

8 April 2022

Director, Policy and Rules
Australian Transaction Reports and Analysis Centre
PO Box 5516
West Chatswood NSW 1515

By email: guidance_consultation@austrac.gov.au

Dear Sir/Madam,

Consultation on proposed guidance relating to source of funds and source of wealth

1. This submission is made by the Financial Services Committee of the Business Law Section of the Law Council of Australia (the **Committee**). The Committee thanks the Australian Transaction Reports and Analysis Centre (**AUSTRAC**) for the opportunity to comment on the proposed guidance on the source of funds and source of wealth in the AML/CTF compliance framework issued for consultation on 18 February 2022 (**Guidance**).
2. The Committee has the following four general comments and observations in relation to the proposed Guidance:
 - the Guidance refers to the obligation to "establish" the source of funds and source of wealth as involving collecting information about the customer and verifying it for accuracy using reliable and independent documents and data. This conflation of the concept of 'establishing' (and other similar language) in the *Anti-Money Laundering and Counter-Terrorism Financing Rules Instrument 2007 (No. 1)* (Cth) (the **Rules**) with the separate and more rigorous 'collect and verify' standard used in other contexts goes further than the existing mandate under the Rules as they are presently drafted;
 - the Guidance appears to require that all AML/CTF Programs include risk-based procedures documenting when and how a customer's source of funds and wealth will be established. This requirement is not proportionate to the risks in many circumstances and is overly prescriptive. Under the Rules this obligation to establish the source of funds and source of wealth is risk based and is not necessarily to be expected in all AML/CTF Programs outside the basic requirements regarding High Risk / Foreign Politically Exposed Persons and Enhanced Customer Due Diligence;
 - the Guidance would benefit from a more specific industry focus recognising the diversity of the risks presented by different designated services rather than the current "one size fits all" approach which appears to be heavily focused on banking and financial services reporting entities; and

- the Guidance could usefully focus on practical steps that reporting entities could take to deal with the obligation to establish customers' source of funds and wealth.

Obligation to include documentation of procedures to identify source of funds and source of wealth

3. The Guidance states in the opening paragraph that:

[AML/CTF Programs] must include risk-based procedures that document when and how you will establish your customers' source of funds and source of wealth.

4. This opening statement is highly prescriptive and extends the obligation well beyond the requirements of the current Rules. It assumes that all reporting entities will provide designated services in circumstances where it is proportional and appropriate to collect this information. In contrast:
- (a) Rule 4.13.3 requires a reporting entity to include appropriate risk management systems in its AML/CTF Program, among other things, to take reasonable measures¹ to establish² the source of funds and source of wealth for high risk / foreign politically exposed persons (**PEPs**); and
 - (b) under Rule 15.10 the enhanced customer due diligence program for a reporting entity must include "appropriate risk-based systems and controls" so that, if any relevant circumstances arise (the ML/TF risk is high, the customer or beneficial owner is a foreign PEP, there is a potential suspicious matter or there is a party to a transaction or proposed transaction in a prescribed foreign country), the reporting entity must undertake "measures appropriate to those circumstances", and such measures may relevantly include "undertaking more detailed analysis" of the customer's KYC information and beneficial owner information, "including, where appropriate taking reasonable measures" to identify³ the source of the customer's and each beneficial owner's funds and the source of their wealth.⁴
5. It is very hard to find explanation in the Guidance of when or how the circumstances in which the customers', or the beneficial owners', source of funds or source of wealth is required to be verified.
6. For example, it would be apparently unnecessary for a low risk reporting entity such as a superannuation fund or a small "kitchen table" money remitter to incorporate these extensive and potentially difficult procedures for PEPs and enhanced customer due diligence into their AML/CTF Program when a reporting entity of this kind has no reasonable basis for considering that there is any likelihood of their business encountering such a customer or beneficial owner. If the reporting entity did encounter such an individual, the establishment / identification of source of funds or source of wealth would be a reasonable measure without the necessity for verification.

¹ "Reasonable measures" are defined in the Rules as meaning "appropriate measures which are commensurate with the money laundering or terrorist financing risks."

