



2 June 2011

Ms Julie Dennett
Committee Secretary
Senate Legal and Constitutional Committees
PO Box 6100
Parliament House
Canberra ACT 2600

By email: legcon.sen@aph.gov.au

By electronic submission

Dear Ms Dennett

INQUIRY INTO THE:
AUSTRALIAN TRANSACTION REPORTS AND ANALYSIS CENTRE SUPERVISORY COST
RECOVERY LEVY BILL 2011
AUSTRALIAN TRANSACTION REPORTS AND ANALYSIS CENTRE SUPERVISORY COST
RECOVERY LEVY (COLLECTION) BILL 2011
AUSTRALIAN TRANSACTIONS REPORTS AND ANALYSIS CENTRE SUPERVISORY COST
RECOVERY LEVY (CONSEQUENTIAL AMENDMENTS) BILL 2011

The Australian Financial Markets Association (AFMA) appreciates the opportunity to make a submission to the Senate Standing Committee on Legal and Constitutional Affairs (the Committee) inquiry into the Australian Transaction Reports and Analysis Centre Supervisory Cost Recovery Levy Bill 2011; Australian Transaction Reports and Analysis Centre Supervisory Cost Recovery Levy (Collection) Bill 2011; and the Australian Transactions Reports and Analysis Centre Supervisory Cost Recovery Levy (Consequential Amendments) Bill 2011.

The Australian Financial Markets Association (AFMA) is the leading industry association promoting efficiency, integrity and professionalism in Australia's financial markets and provides leadership in advancing the interests of all market participants. These markets are an integral feature of the economy and perform the vital function of facilitating the efficient use of capital and management of risk. Market participants perform a range of important roles within these markets, including financial intermediation and market making.

AFMA represents over 130 members, including Australian and international banks, leading brokers, securities companies, fund managers, traders in electricity and other specialised markets and industry service providers.

Many AFMA members are reporting entities for the purposes of the *Anti Money Laundering/Counter Terrorism Financing Act 2006* (the AML/CTF Act) and provide designated services which are regulated by the Act.

AFMA members accept that financial institutions, as facilitators of money flows, have a vital role to play in the prevention and detection of crime and terrorism financing. They have shouldered this responsibility at an estimated compliance cost of over \$1 billion. AFMA members remain strongly committed to the objectives of the AML/CTF Act.

AFMA members also accept that cost recovery is a Government policy and are willing to pay their fair share of the costs of AUSTRAC regulation, provided that the charges are connected to the level of money laundering risk posed and the consequential supervision costs.

On behalf of its members, AFMA wrote to the Hon. Brendan O'Connor, MP, Minister for Home Affairs, in May 2010 following the announcement in the May 2010 Budget that the Government intended to recover some of the costs of Australian Transaction Reports and Analysis Centre's (AUSTRAC) regulatory activities. A copy of that letter was provided to AUSTRAC CEO John Schmidt. In the letter AFMA noted it is clear that the objects and purpose of the AML/CTF Act and AUSTRAC's regulatory activities are to provide a public and social good to the Australian people by combating money laundering and the financing of terrorism. Accordingly as the benefit of Australia's AML/CTF regime accrues to all Australians, the costs of AUSTRAC's regulatory activities should not be borne solely by reporting entities.

The Replacement Explanatory Memorandum to the AML/CTF Bill, presented to the House by the then Minister for Justice and Customs, states on page 20 that *"..as with other law enforcement measures, it is certainly not necessary that AML/CTF regulation be self-funding."* In AFMA's view the cost recovery proposal as it stands is contrary to the justification presented to Parliament for the introduction of the legislation – that the AML/CTF Bill was necessary for Australia to comply with its international obligations, but that it was not necessary for it to be self-funding.

1. Misalignment of Cost Recovery and Regulatory Benefit

The compliance cost associated with the introduction of the AML/CTF Act to Australia stands at about A\$1.02 billion for the banking industry as a whole at 2007 prices¹. It needs to be borne in mind that AUSTRAC reporting entities, particularly large entities, are part of the allied industry collaborative apparatus combating money laundering and terrorism financing activities. Reporting entities are providing intelligence gathering services to the Government for free, which is of benefit to the Australian community as

¹ Milind Sathye, (2008) "Estimating the cost of compliance of AMLCTF for financial institutions in Australia", *Journal of Financial Crime*, Vol. 15 Iss: 4, pp.347 – 363.

a whole. The value of these services provided by the financial services industry to the Australian community is not acknowledged in the Cost Recovery Impact Statement (CRIS).

AUSTRAC supervision provides no commensurate benefit to reporting entities individually, in contrast to financial services regulation which provides systemic, prudential and market integrity value to market participants.

