FINANCIAL ADVICE ASSOCIATION AUSTRALIA

Ms Katherine Jones PSM
Secretary
Attorney-General's Department
3-5 National Circuit
BARTON ACT 2600

28 June 2024

Dear Ms Jones

Modernising Australia's AML/CTF regime and introducing Tranche 2

The Financial Advice Association of Australia (FAAA)[1] welcomes the opportunity to provide feedback on the Attorney-General's Department's (AGD) proposals to modernise the Anti-Money Laundering and Counter-Terrorism Financing (AML/CTF) Act and Rules, and to introduce Tranche 2 to extend the regime to professional service providers.

The AML/CTF regime provides vital protection for all Australians from the risks and impacts associated with money-laundering and terrorism financing (ML/TF), as well as Centrelink fraud, and tax evasion.

The FAAA's submission primarily considers the ML/TF risks faced by entities that only provide 'item 54 designated services' – ie. Australian Financial Services Licensees (AFSLs) and authorised representatives providing financial advice – and their clients. We support the intent of the proposed changes to simplify the AML/CTF regime to improve its efficiency for the regulated community and its effectiveness in protecting Australians.

Our key recommendations include:

- the AFSL should continue to be the financial advice reporting entity,
- the 'special program' requirements should be retained for 'item 54 only reporting entities', and
- 'item 54 designated services' should not be inadvertently captured in the tranche 2 designated service definitions and obligations.

We would welcome the opportunity to discuss with the Attorney-General's Department, the issues raised in our submission. Please contact FAAA's Senior Manager Advocacy and Policy, George John (George.john@faaa.au) or myself on sarah.abood@faaa.au or 02 9220 4500 if you have any questions.

Yours sincerely

Sarah Abood
Chief Executive Officer
Financial Advice Association Australia (FAAA)

[1] The Financial Advice Association of Australia (FAAA) is the largest association representing the financial advice profession in Australia, with over 10,000 members. It was formed in 2023 following the merger of the two leading financial planning/advice bodies in Australia – the Financial Planning Association (FPA) and the Association of Financial Advisers (AFA). With this merger, a united professional association that advocates for the interests of financial advisers and their clients across the country was created.

FINANCIAL ADVICE ASSOCIATION AUSTRALIA

Modernising Australia's AML/CTF regime and introducing Tranche 2

Effective date: 28/06/2023
Submitted to: Attorney-General's Department

FINANCIAL ADVICE ASSOCIATION AUSTRALIA
GPO BOX 4285 SYDNEY NSW 2001

CONTACT@FAAA.AU
WWW.FAAA.AU

T 1300 337 301
ABN 62 054 174 453

PAPER 2: FURTHER INFORMATION FOR PROFESSIONAL SERVICE PROVIDERS

Consultation paper 2 proposes new designated services to extend the AML/CTF regime to 'tranche two entities' - lawyers, accountants, trust and company service providers, real estate professionals, and dealers in precious stones and metals. In addition, the paper proposes professional service providers (PSPs) as a " … *collective term …..to describe legal practitioners, accountants, consultants, trusts and company service providers, financial advisers and business brokers*".

The professional services provided by financial advisers have been regulated under the AML/CTF Act since it was first introduced. Our submission discusses the need for careful legislative drafting for tranche two purposes, to avoid potential unintended consequences for financial advisers.

Application of AML/CTF to financial advice regime and business models

Regulatory overview of financial advice

Financial advice is regulated under the Corporations Act 2001 (Cth) as 'financial product advice'. A financial adviser must provide financial advice as a representative of an Australian Financial Services Licence (AFSL) holder (a licensee).

A financial adviser is often referred to as a 'representative'. A 'representative' of an AFS licensee may be:

- An 'authorised representative' of the licensee (self-employed)
- An employee or director of the licensee
- An employee or director of a related body corporate of the licensee.

AFSL holders are subject to general licensee obligations, conduct and disclosure obligations as well as additional obligations for providers of financial product advice to retail clients (discussed below). There are also legislated education and professional standards (including a legislated Code of Ethics) that apply directly to representatives providing personal financial advice.

Financial product advice can be personal financial advice or general advice, and is provided to retail clients and wholesale clients[2]. To be legally able to provide personal financial advice to retail clients, a financial adviser must meet the legislated education and training standard, be authorised by a licensee, and be registered on ASIC's Financial Adviser Register (FAR). The large majority of FAAA members are registered on the FAR and provide personal financial advice to retail clients.

Business models

The licensing regime has led to the development of a variety of different business models in the advice profession.

Dealer groups (Advice AFSLs)

Financial advisers can operate in advice groups under an AFSL (also known as dealer groups or large licensees). Under this structure, a corporate entity in the group will hold an AFSL, permitting the

[2] Corporations Act, s761G Meaning of retail client and wholesale client

financial advisers who are members of the advice group to operate as its authorised representatives and provide financial advice to consumers on its behalf.

The advice licence may also be held and operated by a separate legal corporate entity within a larger group. If this is the case, it is the AFSL holder within the group that authorises both corporate authorised representatives (CARs) and individual financial advisers.

Dealer groups provide their authorised representatives with centralised financial advice back-office services and support (discussed below).

Business model examples

- Large licensees will have multiple (some as many as 300 or more) practices (small businesses) located across Australia operating under one licence. Some large licensees have employed financial advisers, corporate authorised representatives (CAR) and individual authorised representatives operating under their licence.
- Corporate authorised representatives (CAR) are authorised under a licensee and employ financial advisers (authorised representatives) to provide advice under their 'corporate authorised representative' status. Authorised representatives commonly operate a small financial advice practice/firm under the licence of a large or medium licensee.
- Small or boutique licensees are often less than 10 financial advisers or a collective of several corporate authorised representatives operating a small business under their own licence.
- Authorised representatives commonly operate a small financial advice practice/firm under the licence of a large or medium licensee.
- Financial advisers may sometimes be employees of licensees, including in some cases subsidiaries of financial institutions.

