and detection systems are implemented

Recent statistics on financial crime

Types of crime to which organisations have been subject



* Only listed companies were asked for insider trading - 10 Oct 05

Source: PwC Global Economic Crime Survey 2005

Key points

- The draft Bill focuses on services, not businesses. This means that many organisations not previously covered will be drawn into this broader regime
- The international operations of Australian companies will need to comply. This could competitively affect Australian companies overseas
- There is a four month consultation period ending 13 April 2006
- Rules and guidelines will be further developed during this period, with industry consultation
- Timetables for implementation will be considered during the consultation period

What is required?



The draft Bill requires implementation and maintenance of an AML/CTF program.

Minimum AML/CTF program requirements

The draft Bill, Rules and guidelines discuss requirements for an AML/CTF program including:

- Systems and controls to effectively identify and materially mitigate AML/CTF risks
- Two-tiered customer due diligence
- AML/CTF risk awareness and reporting training to all staff
- Employee and third party due diligence programs
- A compliance program
- A system for regular independent review of the program

Materially mitigate

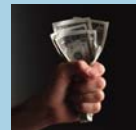
Reporting Entities will need to demonstrate that their AML/CTF program materially mitigates the risk of facilitating money laundering or terrorist financing.

Materiality has not been defined. This represents an important opportunity for industry to work with AUSTRAC to develop a workable outcome.



AML/CTF program approval

The Board will need to be involved in approving and monitoring the AML/CTF program.



A risk based approach

A risk based approach means that an organisation must tailor its AML/CTF program according to their specific circumstances. A risk based program is a system designed to identify exposures including:

- Higher risk customers such as politically exposed persons
- Services that pose a higher risk, such as international funds transfers
- Higher risk jurisdictions such as countries classified by FATF as non-compliant

Organisations will need to assign a risk classification for each of their customers, and must be able to demonstrate how the classifications were determined.

Business impacts

The impact of the draft Bill will be broad and you will need to consider the following:

- What will happen to transaction times and customer service?
- How will customers respond/react?
- Who will be responsible for employee due diligence?
- How will frontline staff know when to move beyond initial KYC?
- How will suspicions be communicated internally, within the required timeframes?
- Who is responsible for investigating suspect transactions and escalating them to AUSTRAC?
- How will you monitor transactions on a timely basis?
- How will you align your reporting structure with your current governance framework?
- How frequently and extensively should an independent review be conducted? Who will conduct them?
- How will you ensure your outsourced providers' and agents' systems meet minimum requirements?

- Are your current record management procedures sufficient to cope with the new requirements?
- Who will have ultimate responsibility for the AML/CTF program across your business?

Lessons we have learnt overseas

- Under the draft Bill there is no requirement to validate all current customers (customer remediation). However this may arise progressively in response to trigger events. Some of our overseas clients experienced significant costs in remediation as they had failed to implement a sufficient system in the first instance
- Some clients overseas are now integrating other fraud and financial crime activities with AML/CTF. It may be more efficient to do this from outset
- While the draft Bill aims for technological neutrality, it will be difficult for many institutions, both retail and wholesale, to comply with its requirements without using technology.
- Our clients overseas found that implementing technology is not the solution in itself. Technology is only one component of an overall solution

What is required?



Timelines for implementation

The draft Bill does not specify the date of commencement nor an implementation timeframe. Many overseas Reporting Entities have required a two/three year implementation timetable. The ongoing discussions between business and the regulator will provide an opportunity to develop a workable solution



UK cost experience

Financial institutions do not generally collect cost statistics for AML programs to permit detailed analysis. However, the ranking of costs in order of highest spend has typically been:

	High transaction volume	Low transaction volume
Data	1	1
Processes	2	2
Technology	3	4
People	4	3

Key elements in AML/CTF programs



Key points

- New customers will need to be risk assessed on commencement
- All customers will need to be risk assessed by a date to be specified. This requirement has the potential to be onerous
- Further customer assessments will be required if triggers are activated
- Triggers will arrive from any and all customer touch points. Implementing an AML/CTF solution will affect many business processes and all channels
- The draft Bill moves us from a 'tell me' to a 'show me' regime, and positive returns may accrue from doing it right the first time

Customer Identification (KYC)



What is KYC?