² "Establish" is not defined in the Rules, nor any other AUSTRAC Guidance or Public Legal Interpretation.

³ "Identify" is not defined in the Rules, nor any other AUSTRAC Guidance or Public Legal Interpretation.

⁴ Rule 15.10(2).

7. Rule 15.10, in setting out the appropriate risk based systems and controls for an enhanced customer due diligence program, requires the identification of source of funds and source of wealth when the particular circumstances set out in Rule 15.9 apply. These are that the reporting entity determines under its risk based systems and controls that the ML/TF risk is high, or that a designated service is being provided to a customer who is or has a beneficial owner who is a foreign PEP, or the matter is a suspicious matter, or the transaction involves a entity in a prescribed foreign country. These circumstances are quite limited and deserve further expansion and explanation in the Guidance.

8. Paragraph 5 of the draft Guidance states:

Source of funds' refers to how and where the customer obtained the funds for a specific transaction or designated service you provide to the customer. Verifying your customer's source of funds will assist you in applying risk-based systems and controls in accordance with your AML/CTF program, and help you meet your transaction monitoring and suspicious matter reporting obligations. This process includes determining if you suspect that the funds could be the proceeds of crime or may be relevant to the investigation of a criminal offence.

9. This paragraph gives the impression to a reporting entity that verification of source of funds is a mandatory element of Rule 4.13.3 and Rule 15.10, which, respectfully, is not what these provisions say.

10. Further, verification of the source of an asset as readily transferable and fungible as money is potentially extremely onerous. Many practical difficulties emerge. Are the patrons of every hotel or club offering \$1 poker machines as a form of entertainment to be required to produce verified copies of bank statements and pay slips and to be quizzed on these as a condition of entry before being permitted to play, whether for 5 minutes or five hours? Are the benefactors of an inheritance, or donees of a gift, large or small wishing to invest these assets to be required to prove that the inheritance or gift was generated through legal and legitimate activity?

11. Paragraph 12 of the Guidance explains the triggers for source of funds and source of wealth checks as follows:

Your AML/CTF program should include triggers for source of funds and source of wealth checks:

- *As part of your applicable customer identification procedures (ACIP) before commencing to provide a designated service to a customer.*
- *When carrying out enhanced customer due diligence (ECDD) for higher risk customers, including foreign PEPs.*
- *As part of ongoing due diligence and monitoring for all customers, particularly for customers that pose a higher ML/TF risk. This may change over time as the ML/TF risk profile of the customer changes.*

12. The wording of this paragraph would suggest to a reporting entity that these are the legal obligations: however, only the second point is a trigger required by the Rules (Rule 15.10). There is no blanket rule for source of funds and source of wealth checks as part of ACIP for customers who are not known to be PEPs under Rule 4.13.3. Nor is there a blanket rule during ongoing customer due diligence outside Rules 15.8 to

15.10. That is not to say that source of funds and source of wealth should not be enquired about. Rather it is the view of the Committee that regulatory guidance should only be expressed in mandatory terms when that reflects the terms of the underlying legal obligation in the Rules. If AUSTRAC provides examples of suitable measures based on a reporting entity's appropriate risk based systems and controls, the guidance should make it clear that these are examples only, not necessarily mandatory for all reporting entities.

'Collect and verify' versus 'establish' and 'identify'

13. The Guidance sets out that "establishing" the source of funds "involves" collecting information about the customer and their beneficial owners, and verifying it for accuracy using reliable and independent documents and data. This position is not supported by the Rules which require the AML/CTF Program's ECDD program to include appropriate risk-based systems and controls to undertake, where appropriate, reasonable measures to identify the source of funds and source of wealth.
14. The ordinary meanings of the words "establish" and "identify" are fundamentally different from the concept of "to collect and verify", contrary to the assertion in the Guidance. The obligation to collect and verify applies in relation to more fundamental KYC information and verification is to be done using reliable and independent documents and data. As different language was used in relation to establishing or identifying the source of funds or source of wealth, it is reasonable to assume that it was not the intention of the drafters to impose this higher and more difficult obligation (that is feasible in relation to an individual's name and other basic information) on the concept of the "source" of funds and wealth. For example, it would be extraordinarily intrusive for a schoolchild travelling to visit relatives and wishing to purchase travellers cheques for the trip to have to provide an independently verified copy of a bank statement or other similar documentation (potentially from other parties such as parents that supplied the funds), in order to conduct such a low risk transaction.
15. AUSTRAC's Draft Guidance Note 15/01: *Key terms used in "politically exposed person" definition*⁵ outlines AUSTRAC's view of reasonable measures with respect to source of funds and source of wealth with respect to PEPs. It states:

3.13 The extent of investigation expected of a reporting entity in relation to the source of wealth and source of funds for the PEP is determined by the use of 'reasonable measures', which is defined in Chapter 1 of the AML/CTF Rules as 'appropriate measures which are commensurate with the money laundering or terrorist financing risks'. The investigation by a reporting entity must be 'reasonable' in the context of the circumstances under consideration, and this may vary from case to case. Accordingly a definitive explanation of what is 'reasonable' cannot be given.⁶

3.14 If a reporting entity is unable to determine the source of wealth and the source of funds after undertaking a demonstrated investigation, then the reporting entity may consider whether it is appropriate to continue the business relationship, or if the

⁵ Draft Guidance Note 15/01: *Key terms used in "politically exposed person" definition*, second round public consultation: August 2015.

⁶ Ibid., page 4.

*relationship does continue, whether to submit a suspicious matter report for that particular PEP.*⁷

16. The wording of this guidance is in line with Rule 4.13.3 and can be extrapolated to Rule 15.10.

Industry focus and practical guidance

17. The Guidance does not appear to take into account the broad range of designated services and reporting entities which may be potentially impacted by the position AUSTRAC takes. This Guidance rather appears heavily biased towards banking and financial services reporting entities. Whilst those reporting entities are important, they do not reflect the majority of reporting entities. For example, the gambling industry encompasses pubs and clubs with poker machine businesses where the cash taken is notes and coins directly deposited by the customer into machines, through to online gambling, through to casinos. Equally, in the financial sector while there will be many potentially high risk businesses turning over large amounts of money there will be many others on a micro scale by comparison, such as the "kitchen table" remitters mentioned above and like operations.
18. The Guidance would benefit, in the Committee's view, from some specific examples and other practical guidance as to what AUSTRAC expects of particular industries in terms of the verification of their customers' (and those customers' beneficial owners) source of funds and source of wealth in their particular circumstances. These may include circumstances such as high cash turnover businesses like poker machines in pubs and clubs, low risk businesses like the issuers or distributors of travellers cheques and other similar instruments, and businesses where the source of funds and source of wealth is not necessarily a key factor in the most likely expected money laundering typologies, such as trade finance.
19. The United Kingdom's Joint Money Laundering Steering Group (**JMLSG**) Guidance⁸ is an excellent example of guidance for financial sector reporting entities in general, and for source of funds and source of wealth inquires specifically. The JMLSG Guidance for the UK Financial Sector Part 2 covers Sectoral Guidance for specific financial industry sectors, including: retail banking; financial advisors; investment managers; private equity; crypto asset exchanges and so on. Part 2 provides detailed guidance for each sector on when and to identify source of funds and source of wealth, and when and how – on a risk-based approach - to verify that information. Part 2⁹ also provides detailed examples. The Committee would welcome a similar approach from AUSTRAC.
20. We trust AUSTRAC will find the above comments of interest and members of the Committee would be pleased to make themselves available to discuss them with AUSTRAC at your convenience.
21. Please contact the Chair of the Committee, Pip Bell, at pbell@pmclegal-australia.com if you would like to further engage with the Committee.

⁷ Ibid., page. 4.

⁸ The Joint Money Laundering Steering Group <https://www.jmlsg.org.uk/guidance/current-guidance/> (referenced 2022-03-30)

⁹ Ibid

Yours faithfully

A handwritten signature in black ink, appearing to read 'P. Argy', with a long, sweeping flourish extending to the right.

Philip Argy
Chairman
Business Law Section