Economies of scale through licensing regime

Under the Corporations Act, AFSLs have obligations under s912A of the Corporations Act relating to:

- conduct and disclosure
- the financial services the entity provides
- the competence, knowledge and skills required to operate the licence
- the training and competence of its financial advisers and authorised representatives, including Continuing Professional Development (CPD)
- ensuring its financial advisers and authorised representatives comply with the financial services laws
- compliance, managing conflicts of interest and risk management
- the adequacy of its financial, technological and human resources, and
- dispute resolution and compensation arrangements (if its clients include retail clients).[3]

Under the AFS licensing regime, the licensee holds the legal responsibilities for the services provided by its representatives (authorised and employed) operating under its licence. Licensees provide services to its representatives including some or all of:

- policies, guidelines and procedures to assist advisers and companies to provide advice to consumers in compliance with current regulatory requirements, including AML/CTF obligations
- software
- research

[3] AFS licensee obligations | ASIC

- Approved Product List (APL)
- paraplanning
- practical day to day compliance assistance
- technical support
- compliance audits and coaching
- training, including conferences, Professional Development days and other CPD
- practice development and management support
- templates and stationery, including Statement of Advice (SoA) templates
- access to back-office processes and systems
- professional indemnity insurance cover
- internal and external dispute resolution systems
- recording and registering financial advisers on the ASIC Financial Adviser Register (FAR)
- lodging reports with regulators when required – this includes Suspicious Matter Reports to AUSTRAC.

Some licensees also offer access to third party research facilities, execution, clearing and settlement providers and trading platforms.

Providing such services to a larger number of authorised representatives under one licence offers economies of scale benefits for financial advice practices including in relation to the systems, processes and training necessary for financial advisers to fulfil AML/CTF obligations.

AFSL regime and the AML/CTF reporting entity

AFSL holders that only provide 'item 54 designated services' are considered 'item 54 only reporting entities' under the AML/CTF Act. It is the AFSL holder that must be registered with AUSTRAC as the reporting entity. This means that financial advisers (and practices) operating under another entity's AFSL, must comply with and report into the AML/CTF processes, systems, and controls of the licensee. This is based on the ML/TF risk of licensees, not the ML/TF risk of the individual financial adviser or their practice.

We note that consultation paper 2 extends the AML/CTF regime to 'tranche two' entities. However, the consultation paper also suggests that '*professional service providers'* (PSP) would *"be defined as a collective term used by the department to describe legal practitioners, accountants, consultants, trust and company service providers, financial advisers and business brokers*".[4]

Based on the information provided in the consultation paper, it is unclear at this stage who the reporting entity would be for the new 'tranche two' entities – for example, whether the individual professional, a practice, or firm would be required to register with AUSTRAC as the reporting entity. It is also unclear whether PSPs would be defined and if this approach would be extended to all PSPs, including potentially financial advisers currently operating under item 54 only reporting entities (eg AFS licensees).

It is currently unclear whether any legally binding obligations would apply to a potential definition of PSP. Given the significantly different levels and types of AML/CTF risk involved in the provision of these professional services, the FAAA would be concerned about unintended consequences by the creation of such a definition and how it may be applied in the future.

Since the enactment of the AML/CTF Act on 12 December 2006, AFS licensees have been required to register with AUSTRAC and meet the obligations of 'item 54 only reporting entities' under the Act. We can see no reason to change who the reporting entity is for the financial advice sector, which is

[4] Page 4

well established under the AML/CTF regime: Changing the reporting entity for 'item 54 only designated services' (currently the AFSL) would:

- create significant confusion and cost for the financial advice profession
- waste effective AML/CTF risk management and compliance systems, processes and controls
- require new systems and controls to be developed at the 'new' reporting entity level
- remove the economies of scale delivered through the structure of the AFSL regime of the financial advice profession.

This would have a significant impact on financial advisers, the majority of whom operate small businesses or are sole practitioners, and it would deliver no additional AML/CTF benefit or protection.

Current obligations for 'item 54 only reporting entities'

Given the financial services provided, and the position financial advisers play in the financial advice/services supply chain (discussed in detail below), the provision of financial advice to retail clients, in our view, presents a low ML/TF risk.

This is reflected in the current AML/CTF regime and the requirement for 'item 54 only reporting entities' to comply with the 'special program' obligations only.

We understand that the government's intent is to retain the 'special program' requirements for 'item 54 only reporting entities'. The FAAA welcomes and supports this view.

Recommendations - Application of AML/CTF to financial advice regime

The FAAA recommends the retention of:

- *the 'item 54 only reporting entity' definition in Table 1 of s6 of the AML/CTF Act – that is, the 'holder of the Australian Financial Service Licence' is the reporting entity, and*
- *the 'special program' requirements for 'item 54 only reporting entities'.*

Financial advice services and PSPs

What is financial advice?

Financial advice is defined in s766B of the Corporations Act and includes:

> ***766B Meaning of financial product advice, personal advice and general advice***
>
> *(1) Financial product advice means a recommendation or a statement of opinion, or a report of either of those things, that:*
>
> > *(a) is intended to influence a person or persons in making a decision in relation to a particular financial product or class of financial products, or an interest in a particular financial product or class of financial products; or*
> >
> > *(b) could reasonably be regarded as being intended to have such an influence.*

(1A) However, subject to subsection (1B), the provision or giving of an exempt document or statement does not constitute the provision of financial product advice.

(1B) Subsection (1A) does not apply for the purpose of determining whether a recommendation or statement of opinion made by an outside expert, or a report of such a recommendation or statement of opinion, that is included in an exempt document or statement is financial product advice provided by the outside expert.

(2) There are 2 types of financial product advice: personal advice and general advice.

