File Number: 200606

10 March 2006

Mr Jonathon Curtis
Committee Secretary
Senate Legal and Constitutional Committee
Department of the Senate
Parliament House
Canberra ACT 2600
Email: legcon.sen@aph.gov.au

Dear Secretary,

ASFA Submission to Senate Legal and Constitutional Committee on AML/CTF Exposure Draft Bill and Rules

The Association of Superannuation Funds of Australia Ltd (ASFA) is pleased to make this submission to the Senate Legal and Constitutional Committee on the Anti-Money Laundering / Counter Terrorist Financing (AML/CTF) Exposure Draft Bill and Draft Rules, released for public comment on 16 December 2005.

ASFA is a non-profit, non-political national organisation whose mission is to protect, promote and advance the interests of Australia's superannuation funds, their trustees and their members. Our members, which include corporate, public sector, industry and retail superannuation funds, account for more than 5.7 million member accounts and over 80% of superannuation savings.

ASFA's General Position on AML/CTF

ASFA's general position on anti-money laundering, as expressed in the *ASFA Policy Principles – November 2005*, is as follows:

"22.1 – ASFA supports the use of a risk-based approach to regulation but does not support an industry / government partnership approach which would require industry bodies to take on the role of regulator.

22.2 – ASFA considers that due to both the regulatory environment in which funds operate and the operating procedures in place to meet these requirements complying regulated funds should be considered low risk of being used for money laundering and therefore exempted from specific record keeping and reporting requirements."

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ASFA strongly believes that the regulatory approach taken must be genuinely risk based. Given the enforceable nature of the detailed requirements within the Bill and the Rules, the current AML/CTF Exposure Draft Bill and Rules do not meet this standard. The current approach is inappropriately prescriptive both within the Draft Bill, for instance the Part 2 requirements for customer identification, as well within the Draft Rules, for instance the AML/CTF Program Draft Rules.

A genuinely risk-based approach should set down high-level principles in line with the FATF requirements. Reporting entities would then be able to introduce their own policies and procedures that are appropriate given the risks presented by their products and customers as well as the entity's size and capacity. As well, we would be supportive of guidelines designed to assist entities, particularly the smaller players, comply with their obligations.

A genuinely risk based approach would allow for features of the entity, product and customer to be factored into the development and implementation of an AML/CTF program. ASFA's strongly held view is that any AML/CTF regime in Australia must recognise the unique features of the Australian superannuation system – including employer compulsion to pay superannuation on behalf of employees, preservation of superannuation until retirement and the regulatory and reporting requirements on superannuation funds. These features are further explained in the Attachment A to this submission.

ASFA's Specific Comments on AML/CTF Exposure Draft Bill and Rules

1. Customer Identification by Superannuation Funds

Superannuation fund trustees will be reporting entities under the proposed AML/CTF regime because they ordinarily provide designated services.

The primary obligation of a reporting entity under Part 2 of the Exposure Draft Bill is to verify a customer's identity before providing the designated service (clause 29).

However, there are a number of provisions that provide a concession from this specific requirement. These include:

- No up-front customer identification for certain low-risk services (clause 28).
- Identification within five days after the designated service has been provided (clause 30).
- Exemption from the operation of the Part 2 identification requirement and for a designated service to be also exempted in circumstances specified in the AML/CTF rules (clause 35).

ASFA's main concern in respect of up-front customer identification requirements is its interaction with the unique features of superannuation funds including where contributions are made by an employer.

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The Superannuation Guarantee (SG) effectively imposes a requirement on employers to contribute a prescribed amount to a superannuation fund on behalf of its employees. There are strict time limits for payment, so a late payment can trigger significant tax penalties on the employer. This requirement creates a situation where employers often request superannuation funds to open accounts for new employees, so that the SG payments can be made. This is permitted under current law and is common industry practice. The vast majority of contributions flowing into the superannuation system can be categorised as mandated employer contributions.

For an "employer-sponsored" member, there is no legal obligation for the new member to complete an application form and the fund has up to three months after the member joins the fund to provide the member with a Product Disclosure Statement. There are minimal legal obligations on employers to provide information about the member. A new employer sponsor of a fund is ordinarily required to complete an application form for themselves and the first member of the fund. After that, it is up to the fund to pursue employers for information about new members. Often employers provide poor, late or incorrect information and in some cases provide no information about new members. Funds expend considerable resources pursing employers for this information.

Under the proposed regime, if the employer fails to provide the necessary identification information about new employees (which is far in excess of current requirements) to the superannuation fund, the superannuation fund may, as reporting entity, be unable to continue to provide the service. If this means "unable to accept contributions" this will have a significant impact on employers. The employer may find themselves in breach of the SG as contributions are returned.

It should also be noted that superannuation is generally seen by many in the community as a component of an employee's remuneration, like wages, rather than a financial product or service. As well, superannuation is often regulated by industrial instruments such as awards and agreements – as well as under common law contracts of employment. The employer may be obliged to make contributions to superannuation or to a particular fund under these requirements and if it fails to do so will potentially be in breach.