Knowing your customer (KYC) involves identifying your customer. It is a cornerstone of the legislation and a key element of the AML/CTF program. KYC acknowledges the need to understand the risks posed by customers and requires Reporting Entities to:

- Obtain additional information on customers where risks indicate greater due diligence is required
- Verify new customers and, where relevant, re-verify existing customers
- Further understand sources of funds, the purpose of transactions, and ultimate beneficiaries.

Customer identification covers:

- Individuals/natural persons
- Companies
- Non-natural persons other than companies
- Natural persons operating as a corporation sole

Pre-commencement

Where identification is not completed before the service is provided (Pre-commencement), it must be undertaken within five business days. If this is not done the Reporting Entity must stop providing designated services to that customer.

When do I have to undertake KYC?

Reporting Entities are required (in most cases) to identify new customers before providing them with a designated service (Pre-commencement).

However, differing circumstances apply where:

- Low risk designated services (to be specified in the Rules)
- When identifying a customer before providing a service would 'disrupt the normal course of business', and;
 - services not provided face to face
 - the service consists of the acquisition/disposal of a security/derivative on behalf of a customer; or
 - the service consists of issuing/undertaking liability as insurer under a life or sinking fund policy.

Further customer risk assessment (retrospective remediation)

The bill does not require a Reporting Entity to undertake a specific customer remediation process. However, in practice entities may find themselves undertaking this process in the guise of re-verification arising from trigger events.

Examples of issues and impacts

Identification of customers and agents

- Minimum, additional, and where relevant, enhanced data will need to be gathered. Data gathering can be outsourced to third parties. Such circumstances require an evaluation of the outsourced providers KYC processes

Verification and re-verification

- Pre-commencement Rules and trigger events will determine the extent and cost of this activity. The consultation period will determine the Rules that govern trigger events

Ongoing customer monitoring

- All customers will have to be monitored on an ongoing basis. Information in respect of each customer needs to be updated at appropriate intervals as determined by the Reporting Entity

Privacy

- The relationship between disclosure and privacy will be addressed during the consultation period

What about correspondent banking?

A number of requirements are stipulated for correspondent banking relationships such as:

- A prohibition on entering into a relationship with shell banks
- Due diligence before commencing a correspondent relationship
- Regular monitoring reviews of correspondent banking relationships

There are seven areas to be considered when assessing a correspondent banking relationship including:

- The reputation of the respondent financial institution
- The adequacy of the respondent institution's AML/CTF controls and internal compliance practices (eg you cannot enter a relationship with an institution that has a relationship with shell banks)

Details of correspondent relationships must be set out in a signed agreement.

Key Point

Financial institutions may experience practical difficulties meeting these requirements.



A number of reporting requirements are changing with this draft Bill

Future requirements	Implications
Suspect matters to be reported include pre-transaction events	Requirement expanded to include pre-transaction events. That is, where a person requests the entity to provide a service or enquires whether the entity would be willing or prepared to supply a service
The \$10,000 threshold remains the same for now, but has been broadened to include e-currency	Dealers in precious metal and bullion will need to report internet-based electronic transactions
Threshold transactions to be reported within 10 days of transaction	The reduced and short reporting timeframes mean that Reporting Entities must implement improved systems to rapidly deal with the identification and reporting of suspect matters
Suspect matters must be reported within 3 business days of forming the suspicion.	
If the suspect matter relates to the financing of terrorism, the entity must report within 24 hours.	
Certain international funds transfer instructions must be reported within 10 days	

A key question to be answered by Reporting Entities will be, "How will you capture, investigate, escalate and report suspect matters identified by front line staff?". An ongoing challenge will be to implement enterprise wide systems and processes that will capture triggers from every channel of your business.