(3) Personal advice is financial product advice that is given or directed to a person (including by electronic means) in circumstances where:

(a) the provider of the advice has considered one or more of the person's objectives, financial situation and needs (otherwise than for the purposes of compliance with the Anti-Money Laundering and Counter-Terrorism Financing Act 2006 or with regulations, or AML/CTF Rules, under that Act); or

(b) a reasonable person might expect the provider to have considered one or more of those matters.

(3A) However, the acts of asking for information solely to determine whether a person is in a target market for a financial product, and of informing the person of the result of that determination, do not, of themselves, constitute personal advice.

(4) General advice is financial product advice that is not personal advice.[5]

Many of the financial advice obligations do not apply to the provision of financial advice to wholesale clients.

Financial advice provided to retail clients by reporting entities that provide item 54 designated services involves understanding and assessing a client's circumstances, attitude to money, risk tolerance and capacity to risk capital, to help them identify and achieve their financial goals. Financial advisers must provide advice, strategies and recommendations in the best interest of their client.

Financial adviser - a defined term under the Corporations Act

2019 saw the commencement of the following legislated professional and education standards[6], which individuals must meet to be able to provide personal financial advice to retail clients, and to use the enshrined terms[7], financial adviser and financial planner:

- complete an approved education qualification – a bachelor or higher degree, or equivalent qualification, approved by the Minister. Currently the only approved qualifications are financial planning specific.

- New entrants – individuals wanting to become a financial adviser/planner - must also complete a professional year that includes at least 1,500 hours of work activities and at least 100 hours of structured training,

[5] See Corporations Act for all provisions under s766B

[6] Section 921B of the Corporations Act

[7] Section 923C of the Corporations Act

- pass the Financial Adviser Exam to test the practical application of their knowledge in key competency areas (administered by ASIC), participate in at least 40 hours of annual continuing professional development (CPD) to maintain and extend their professional capabilities, knowledge and skills, and

- comply with the Financial Adviser Code of Ethics 2019 (as registered on the Federal Registration of Legislation), a set of principles and core values in the areas of ethical behaviour, client care, quality process and professional commitment.

Under the Corporations Act, financial advisers/planners are defined as 'relevant providers' (or 'provisional relevant providers' for those undertaking their professional year (PY) from commencement of quarter 3 of the PY). All relevant providers must be registered on the ASIC Financial Adviser Register (FAR).

The use of the terms Financial Planner and Financial Adviser, and 'like terms', are protected under s923C of the Corporations Act. Only individuals who meet the above requirements can use these (or 'like' terms), be listed on the ASIC FAR, and legally provide personal financial advice to retail clients. Australian Financial Services Licensees (AFSLs) are licensed by ASIC and authorise representatives to provide personal financial advice under their licence.

While s923C does not entirely preclude the term financial adviser from being used in other contexts, it may be confusing if it is used by a Regulator to apply to a broader category of advisers.

It is unclear whether the proposed inclusion of 'financial adviser' in the suggested definition of PSP is intended to capture a different type of service such as investment bankers and business advisers, rather than personal advice to retail clients provided by registered financial advisers as enshrined under the Corporations Act. We seek clarity in this regard.

Tranche 2 proposed designated services

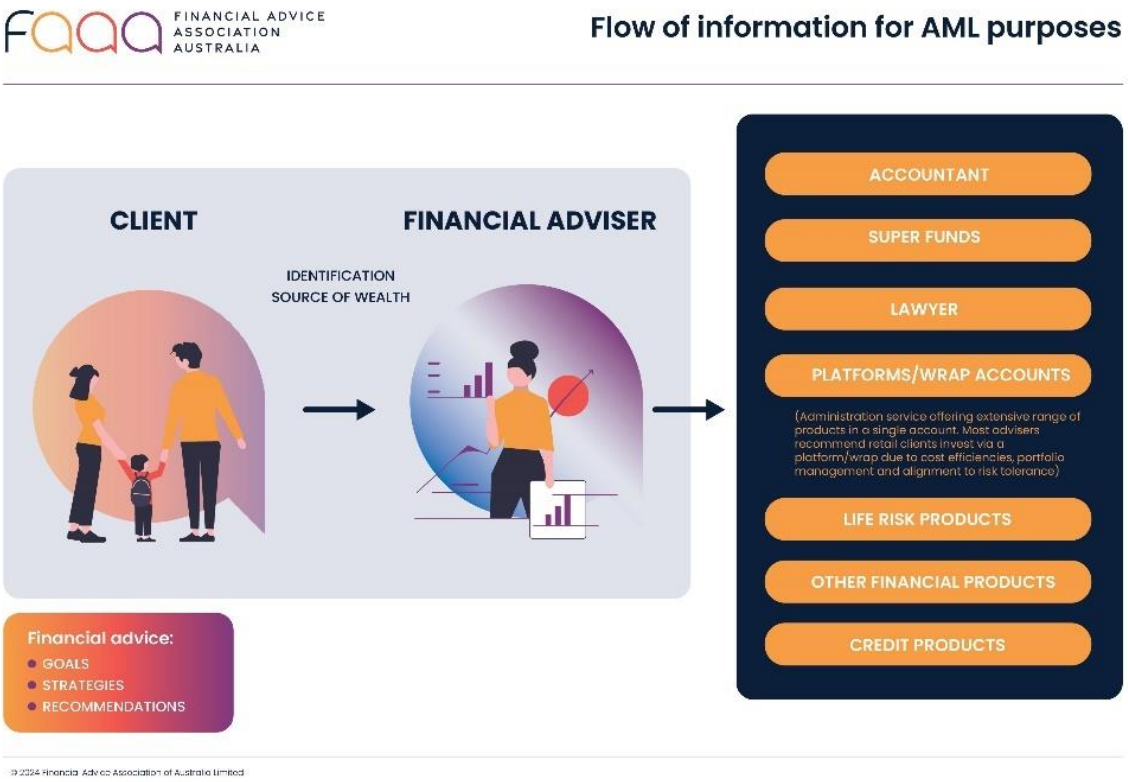
Financial advisers, in the normal course of business, do not provide any of the designated services outlined in proposed designated services 1, 2, 3, 4, 5, 6, 7 or 8.