It is also important to realise that superannuation funds are already required to provide significant details about contributions made by, or on behalf of, each fund member to the Australian Taxation Office (ATO), to assist in administering Government programmes such as the co-contribution. As well, superannuation funds are required to report to the ATO on the payment of most benefits under the Reasonable Benefit Limit (RBL) reporting requirements.

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Further since 1 July 1999, all superannuation contributions are preserved until retirement or another prescribed condition of release. This means that in most instances, superannuation will not be available to the member until they reach their preservation age of 55 or higher (up to age 60 for those born after 1 July 1960). Further details about preservation and the conditions of release are contained in Attachment A.

The combination of these factors means that it is when the benefit is actually paid out of the superannuation system or when the member asserts control over their interest, rather than when contributions are received by the fund, that particular risks arise and customer identification is required. This point is recognised in similar situations within overseas jurisdictions.[1] Superannuation funds already conduct identification at this point, to ensure that a benefit is paid correctly. As a result, this is the more appropriate time at which any required identification should be made.

RECOMMENDATION ONE: A superannuation fund should not be required to conduct customer identification when the contribution is made but would be required to conduct customer identification before any benefit was paid from the fund, including rollovers. The identification process should be that currently recommended by ASFA in relation to prevention of fraud and theft and the provision of efficient service to members. (ASFA Best Practice Paper: Transfer Rollover and Cashing of Benefits)

RECOMMENDATION TWO: If the transfer or rollover to another fund is customer-initiated, then it should trigger customer identification by the first fund before the transfer is undertaken. The identification process should be that currently recommended by ASFA in relation to prevention of fraud and theft and the provision of efficient service to members. (ASFA Best Practice Paper: Transfer Rollover and Cashing of Benefits) The receiving fund should be able to accept money and information from another RSE.

Where the transfer / rollover is not customer-initiated, for example, where there is a fund merger or where the member is sent to an Eligible Rollover Fund, customer identification should not be required before transfer.

ASFA would further note that we are unable to establish how the current Exposure Draft Bill would accommodate such an approach. We believe the Bill will need to be changed to accommodate this. Introducing provision for a risk based approach to identification requirements could solve the problem. If the bill is not substantially changed in this fashion, then we will require clear guidance on how to seek appropriate exemptions under the current proposal.

[1] In respect of USA PATRIOT Act obligations see *FAQs: Final CIP Rules*, Issued 28 April 2005, in particular FAQ 4 in respect of 31 CFR 103.121(a)(3) – Definition of "customer". Available from www.fincen.gov/faqsfinalciprule.pdf .

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2. Threshold Transaction Reporting

The Exposure Draft Bill imposes an obligation on reporting entities to report to AUSTRAC if they provide a service that involves a threshold transaction. A threshold transaction is a transaction involving the transfer of physical currency, or money in the form of e-currency, where the amount transferred is $10,000 or more. Provision is made for the regulations to specify lower thresholds for specific transactions or to specify specific property transfers as threshold transactions.

The threshold transaction reporting requirement, particularly if the regulations expand to capture of transactions beyond cash and e-currency, would significantly impact on all superannuation funds. Funds/administrators could be required to report every transfer, rollover or benefit payment of $10,000 or more to AUSTRAC within 10 business days of performing the transaction. If a fund operates a clearinghouse service, the clearinghouse could have a reporting obligation where the gross employer contribution is $10,000 or more. Funds themselves may even be the subject of reports in respect of transfers of currency out of their accounts as part of the investment process.

This would be inappropriate for superannuation funds. APRA statistics show that there were 2.9 million exits from superannuation funds – consisting of benefit payment, transfer and roll-overs. Household Income and Labour Dynamics in Australia (HILDA), indicate that the average superannuation holdings of an Australian adult is in the $50,000-$60,000 range. The tax-free threshold (which represents a modest benefit) for superannuation is $129,751. $10,000 is a very low amount for superannuation fund benefits – which are often taken as a lump sum. All but the smallest benefit could be subject to threshold transaction reporting.

RECOMMENDATION THREE: The proposed $10,000 threshold for reporting a transaction is too low for superannuation contributions, rollovers, transfers and benefit payments, if all such payments are captured. It may also be too low for reporting of contributions in some funds and in some situations. The need to report a transaction could be risk-based and ways that funds might put this into operation should be explored.

3. AML/CTF Programs

Under Part 7 (clauses 72 to 76) each reporting entity is required to develop, maintain and comply with AML/CTF programs (clause 73).

In essence, an AML/CTF program is one that is designed to ensure that a reporting entity takes appropriate action to identify and materially mitigate the risk that the provision of a designated service might facilitate a transaction that is connected with the commission of a money laundering or financing of terrorism offence (clause 74).

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There are a number of specific items that the draft rules propose should be in all AML/CTF Programs:

- Risk Identification
- Risk Mitigation
- Customer Due Diligence / Enhanced Customer Due Diligence
- Suspicious Reporting – Systems and Controls
- AML/CTF Risk Awareness Training Programs
- Employee Due Diligence
- Third Party Due Diligence
- Compliance Program
- Application of the AML/CTF program
- Record Keeping
- Board Oversight
- Independent Review

By 1 July 2006, all superannuation fund trustees other than self managed superannuation funds (SMSF) will be licensed under new APRA licensing requirements. These requirements focus heavily on the management of risk within the trustee and the fund; the management of outsourcing risk; ensuring the fitness and propriety of responsible officers, which includes trustee directors and senior managers; and managing issues in respect of staff and technology. The Risk Management Strategy and the Risk Management Plan include management of the risk of fraud and theft. Annual audit and reporting to the Regulator, APRA, is required.