Key points

- You will need to be able to specify exactly when a suspicion is formed to ensure that time limits are met
- You may wish to develop a system where reports are processed through a single channel to AUSTRAC
- The draft Rules provide guidance in the form of 24 factors that are to be taken into account when forming a suspicion. This is designed to prevent entities making spurious or unfounded reports, or reporting every matter (defensive reporting)
- Improved systems and processes will be required to deal rapidly with the reporting of suspect matters

Tipping off and record keeping



Tipping off

The offence of tipping off is found at Section 95 of the draft Bill. Reporting Entities must be careful not to disclose to any person that it has either formed a suspicion, made a report to AUSTRAC, or both.

There are certain exemptions that apply for a Reporting Entity that is a legal practitioner.

Lessons we have learnt overseas

In overseas jurisdictions, organisations have worked with regulators to develop hypothetical scenarios. These scenarios are designed to assist in the decision making process to ensure that interaction with customers and others does not amount to tipping off

Record-keeping requirements

The draft Bill requires the Reporting Entity to retain records, including:

- Designated services
- Customer-generated transaction documents
- Identification procedures (including those carried out on behalf of the Reporting Entity)
- Due diligence assessments of correspondent banking relationships

The period for which these documents must be retained has not yet been defined and the regulator is actively seeking input to this matter.

Identification records and details completed by agents must be forwarded to the Reporting Entity. These records must also be retained by the Reporting Entity for a period not yet defined.

What are the penalties?

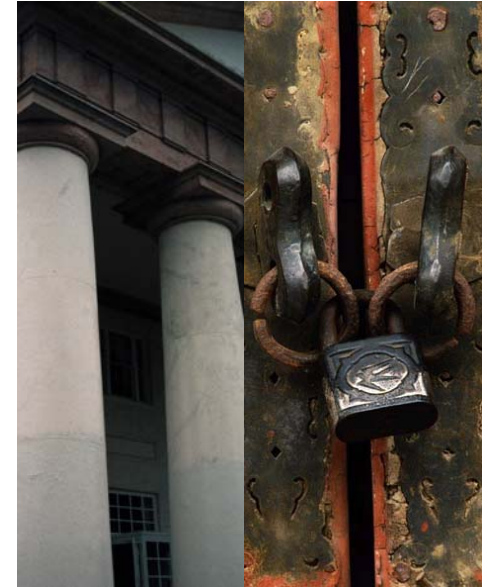
Non-compliance can result in criminal and civil sanctions. Unlike other jurisdictions there is no requirement to designate a Money Laundering Reporting Officer (MLRO).

Training and awareness

Under the draft guidelines training should be provided to staff to deliver:

- An understanding of the specific responsibilities/functions of the staff member in managing the risks of the Reporting Entity
- An understanding the Entity's reporting obligations
- An understanding of the processes and procedures of the Reporting Entity's AML/CTF program

The Rules do not prescribe the frequency of training but require updates to take account of changes to the legislation.



Key points

- No MLRO is required by the draft Bill. Overseas we saw improved effectiveness and compliance when organisations increased the profile and seniority of the MLRO
- Reporting Entities will need to retain identification records created by third parties
- Training will affect all employees



AUSTRAC

AUSTRAC is the regulator responsible for AML. Distinct from some other jurisdictions, AUSTRAC is also Australia's Financial Intelligence Centre.