It is suggested in the consultation paper that proposed designated service 3 be defined to capture:

> *"Receiving, holding and controlling or disbursing:*
>
> - *money (other than sums paid as fees for professional services)*
> - *accounts*
> - *securities or securities accounts,*
> - *digital assets (including private keys), or*
> - *property*
>
> *It is intended to capture, with the exception of payments for professional fees, any instance where a business does the following on behalf of a client:*
>
> - *receives or holds money, accounts, securities or security accounts, digital assets (including private keys), other assets or property, and*
>
> - *controls the payment or disburses that money, accounts, securities or security accounts, digital assets (including private keys), other assets or property."*

When giving personal financial advice to retail clients, financial advisers provide the client with strategies and recommendations to achieve their goals. As illustrated in the schematic below, the

financial adviser acts as an intermediary, of sorts, for the flow of information for AML purposes between the client and the higher risk designated service providers. However, financial advisers do not provide the additional designated service themselves.



Financial advisers who provide advice to retail clients do not receive, hold, control or disburse client money, issue financial products or provide financial transaction services. These activities are generally not permitted by licensees.

Financial advisers assist their clients with the implementation of the advice. This may involve referring the client to other providers to receive another designated service such as an investment platform or financial product provider, accountant, or a legal practitioner to establish a trust or EPOA.

We would like to emphasise that, at a high level, financial advisers who provide financial advice to retail clients only, do not provide services that involve the activity set out in proposed designated service 3. Financial advisers and licensees who only provide ‘item 54 designated services’ do not have ‘control over the flow of client money’ as is the intended purpose of designated service 3.

However, we are concerned about how ‘controlling’ could be defined in this regard.

For example, financial advisers generally assist clients to apply for investment products by forwarding the necessary paperwork to the financial product provider. However, financial advisers are not usually involved in the transfer of funds from the client to the product provider for the establishment of the investment. Once the initial investment is made by the client directly to the product provider, some financial advisers may, from time to time, manage the client’s investment within the platform/wrap account. This could involve moving client money from one product in the platform to another product in the platform, on behalf of the client, to maximise the client’s investment in line with their risk tolerance and capacity for loss of capital. The financial adviser does not ‘hold’ the client money; this is

held by the product provider. The flow of client money into and out of the platform is usually conducted directly – client-platform-client.

The FAAA suggests the management of a client's investment within a platform/wrap account where the adviser does not hold client money, should be excluded from 'designated service 3' and care should be taken when drafting the legislation, so as not to inadvertently capture the provision of financial advice and the assistance financial advisers provide clients, in the definition of this designated service.

Item 54 designated services and tranche 2 designated services

If appropriate to the client's needs, a financial adviser may recommend a client seek a particular 'tranche 2 designated service' from a 'tranche 2 entity'. For example, if a financial adviser recommends a client put in place an Enduring Power of Attorney (EPOA), the adviser would recommend the client see a legal practitioner for this service. The financial adviser may not recommend a specific legal practitioner and is not involved in the establishment of the EPOA. The financial adviser may, if requested by the client, check the financial details are correct. The financial adviser does not provide the 'tranche 2 designated service'.

The Corporations Act has rules under the Code of Ethics on conflicts of interest and duty obligations that restrict financial advisers' ability to accept payment for making referrals to other professional service providers. This places material limits on the manner in which referrals can be made. We suggest these rules would equally impact advisers' ability to 'arrange' for a 'tranche 2 designated service' to be provided by a 'tranche 2 reporting entity' to the client.

Risk management in financial advice

Under s912A(1)(h) of the Corporations Act, AFS licensees must have adequate risk management systems in place. This must include a risk management framework that documents its risk management systems and processes, senior management responsible for overseeing the framework, and risk management reporting lines and staff training. The framework must be approved by the entity's governing body and reviewed annually.[8]

The licensee must establish and maintain structured and systematic processes for identifying, evaluating, managing and monitoring risks faced by the business; and internal controls that take into account the specific risks relevant to the nature, scale and complexity of the business (including the client types it services).

The Corporations Act also requires AFS licensees to hold adequate professional indemnity (PI) insurance[9]. PI Insurers place additional risk management requirements on licensees.

These risk management requirements under the Corporations Act support the 'special program' exemptions afforded to 'item 54 only reporting entities'.

[8] ASIC RG104 *AFS licensing: Meeting the general obligations*
[9] Section 912B

Additional financial services provided by some financial advice businesses

Multi-disciplinary professional services

As discussed above, the provision of financial advice is distinctly different to other professional services. However, there are some businesses that provide multi-disciplinary professional services to meet their client's needs. For example:

- financial advice and public accounting services
- financial advice and mortgage broking services

The business structure of multi-disciplinary professional service providers generally includes strict controls to prevent the spreading of risk across the different services. The financial services regulatory and professional environment lends itself to this demarcation of responsibilities and segregation of services. For example, a business group that provides accounting and financial advice services would generally operate under a structure that included two separate and distinct legal entities:

- Company 1 - AFS licensee or Corporate Authorised Representative providing financial advice services
- Company 2 - Accounting business providing public accounting services.

This business structure is commonly used within a large business group as well as small multi-disciplinary professional service businesses.

The AML/CTF obligations should apply to the services provided by the legal entity and the professional. Financial advisers who provide 'item 54 designated services' only should not be required to meet the obligations for the higher risk 'tranche two' services. In the above scenario, we believe Company 2 would have PSP obligations, but Company 1 should be required to meet the 'special program' obligations as it would only provide 'item 54 designated services'.

This approach mirrors the application of the current AML/CTF obligations where a business group may provide multiple designated services and a separate legal entity within the group holds the AFSL and is registered with AUSTRAC as a 'item 54 only reporting entity'. With professional service providers, this could just be done on a smaller scale.