Seen in this context, AML/CTF Program requirements appear too prescriptive and fail to recognise how APRA –regulated superannuation fund trustees already manage risk. The APRA requirements could accommodate many of the topic areas noted above. The existence of a risk management framework in particular provides an excellent mechanism for the on-going management of money laundering and terrorist financing risk by superannuation fund trustees.

RECOMMENDATION FOUR: RSEs should able to integrate AML/CTF program requirements into their RMS/RMP requirements.

4. KYC Requirements

The draft minimum KYC information is more extensive than that currently held by funds and includes the customer's (member's) place of birth, country of citizenship and country of residence.

Currently superannuation funds ordinarily seek to collect data on the member's name, place of residence, date of birth and tax file number. In transfers they also collect information about the tax status of the various elements that make up the account. This information assists in remaining in contact with the member, including

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complying with the requirement to report annually to members and the payment of benefits with the correct tax.

Information such as place of birth, citizenship and residency has normally not been collected by superannuation funds. Requiring its collection would place additional obligations on employers who often establish superannuation accounts on behalf of their employees to ensure the employer can meet their SG and other legal obligations.

RECOMMENDATION FIVE: Superannuation funds should be required to seek the member's name, residential address, date of birth and tax file number.

5. Use of Agents

The AML/CTF Exposure Draft Bill envisages reporting entities being able to rely upon others (either agents, other reporting entities or entities accredited by AUSTRAC) to undertake customer identification. This is called "the chain" and the Exposure Draft Bill notes that a superannuation fund might rely upon a financial planner to undertake the customer identification.

This raises a number of issues such as:

- Who holds the customer identification / customer due diligence documentation?
- What happens if a business relationship ends?
- Who is liable?

These issues require careful consideration and clarification.

RECOMMENDATION SIX: ASFA seek further clarification in relation to issues relating to the use of agents.

6. Self-Managed Superannuation Funds

Self-managed superannuation funds have less than five members and the trustees and the members are generally the same people. Self-managed funds are subject to similar requirements in respect of the role of the trustee, taxation and preservation but are regulated by the ATO rather than APRA. The trustee is not required to be licensed by APRA.

This sector has seen considerable growth. There are over 300,000 self-managed funds that have about $160 billion in assets (about one quarter of all superannuation assets in Australia). Most funds have one or two trustee/members. Employees eligible to choose their superannuation fund can now direct their employer to contribute to a self-managed fund.

Establishing a self-managed fund is relatively easy. If there is more than one person involved in the fund they must ordinarily have a familial or business relationship. The only obligations preventing a person from establishing a self-managed fund are

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that the trustees cannot be a "disqualified person" (person convicted of a dishonest offence, undischarged bankrupt, subject to civil penalty order or otherwise disqualified by a superannuation regulator) or a minor.

The current four major steps to setting up a new self-managed fund include:

- Obtain a trust deed
- Lodge an application for TFN/ABN registration with the ATO. This includes
  - election with the ATO to become a regulated fund
  - trustee's TFN details or their residential address
- Develop an investment strategy – required under the SIS Act
- Open a bank account – ordinarily done but not strictly required under law.

When lodging the election, the ATO does no substantive check of the suitability of the trustee beyond any self-declaration made by the applicant about their status as a disqualified person. We understand that the ATO now does a "post registration" check against various records to confirm that the trustee is not a disqualified person.

While the ATO does conduct reviews of self-managed funds and their advisers, the only regular external oversight required is by the external auditor, who must perform a compliance and financial audit on the self-managed fund. The external auditor is also required to notify the ATO of breaches. External auditors of self-managed funds are not required to demonstrate any superannuation-specific training, knowledge or experience. As well, the external audit is performed after the end of the relevant financial year.

Most self–managed funds would have a bank account but it is not a legal requirement. Many self-managed funds rely on other professionals to provide advice or services – including solicitors, actuaries, financial planners or brokers. However, there are few statutory requirements to use these services (though an accountant is required to prepared the fund's accounts and, until recently, an actuary has been required to sign off on the paying of a pension from the fund).

The large number of difficult-to-supervise entities and the potential for collusion between the trustee and member (who are usually the same person) may represent a risk for money laundering and terrorist financing, but if that is the case, the provisions in the Bill requiring customer information and AML/CTF Programs do not work for this group.

Although self-managed funds represent a particular challenge to any AML/CTF system, in the interest of competitive neutrality they should not be exempted from the AML/CTF regime.

ASFA is currently consulting with its self-managed fund constituency to explore an appropriate means of regulating these entities.

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If you have any questions or comments on this submission, please feel free to contact me at the ASFA Secretariat on 02 9264 9300.

Yours sincerely,

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