In addition to the assistance that the financial services industry is providing in combating money laundering and terrorist financing without compensation, the data provided to AUSTRAC is a key component in enhancing the integrity of the tax collection system in Australia. The Australian Taxation Office (ATO) undertakes data matching exercises with AUSTRAC information, which assists it to detect instances of undeclared income, high-risk non-lodgers, offshore accounts in tax havens and serious taxation non-compliance. Data matching was used by the ATO to support inter-agency projects such as the offshore voluntary disclosure initiative, which encourages people to make disclosures of previously undisclosed income from offshore activities. In 2009-10 AUSTRAC information contributed to 1,841 ATO cases, resulting in \$272.52 million in additional tax assessments². In the same year AUSTRAC data, once matched with tax file numbers, directly assisted the ATO's offshore voluntary disclosure initiative to recover \$20.1 million in taxpayer liabilities through voluntary disclosures. A similar ATO initiative matched tax file numbers with AUSTRAC data to detect and recover 'omitted' foreign source income, leading to an additional \$10.1 million in recovered revenue for Government tax receipts³. AUSTRAC information contributed to 1,238 Centrelink cases and \$7.2 million of annualised savings for the agency in 2009-10⁴.

Table: Economic Value of AML/CTF Regime

<i>Benefits</i>	<i>Value</i>	<i>Costs</i>	<i>Value</i>
Combating money laundering and terrorist financing ⁵	\$5.7 billion	Industry Implementation	\$1.02 billion
<i>Annual</i>		<i>Annual</i>	
ATO per annum	\$30 m \$272 m	Industry compliance ⁶	\$256 m
Australian Government agencies ⁷	\$11 m		
Australian social justice agencies	\$7 m		
AUSTRAC levy	\$29 m	AUSTRAC levy	\$29 m
Annual gain to Cth Revenue	\$349 m	Industry cost burden	\$285 m

² AUSTRAC annual report 2009-10, p48

³ AUSTRAC annual report 2009-10, p60

⁴ AUSTRAC annual report 2009-10, p48

⁵ Mean estimate of the value of money laundering in Australia in 2004 was \$4.8 b according to AUSTRAC, J Walker, RMIT 2007, 'The extent of money laundering in and through Australia in 2004, Australian Institute of Criminology'. \$4.8 b inflation adjusted from 2004 to 2010 based on RBA calculator is \$5.7 b

⁶ Annual industry compliance cost - Australian Institute of Criminology 2008 estimate is 0.02% of GDP. Aust 2009-10 GDP was \$1,283.8 b x 0.02% = \$256.76 m

⁷ Annualised proceeds of crimes collection by the Commonwealth: Transnational crime brief no. 1 Canberra: Australian Institute of Criminology, January 2008

Overall, while the financial services industry has borne the burden of a huge implementation cost for the AML/CTF regime and is providing data which directly contributes to substantial additional tax revenue flows to the Government, no recognition is given to this in the cost/benefit analysis supporting the legislation for implementing the levy.

AFMA has been an active participant at all stages of the consultation process conducted by AUSTRAC and the Government in relation to the development of the cost recovery model. AFMA's submissions to the two consultation papers issued by AUSTRAC are attached to this submission (submissions dated 10 December 2010 and 4 April 2011) for the Committee's information. In addition to the written submissions, AFMA has had discussions with, and sought clarification from, AUSTRAC about a number of issues in the course of the development of the cost recovery model.

In our submissions, AFMA has clearly acknowledged that the Government has made AUSTRAC cost recovery a budget measure. AFMA members accept the Government's decision that industry should bear a share of the costs of AUSTRAC's regulatory activities. However, these costs should be allocated equitably between reporting entities, consolidated revenue, and the users of the financial intelligence produced by AUSTRAC with recognition of the actual economic value of the data being provided and its source. The financial services industry in Australia already contributes to this process by providing the reports AUSTRAC needs to form financial intelligence and fulfil its statutory obligations.

AFMA has examined the bills currently before Parliament in relation to AUSTRAC cost recovery and the CRIS for the period 1 July 2011 to 30 June 2012 published by AUSTRAC. We make the following observations to the Committee.

2. Limited/no correlation between the money laundering risk posed by particular business activities and the cost recovery burden imposed

In the Cost Recovery Impact Statement at page 8, AUSTRAC states that:

...larger entities have relatively more customers and typically provide products that are more complex over multiple distribution channels and multiple jurisdictions. In addition, large reporting entities are relatively more important to the overall integrity of Australia's financial system. Accordingly, AUSTRAC applies relatively more supervisory resources toward regulating larger entities compared to small entities.

AFMA members are not aware of any evidence or empirical analysis that demonstrates that a complex financial services business is more prone to the risk of money laundering or terrorism financing activities occurring through the designated services provided by the financial intermediary. AUSTRAC has not provided any evidence in the Cost Recovery Impact Statement or elsewhere that these types of businesses are inherently more risky and therefore, that a significantly higher level of supervision by AUSTRAC is required.

It is not correct to assume that a financial intermediary which has more customers is exposed to a higher level of money laundering risk. Indeed, the clients that AFMA members typically deal with are institutional and wholesale clients who, in turn, are likely to be reporting entities themselves and regulated under the AML/CTF Act, or under an AML regime in a comparable jurisdiction. These types of clients are, we suggest, at much lower risk of being engaged in money laundering and terrorism financing activities.