Based on the consultation paper, it is unclear who would be considered the reporting entity for AML/CTF regulated accounting services. Is it the firm, the individual professional or a larger overall group?

MDA and IDPS operators

A small number of AFSL holders make an informed business decision to provide other financial services in addition to financial advice. For example, offering managed discretionary accounts (MDA) (including managed accounts) and unregistered managed investment schemes as an additional service for their clients. These financial services have more stringent requirements under the Corporations Act including higher risk management obligations[10], and MDAs and IDPSs form unique subsectors of the 'investment sector' (ie. separate to the 'financial advice sector') in the ASIC Supervisory Cost Recovery model. ASIC provides regulatory guidance on these two services:

- Managed discretionary accounts (RG 179)[11]

[10] Regulatory Guide 259 *Risk management systems of responsible entities* (RG 259).
[11] https://asic.gov.au/regulatory-resources/managed-funds/managed-discretionary-accounts/

- Platforms (including operators of investor directed portfolio services (IDPSs)) that are managed investment schemes and nominee and custody services (RG 148)

We note that reporting entities who currently provide these services under their AFSL would already have Part A and Part B program obligations as they do not provide 'item 54 only designated services' and hence do not qualify for the 'special program'. This should continue.

Professional fees

Consultation paper 2 proposes to exclude professional fees from the intended professional designated service 3. While noting our recommendation to specifically exclude from this designated service 3 'item 54 designated services' and services provided by 'item 54 only reporting entities', we support the proposal to exclude professional fees from PSP definitions. The professional fees are incidental to the provision of the service and when paid, do not represent client funds.

The methods permitted for the charging of financial advice fees to retail clients are regulated under the conflicted remuneration provisions in the Corporations Act[12] and subject to client disclosure and consent obligations.

Recommendations – Financial advice services and PSPs

The FAAA recommends:

a) proposed designated service 3 be re-worded to exclude any prospect of incorporating 'item 54 designated services' and services provided by 'item 54 only reporting entities'.

b) the 'special program' exemptions that currently apply to reporting entities that only provide 'item 54 designated services' be retained, including for

a. licensees or Corporate Authorised Representatives within a business group, where other entities within the group provide 'tranche two' designated services, and

b. individual financial advisers who only provide financial advice within a multi-disciplinary PSP firm

c) that the extension of the AML/CTF regime to 'tranche two' entities:

a. clearly identifies the reporting entity for 'tranche two' designated services

b. enables the identification of separate reporting entities for each professional service, where applicable

c. does not inadvertently capture the provision of financial advice or financial advisers who only provide 'item 54 designated services'

d. *clearly sets out how the AML/CTF regime intends to apply to multi-disciplinary professional service providers.*

d) the law make it clear that providing assistance to a client to seek a 'tranche 2 designated service' from a 'tranche 2 reporting entity' should not:

[12] Divisions 4 and 5 of Pt7.7A; RG246: Conflicted and other banned remuneration

a. *be considered an 'item 54 designated service' or an AML/CTF designated service*

b. *permit CDD to be undertaken or relied upon under third party reliance.*

Paper 5: Broader reforms to simplify, clarify and modernise the regime

CDD framework

The FAAA welcomes the intent that the proposed CDD reforms will be technology neutral and provide flexibility to reporting entities about how they fulfil their CDD obligations commensurate with customer risk.

The proposed CDD framework includes a new mandatory customer risk rating assessment and assignment, and five types of CDD requirements. As noted in this consultation paper, the Rules will establish minimum KYC information collection and verification requirements for customer types; and reporting entities will retain flexibility in how to meet initial CDD obligations in practice. It is difficult to provide detailed feedback based on the high level proposal in the absence of these Rules.

The security and efficiency benefits of a technology neutral regime could be realised through digitised flow chart processes of the proposed CDD framework. For example, a digitised flow chart could record the outcome of an individual risk rating and trigger the type of CDD required to be undertaken.

While this offers flexibility to reporting entities, we are concerned about the potential complexity in applying the proposed CDD framework in the context of 'item 54 designated services' and for financial advisers acting under third party reliance with other reporting entities. AUSTRAC guidance in this regard would be helpful.

Customer risk rating

The consultation paper outlines a proposed requirement that reporting entities must assign a risk rating to each customer before providing a designated service.

Under the AML/CTF Act, financial advisers provide an 'item 54 designated service' when they 'make an arrangement' to enable a customer to receive a designated service. This relates to the implementation of the financial advice and may include, for example:

- introducing the provider of the designated service to the client
- negotiating the terms and conditions between the product issuer and the client
- assisting and providing guidance on completing the product issuer's documentation.

Hence, the proposed customer risk rating would be undertaken by the financial adviser at the time of implementing the financial advice recommendation, if this involved the provision of a designated service. This is current practice under the AML/CTF Act and should not change. Financial advisers would collect some of the information used in the customer risk rating earlier in the advice process.

The consultation includes proposed 'triggers' requiring a re-assessment and potential changes to the customer risk rating. These could be problematic in relation to an 'item 54 designated service' in some instances. For example, if the 'trigger' occurs outside of meetings or conversations between the adviser and the client, the adviser may not know of the change at the point in time that it changes. The financial adviser may only be made aware of the change when the client notifies the adviser.

The ‘item 54 designated service’ is often provided to a couple as a single client under the financial advice regime. Depending on the advice recommendations, the ‘arrangement’ for another ‘designated service’ to be provided by another ‘reporting entity’ (ie not the financial adviser) may be for each individual or for the couple as a single client. For example, superannuation can only be taken out by the individual, but legal services may be provided to the couple as a single client. It is unclear how the risk rating should apply to a ‘couple’ client.

The FAAA supports the proposal to empower the AUSTRAC CEO to make rules providing for specific risk factors to be considered as part of the customer risk rating. While this provides flexibility for the regime to respond to emerging risks, sufficient transition arrangement would be required between rule changes and implementation to allow time for digitised AML/CTF systems to be updated to cater for the rules changes.