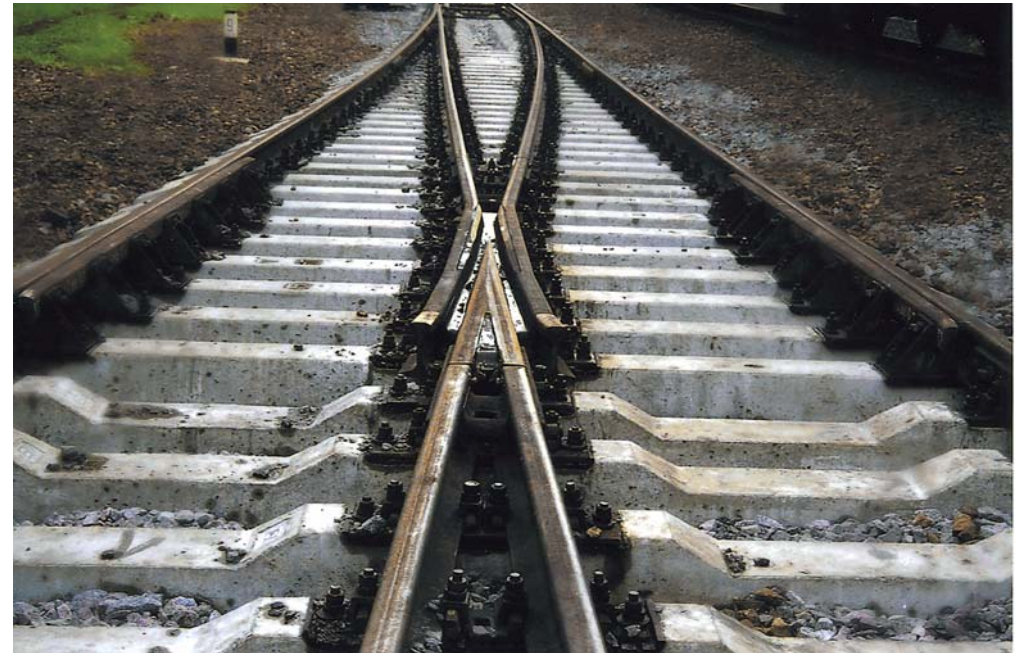
AUSTRAC's powers have been enhanced under the draft Bill and include:

- The right of audit and inspection
- The right to enter a Reporting Entity's business premises
- Co-ordination with the federal police, ATO and other government agencies
- Definition of prescribed countries for which additional reporting will be required and/or to prohibit transactions with that country

It is understood that AUSTRAC is pro-actively assessing its structure and resourcing to effectively meet these expanded responsibilities.

Reporting trends – lessons from the UK

- Reported transactions increased 20 fold over 12 years due to changing requirements, and improved identification and analysis techniques
- Where Rules were developed with input from all affected business sectors, implementation and compliance has been quicker, and more effective
- It took both the regulator and industry a few years to implement the new requirements
- Initially there was limited feedback to Reporting Entities on the use of the reports that had been submitted. In recent times the regulator's ability to process, analyse and interpret data has advanced and they are now providing feedback on analysis, trend identification, and prosecution. This has enhanced the sense of value in reporting suspicions and has resulted in a more co-operative interaction.



Stay tuned

The consultation period provides the opportunity for government, industry and the regulator to continue working together to develop a workable framework of Rules and guidelines. Examples of areas where this may be productive include:

- Clarification of the expectation of individual customer risk ratings
- Materiality definitions and acceptable risk management practices
- Definition of trigger events
- Timelines for implementation
- Implementation of correspondent banking requirements
- Expectations and implications of overseas subsidiaries
- Interaction with privacy requirements
- Better understanding of tipping off issues

Where to from here?



Impact assessment

At this point in the process an impact assessment should be conducted, considering a range of issues including:



This impact assessment will provide you with an understanding of:

- The 'gaps' that your organisation must address to meet requirements
- Any uncertainties that require clarification
- Estimated project costs and timelines

Ongoing program of work

While the Rules will continue to be refined and modified over the consultation period, the underlying principals are unlikely to change significantly. The following diagram illustrates indicative tasks and ordering for an AML/CTF program.

Task	Exposure Period (13 Dec 05 to 13 Apr 06)	Passage of Legislation (14 Apr 06 to date of Royal Assent)	Transition Period (tbc) and Full Enforcement Compliance
Consultation with industry	=====		=====
Impact assessment and gap analysis	=====		
Interaction with AUSTRAC and government	=====		
Training awareness and readiness			
Board	=====		
Management	=====		
Front line staff			=====
Reporting staff			=====
Establish Governance structure		=====	
Policy and procedure design		=====	
Transaction monitoring systems		=====	
Data quality remediation			=====
Reporting processes		=====	
Investigation process design and implementation		=====	
Compliance program implementation			=====

Key questions you need to ask

- Who will be responsible for your AML/CTF program? How senior is the role?
- Who will be responsible for AUSTRAC and government liaison?
- What are the key impacts and capability 'gaps' such as customers, stakeholders, operations, systems, data, personnel, costs?
- How will you resource the program and what will be the impact on the business as usual.

Key point

A project sponsor should be identified and an impact assessment initiated within the next four weeks



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