Many AFMA members are part of multinational organisations that operate on a global basis and accordingly, are regulated under AML regimes in other jurisdictions where they operate. So the mere fact that a large entity may operate over multiple jurisdictions is not something for which AUSTRAC has supervisory responsibility, and is not a basis to justify a level of cost recovery that is out of proportion to the money laundering risk posed by the financial intermediary's legitimate activities. It should also be noted that these activities are regulated through banking, securities and derivatives, and financial services laws, further reducing the likelihood that transactions conducted by the financial intermediary either on its own behalf or on behalf of clients are for money laundering purposes.

AFMA members who are reporting entities under the AML/CTF Act typically have extensive and detailed compliance programs and resources in place to ensure they meet their obligations under the AML/CTF Act. The allocation of a higher level of AUSTRAC supervision resources during the implementation of the new supervision and compliance regime does not reflect AML/CTF risk in complex financial services businesses but rather the training and development that has to be developed in AUSTRAC because of its relative lack of expertise around the way in which these businesses operate. The area of educating the regulator and building its capacity is one to which large entities have devoted significant resources and is one for which they are being penalised rather than compensated under the levy arrangements. Complexity of an organisation is not a basis to justify a level of cost recovery that is out of proportion to the potential AML/CTF risk flowing through a financial intermediary's legitimate and highly regulated activities.

In its submissions on the development of the cost recovery model, AFMA suggested that an alternative model for cost recovery should be based on a rigorous analysis of the money laundering and terrorism financing risk posed by particular types of business activity and the supervision costs associated with monitoring those activities and ensuring compliance with the AML/CTF Act. This alternative approach is not addressed in the CRIS.

3. The cost recovery burden is not equitably shared

AFMA members will pay the large entity component plus the volume and value reporting component of the cost recovery model. They are disproportionately represented in the dollar recovery figures in the CRIS – representing approximately \$20 million out of the projected \$29.6 million to be collected by the levy. Banks both domestic and foreign will be contributing around \$11.5 million alone to the levy.

It is unfortunate that large entities are expected to contribute a disproportionate amount simply because they are large organisations. The CRIS contains statements (see page 6) that refer to large entities that have the capacity to pay. A capacity to pay is not a valid policy justification for cost recovery.

The CRIS refers to a portion of the funds recovered being used to fund programs to enhance compliance by small entities with the AML/CTF Act. Large entities are effectively cross-subsidising small entities who consume proportionately more than their share of AUSTRAC supervision resources but are not expected to pay anything close to the cost of those supervision resources, while large entities are expected to over-pay.

4. Due Process Needed for Determination of Levy

Government pursuit of cost recovery as policy across regulatory agencies will drive behaviours that may result in fundamental changes to the way business is conducted in the Australian financial markets. New costs and charges that are an impost on business will affect how those businesses view the competitive environment and the relative attractiveness of doing business in Australia compared to other jurisdictions.

It is important to bear in mind too that a levy collected by an agency operating under the *Financial Management and Accountability Act 1997*, which includes AUSTRAC, flows directly into the Government's consolidated revenue account. Agency funding is dependent on a budget appropriation which is at the Government's discretion. While agency funding may be correlated to the levy amount raised it is a decision for the Government to decide upon the actual funding for an agency as part of the annual budget process. Australian Securities and Investments Commission (ASIC) funding is a good example of how revenues raised by an agency and through fees and a levy are dealt with separately to decisions around its funding.

Government needs to have a cohesive and consistent policy for cost recovery, rather than an agency by agency piecemeal approach. The cost recovery policy should be developed by financial experts with appropriate modelling and quantitative skills that correctly measure inputs, outputs and costs and determine, with a much greater level of accuracy and reliability than demonstrated during the development of the AUSTRAC model, which sectors/entities are the largest source of supervisory cost/largest consumers of supervisory resources (or whatever "product" is produced by the agency in question) and should be levied accordingly.

For example, the financial institution supervisory levies are set to cover the operational costs of the Australian Prudential Regulation Authority (APRA), and certain market integrity and consumer protection functions undertaken by ASIC and the ATO. Under the various APRA levy imposition Acts there is a well developed model for the determination of an industry levy to fund the costs of regulatory supervision. There is transparency, public consultation and accountability on an ongoing basis for the calculation of APRA related levies. Firstly there is a periodic 5 year review process of levy arrangements conducted by the responsible policy department, Treasury in this

case with APRA's assistance. The methodology for the determination of levies is settled by this periodic review process. This is then supported by an annual Consultation Paper on 'Proposed Financial Institutions Supervisory Levies' for the forthcoming financial year to seek industry views on the proposed financial sector levies. The paper discusses potential impacts of the proposal on each industry sector and institution regulated by APRA. The views provided on the paper will be taken into account in the determination of the levies to apply next year.

5. Failure to introduce Tranche 2 of the AML/CTF regime is adversely impacting entities currently regulated under the AML/CTF Act

Successive governments have failed to introduce Tranche 2 as promised at the time the AML/CTF regime was implemented. There are a significant number of entities that would become reporting entities under Tranche 2 and would therefore be subject to cost recovery, which would reduce the cost recovery burden on existing reporting entities.

If the Committee would like to meet with us or have any questions you would like us to follow up, then please contact me on _____ or _____ and I would be pleased to assist.

Yours sincerely

Tracey Lyons
Director Market Operations