Customer due diligence

The consultation paper provides a high level proposed framework for CDD and notes that the Rules would establish the minimum information collection and verification requirements for a reporting entity to be reasonably satisfied that it knows the identity of its customer. Our feedback relates to the concept of this framework only. It is difficult to provide detailed feedback in the absence of these Rules.

Initial CDD - The consultation paper indicates that “initial CDD may include leveraging existing ‘Know Your Customer’ or CDD processes established to fulfil regulatory obligations outside of the AML/CTF regime”. The FAAA supports the intent of this proposal.

Ongoing CDD - The consultation paper states: *Reporting entities must apply ongoing CDD measures to each customer proportionate to risk, including transaction monitoring and re-verifying Know Your Customer (KYC) information when appropriate.*[13] Ongoing CDD is currently exempt from ‘special program’ obligations. We recommend this exemption continues.

Enhanced CDD – The FAAA supports the proposed ‘triggers’ that would require enhanced CDD to be applied. Under the existing Rules, the ‘special program’ excludes enhanced CDD. While we suggest it would be appropriate in most financial advice relationships for this exemption to continue, given the potential increased ML/TF risk, we support the suggestion that enhanced CDD should be required:

- for clients who are assigned a ‘high’ risk rating, are foreign politically exposed people (PEPs), or are from a high-risk jurisdiction for which the FATF has called for enhanced due diligence to be applied, or

- there is a suspicion of ML, TF or identity fraud and the reporting entity proposes to continue the business relationship.

Simplified CDD – The FAAA supports the approach for simplified CDD for customers rated as low risk, and the proposal to give the AUSTRAC CEO delegated authority to make rules mandating certain factors to be considered before applying simplified due diligence and to prohibit simplified due diligence in certain circumstances. An example of simplified CDD could be an older client without photo identification where the financial adviser has another basis to believe the client is who they say they are, such as having known them over a long period of time.

[13] Page 15

Standard CDD – Based on the flowchart in the consultation paper[14], standard CDD involves "collecting and verifying KYC in line with the reporting entity's risk assessment, which must at least meet minimum requirements in the Rules". It is currently unclear what these minimum requirements would be, however the FAAA supports the inclusion of standard CDD in the CDD framework. We suggest the framework may be made clearer by stating that standard CDD is to apply, other than where the risk rating permits simplified CDD or requires enhanced CDD to be applied, if this is the intent of the proposed framework.

Record keeping – It is currently unclear whether there will be any changes to the AML/CTF record keeping obligations. We note reference in the consultation paper to the department's commitment to work with stakeholders to explore options to reduce the requirements for sensitive data retention, while maintaining the integrity of the AML/CTF regime. However, product providers often ask financial advisers to provide client identification and documentation to satisfy the product provider for AML/CTF purposes. Consideration should be given to the data security risk in retaining client data and record keeping requirements.

Customer definitions

Consultation paper 5 proposes the introduction of customer definitions:

- 'occasional transaction' - the provision of a designated service to a customer outside a business relationship

- 'business relationship' - a relationship between a reporting entity and a customer involving the provision of a designated service that has, or is expected to have, an element of duration.

Consumers may seek financial advice in different ways. For example:

- one-off advice – eg. simple advice on superannuation, debt management and budgeting. This is generally paid as a fixed fee for service with no further services provided. The process of providing this advice may involve multiple interactions with the client over a duration of a few weeks or more. This is considered a one-off advice service and the client might not seek advice again, or not again for a few years.

- ongoing advice - eg. ongoing advice generally involves more complex advice needs. It can be provided under an ongoing fee arrangement with agreed services generally provided for a fixed or percentage-based fee (such as asset-based fees and investment management fees).

The proposed definition of 'business relationship' would likely capture both a one-off and an ongoing advice service/relationship. Given the low AML/CTF risk of financial advice, we question whether this is the intent of the proposal.

It is important to consider the application of the proposed customer definitions to different industries due to their role in determining the appropriate CDD obligations for the client. For example, a clearer definition when applied to 'item 54 designated services' would be where there is an ongoing service agreement in place and the financial adviser provides designated services for the client on a regular basis. The conclusion of this 'business relationship' would be where there is no (or no longer an) ongoing service agreement in place.

Importantly, as discussed above, we have been informed that the current 'special program' obligations will continue for 'item 54 only reporting entities'. Under the existing Rules, the 'special program'

[14] Page 16

excludes ongoing CDD and enhanced CDD. These exemptions should continue to apply regardless of the application of the proposed ‘customer definition’ to financial advice clients.

Pre-commencement customers

AFSLs came under the AML/CTF Act at the time of the commencement of the regime. We note that the initial transition arrangements of the regime included ‘grandfathering’ pre-commencement clients. Financial advice services are typically either one-off services or involve an ongoing arrangement. When an additional service is provided it is usually triggered by a change in the client’s circumstances. This requires financial advisers to ‘redo’ the ‘know your client’ requirements under the Corporations Act.

We note that, under the current AML/CTF Act, the identification of a client is done prior to providing the first designated service; and if there is no reason to believe the client is not who they say they are, there is no obligation to re-verify the client. However, financial advisers conduct identification verification for product providers under third party reliance. A financial adviser may assist an existing client to invest in a new financial product, which can happen on numerous occasions over the life of an existing client relationship. While the client is an existing client for the adviser, they would be a new client for the new product provider. In these circumstances, it is common for product providers to request re-verification of identification if the initial verification conducted by the adviser was done some time ago. Over the years, product providers have also frequently asked financial advisers to re-verify the identification of existing clients when a client acted on an account (i.e. superannuation).

Hence, we suspect that there may only be a small number of financial advisers’ ‘pre-commencement clients’ whose identification has not been verified since the commencement of the regime. However, for licensees impacted by this proposal, it may be difficult to identify which customers are affected. This is because not all clients obtain a ‘designated service’ (ie where the financial adviser has ‘made arrangements’ for the client to receive a new/additional designated service) every year, and some clients may not have received an additional ‘designated service’ from the financial adviser for some time. For example:

- clients who received life risk advice only, may not have needed an additional 'designated service’ from the financial adviser as any changes in their circumstances may not have had a material impact on the life risk product and they may not have made a claim
- clients may engage a financial adviser for superannuation accumulation advice and review without commencing a pension or making a withdrawal (although identification has often been conducted in relation to this advice even though no ‘designated service’ has been provided by the financial adviser).

For licensees with ‘pre-commencement clients’ who have not been ‘onboarded’ for AML/CTF purposes, this proposal will likely have a large impact if the licensee/adviser does not currently store an individual risk rating for a client. Implementation of this requirement will also be impacted by record keeping requirements and the availability of information regarding ‘pre-commencement’ clients. It will be a time-consuming task for these licensees and a reasonable transition timeframe would be required. This timeframe should focus on the impact for businesses and allow licensees to continue to also meet their ‘business as usual’ AML/CTF obligations. We suggest the FATF review deadline may not provide a sufficient timeframe for impacted licensees to transition ‘pre-commencement clients’.

The FAAA supports the Department's proposal to:

- *"add a trigger for CDD for pre-commencement customers where there is a material change in the nature and purpose of the business relationship that results in medium or high risk,*

- *extend the requirement for a customer risk rating to all pre-commencement customers to inform a risk-based transition into the regime. The AML/CTF Act would then require a reporting entity to collect and verify 'Know Your Customer information' about any pre-commencement customer who is rated as medium or high risk. 'Know Your Customer information' that has previously been collected and verified by a reporting entity could be used for this purpose, where appropriate." (Page 24-25)*

We believe this is a sensible risk-based approach to transitioning 'pre-commencement clients'.

However, it is currently unclear when this proposal would apply to 'pre-commencement' clients of financial advisers. Given the low risk of 'item 54 designated service', would this only apply when a 'pre-commencement' client requested a new designated service? Or is it anticipated that licensees would be required to potentially go through an entire client database to make sure each client is allocated a risk assessment and CDD verified? We suggest this would be an extremely costly and time-consuming exercise for impacted licensees disproportionate to the likely benefit.

We are also concerned about the operation of third party reliance in relation to the proposal to bring 'pre-commencement clients' under the regime. There would likely be a very high cost that would be incurred by financial advisers and AFS licensees, if product providers were to meet this proposal by requesting financial advisers undertake the risk assessment and CDD verification of all product provider clients who might, at one point in time, have received financial advice. Such clients may not receive an 'item 54 designated service' (ie. there may be no client need for the financial adviser to 'make arrangements for another designated service') for some time. We suggest that the product provider should be responsible for onboarding 'pre-commencement clients' directly in such circumstances.

Recommendations – CDD framework

The FAAA recommends

- *the law clarify that a 'trigger' for a potential change in the customer risk rating occurs when the reporting entity becomes aware of the trigger event, rather than when the trigger event occurs*

- *the proposed 'customer risk rating' should be applied to the 'couple' as one client of the financial adviser where two members of a couple are being treated as a single client*

- *'Item 54 only reporting entities' continue to be exempt from ongoing and enhanced CDD obligations.*

- *consideration be given to the application of the proposed definitions of 'occasional transaction' and 'business relationship' to 'item 54 designated services'*

- *AUSTRAC provide guidance on the operation of third party reliance for transition arrangements for onboarding 'pre-commencement clients'.*

Third party reliance

Financial product providers may currently use financial advisers to comply with their CDD verification, re-verification, and ongoing CDD obligations under third party reliance provisions.

As product providers have ongoing CDD requirements under the AML/CTF Act[15] due to the higher risk designated services they provide, financial advisers are regularly requested to undertake additional and ongoing CDD of their clients under the third-party reliance provisions, beyond what is necessary to meet item 54 CDD obligations.

Third party reliance offers both benefits and inefficiencies for financial advisers. For example, third party reliance:

- allows CDD to be conducted by one provider (ie. the adviser) to satisfy the CDD obligations of potentially multiple providers (for example, wrap, super fund, bank, etc)
- reduces the need for every product provider to conduct CDD directly on the client
- provides comfort for clients who may be wary of approaches from service providers other than their adviser, and are reluctant to click on links or action requests received from an organisation they have not dealt with directly before (such as a new product provider)
- advisers wear the cost and time required to undertake additional CDD verification above their own legal requirements
- clients get frustrated with advisers when extra CDD is required to satisfy a product provider, even though the client's details have not changed and they have been a long-term client of the adviser. This impacts the client-adviser relationship.

While there are benefits to clients and product providers, financial advisers wear the downside of third party reliance. The law should permit financial advisers to charge other reporting entities for conducting initial and ongoing CDD under third party reliance, particularly when the customer risk assessment and identification verification exceeds what is necessary for financial advisers to meet their own AML/CTF obligations. This should also be reflected in the Corporations Act.

We appreciate that it is a business choice whether to enter into a third party reliance arrangement or action a CDD request from another reporting entity, however the law and AUSTRAC guidance must be clear on the legal obligations for each party. It is currently unclear how the proposed changes and the proposed move to a more risk-based framework for CDD will operate under third party reliance.

It is our understanding that the initial and ongoing CDD obligations to be met when onboarding a client may require enhanced, simplified, or standard CDD verification, depending on the risk of the client and the designated service to be provided. However, the risk of a client receiving 'item 54 only designated services' from a financial adviser on behalf of an AFS licensee is low; while the risk of a client receiving an investment product from a product provider is higher. This client risk rating must be used to determine the type and level of CDD that is required.

Clarity is required as to how the discrepancy in client risk rating is to be rectified.

[15] s36 of the AML/CTF Act

The consultation paper states:

> *A reporting entity would be able to determine the format of a risk rating scale and could be a matrix, a numerical scale or another means that best reflects a reporting entity's needs and risk tolerance. However, it must be clear from the scale where customers are high, medium or low risk. These risk ratings could be applied at the individual customer level or, where customers can be grouped by similar characteristics, applied across a cohort or grouping of similar customers.*

Standardisation provides significant efficiencies for third party reliance CDD activity. While historically industry has produced standard CDD forms and guidance for third party reliance between financial advisers and product providers, technology advancements provide the opportunity to develop secure digital solutions that would strengthen the AML/CTF outcomes of the CDD obligations.

FAAA supports the suggestion that the "*AUSTRAC CEO be empowered to make rules providing for specific risk factors to be considered as part of the customer risk rating, to allow flexibility and responsiveness to emerging risks and to provide clarity to reporting entities where required. This could include mandating a high-risk rating for certain customers in specified circumstances, for example, where a certain customer is connected with a country subject to sanctions*".

Recommendation – Third party reliance

> *The FAAA recommends*
>
> - *AUSTRAC work with key stakeholders to develop clear and workable guidance on the operation of third party reliance under the proposed CDD framework*
> - *that the proposed changes to 'customer risk rating' allow for industry level standardisation of processes.*

Independent Review of 'special program'

We note the proposal for AML/CTF programs to be independently reviewed at a minimum every four years. Currently 'item 54 only reporting entities' are not required to review their AML/CTF 'special program'.

As discussed above, AFS licensees establish and maintain appropriate risk management protocols and systems to meet their Corporations Act obligations and to satisfy professional indemnity insurers.

Overlaying these obligations with additional AML/CTF requirements will add unnecessary complexity and cost with no additional ML/TF benefit.

Recommendation – Independent review of special program

> *The FAAA recommends 'special programs' continue to be exempt from the independent review requirements.*

Business group

While we welcome the intent of the proposed 'business group' concept to allow greater information sharing between members of a business group and facilitate appropriate group-wide risk

management and sharing of AML/CTF obligations, the FAAA seeks clarity in relation to the detail of the proposal.

Under the current regime, reporting entities within a group of related entities can choose to establish a designated business group (DBG). However, the consultation paper states:

> *"The department proposes replacing the concept of a DBG with a simplified 'business group' concept, which would automatically include all related entities in a corporate group or other structure." (Page 11)*
>
> *"A business group head would be responsible for developing a group AML/CTF program ……[and] must ensure that its AML/CTF program applies to all business group members that provide designated services in Australia….."*

This wording implies that establishing and operating as a business group for AML/CTF purposes:

- would become a mandatory (automatic) requirement
- capture all entities within the business group
- apply a group-wide AML/CTF program to all entities within the group, regardless of each entity's AML/CTF obligations under the Act.

However, a business group may include an 'item 54 only reporting entity' required to meet the 'special program' obligations only under the Act. It is unclear whether the intent is for 'item 54 only reporting entities' that are part of a business group to have to meet all the AML/CTF requirements of the broader group. This would significantly disadvantage one subset of advice providers as those AFS licensees, who are part of a group, and their financial advisers, would be required to meet much more onerous AML/CTF obligations, creating regulatory based competition issues within the market.

We are concerned by the proposal that all related entities in a corporate group or other structure would 'automatically' be included in the 'business group'. Given the breadth of the AML/CTF regime and the diversity of business models and services it covers, the business group concept may disadvantage some businesses over others.

These issues would be particularly problematic for business groups containing more than one professional services business.

We question whether this approach is in line with the "competition tests" in the Australian Government Guide to Regulatory Impact Analysis, and the Regulatory Impact Analysis Guide for Ministers' Meetings and National Standard Setting Bodies. These tests help ensure that regulations do not unduly restrict competition unless they are in the public interest. Given the 'reporting entities' within a 'business group' would already be obliged to meet the requirements in the Act, and those obligations provide AML/CTF protection to the community, there is little public interest in making the 'business group' concept mandatory with a group-wide program to apply to all entities within the group.

Recommendations

The FAAA recommends the proposed business group concept:

- *be a choice for businesses within the group - businesses should not be forced to join the group. This could be based upon an election or opt-out model*

- *should not automatically include all related entities in a corporate group or other structure*
- *A related entity of a 'business group' which is an 'item 54 only reporting entity' should not be required to meet the group-wide AML/CTF program – ie the 'item 54 only reporting entity' related entity should meet the 'special program' requirements only.*

AUSTRAC guidance

FAAA supports the intent of the proposed changes to move to a more outcomes-focused regime and the flexibility this should provide reporting entities when developing a risk-based approach to meeting their AML/CTF obligations.

AUSTRAC guidance specific to the financial advice profession, would be helpful to assist licensees and financial advisers to understand AUSTRAC's expectations in relation to AML/CTF risk at a business and client level, particularly in relation to:

- how to conduct a customer risk assessment
- meeting AML/CTF obligations for small businesses
- the operation of third party reliance:
    - for transition arrangements for onboarding 'pre-commencement clients', and
    - under the proposed CDD framework.

This list summarises the recommendations for AUSTRAC guidance made throughout this submission.

Cost recovery levy

The current AUSTRAC cost recovery levy applies to entities based on earnings and the number and value of transactions reported to AUSTRAC. Usually, only medium to large businesses are required to pay the levy. These are businesses with one or more of the following:

- earnings of A$100 million or more
- a large number of transaction reports relative to other entities
- a high total value of transaction reports lodged with AUSTRAC during a calendar year, relative to other entities.[16]

Under the Act, the Minister has the ability to make a determination including for reporting entities to incur a levy of nil based on criteria included in the determination. In the past, this criteria has included small businesses. We support the retention of this practice to avoid unnecessary small invoices that would otherwise apply to small business reporting entities.

Recommendation – Cost recovery levy

The FAAA recommends the current levy arrangements, that all small businesses do not pay a levy, should continue.

[16] Industry contribution levy | AUSTRAC