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Evan Gallagher
Principal Specialist, Policy
AUSTRAC
4 National Circuit
BARTON ACT 2600

Dear Evan,

Reporting of International Electronic Funds Transfer Instructions - Draft Regulatory Guide

The Australian Financial Markets Association (AFMA) represents the interests of over 120 participants in Australia's wholesale banking and financial markets. Our members include Australian and foreign-owned banks, securities companies, treasury corporations, traders across a wide range of markets and industry service providers. Our members are the major providers of services to Australian businesses and retail investors who use the financial markets. The majority of AFMA's members are reporting entities for the purposes of the AML/CTF Act.

AFMA very much appreciates the collaboration with AUSTRAC that has resulted in AUSTRAC producing the Draft Regulatory Guide on Reporting of International Electronic Funds Transfer Instructions (**the Draft Regulatory Guide**) and related documents, including the diagrams setting out scenarios and primary conclusions as to reportability. We set out below our perspectives in relation to the Draft Regulatory Guide and the positions taken in the Guide.

1. Context For Engagement

Prior to providing industry perspectives on the particular matters raised in the Draft Regulatory Guide, we would like to confirm our view as to the basis for the engagement with AUSTRAC regarding the reportability of International Funds Transfer Instructions (**IFTI**).

As AUSTRAC is aware, the process that has given rise to the Draft Regulatory Guide was initiated by industry out of a desire to obtain clarity as to AUSTRAC's expectations of the reporting obligations that may arise from different scenarios. This clarity was necessary given the removal by AUSTRAC of guidance regarding the reportability of various SWIFT scenarios (both **Guidance Note 11/01** and **PLI 11 on EFTI and IFTI**) and confirmation by AUSTRAC that reporting entities could not rely on guidance

that was not publicly available. This resulted in reporting entities seeking independent legal advice on the reportability of certain scenarios. Given the complexity of both the legislative framework underpinning IFTI reporting and the specific commercial scenarios, the legal advice received was not necessarily consistent across the reporting entity population. This inconsistency was exacerbated through AUSTRAC providing guidance to certain reporting entities on a bilateral basis.

At the commencement of engagement with AUSTRAC, AFMA expressed its preference in terms of outcomes as follows:

- Where there is consensus between AUSTRAC and industry that a certain scenario does not result in an IFTI reporting obligation, that AUSTRAC issue guidance confirming this position; and
- Where consensus is not reached between AUSTRAC and industry that a certain scenario does not result in an IFTI reporting obligation, then clarity is obtained through the Stage 2 Simplification Project that is being conducted by the Department of Home Affairs. This clarity would arise through consideration of both the legal framework, and the extent to which this framework could be simplified, and also the intelligence value associated with the information that may be included in any report.

Under this approach, reporting entities would continue to report IFTIs to AUSTRAC in accordance with their own legal advice and AUSTRAC would adopt regulatory pragmatism in terms of the compliance approach adopted.

AFMA is aware, however, that where there is misalignment, AUSTRAC's preference is to issue guidance setting out regulatory expectations so as to "level the playing field." While such guidance is generally welcomed, AFMA remains concerned that, based on the positions adopted by AUSTRAC in the Draft Regulatory Guide, such guidance will necessitate significant changes by reporting entities to systems, processes and controls. These systems, processes and controls are likely to require further amendment in relation to the Stage 2 Simplification project, resulting in significant costs and regulatory burden for Reporting Entities. Accordingly, in the event that this approach is the one ultimately adopted by AUSTRAC, AFMA would support a regulatory approach whereby AUSTRAC adopted regulatory pragmatism in a similar manner that has been taken for account opening in that reporting entities, over time, will replace or update their infrastructure and will move towards systems that permit the reporting of IFTIs as set out in the guidance in the ordinary course of business. This should also be accompanied by a letter of intent for at least two years from the finalisation of the guidance so as to not allocate compliance resources to reporting entities that are undertaking best endeavours to adapt to the AUSTRAC guidance, nor to any historical reporting approaches that may have been adopted prior to the issuance of the guidance.

It is noted that, based on the positions adopted in the Draft Regulatory Guide, the legal interpretations adopted by AUSTRAC differ to those taken by reporting entities, with some of the fundamental differences detailed further in this submission. AFMA would appreciate the opportunity to have a deep discussion with AUSTRAC in these areas to better understand the legal position adopted by AUSTRAC and to ensure that any guidance as to reportability is based on a current legal obligation as opposed to the intelligence value that would be obtained through the report.

2. Fundamental Concepts

AFMA notes that the fundamental concepts that underpin the IFTI reporting requirements, such as “transfer,” “instruction” and “money controlled by the payer” have been defined expansively in the Draft Regulatory Guide and beyond previously published recent guidance. In relation to these definitions, AFMA seeks clarity on the following:

- The definition and indicators of “control” appear to hinge on the behaviour and actions of the financial institution, that is, where the financial institution will accept the instructions of the customer with respect to the money, then it is money controlled by the payer. Further clarity is sought as to the definition of control prior to the acceptance of the instruction including scenarios where payments arise from contractual obligations e.g. FX derivative trading under an ISDA (refer to section on foreign exchange).
- We also note that AUSTRAC appears to minimise the importance of the word ‘control’ in Section 8 and 9 of the AML/CTF Act. This creates a practical issue for reporting entities in circumstances where the concept of money that is ‘controlled by the payer’ indicates the legislature requires a greater element of direction or power to direct the payment of funds being exercised *by the payer* than the proposed draft guidance contemplates. Ordinarily, we would consider a customer to have control of the money if they have the power to give directions as to its payment or transfer, which must be carried out.
- Finally, clarity from AUSTRAC is sought in relation to specific queries relating to loans, specifically whether funds sitting in a suspense account can be considered to be “controlled by the payer” and whether in a loan scenario both draw-downs and repayments are reportable.

3. Definition of Financial Institution/MT202 Reporting

As has been discussed with AUSTRAC throughout the engagement to date, much of the complexity associated with determining reporting obligations for essentially institutional payments arises due to the lack of alignment between the definition of “financial institution” for SWIFT versus the AML/CTF Act. The consequences of the lack of alignment include requiring reporting entities to screen counterparties to manually determine whether any counterparty involved in the transaction is an entity outside the “financial institution” definition and hence results in a reporting obligation.

AFMA recommends the broad adoption of the SWIFT definition of financial institution, such that a “financial institution” represents an organisation that is eligible as a SWIFT user, apart from Treasury Counterparty (TRCO), non-financial institutions in a Member-Administered Closed User Group, Corporates (CORP) and Securities Market Data Provider (SMDP) categories. This approach would ensure that reportability of wholesale payments would only arise in respect of these categories or where there has been misuse. The proposed approach would reflect the limited intelligence value generally associated with large institutional payments.

In seeking greater alignment of the definition of “financial institution” for IFTI reporting purposes, AFMA members are conscious of the implications for the correspondent banking provisions of the Act, that is an expansion of the definition of “financial institution” may give rise to implications in consideration of correspondent banking relationships. AFMA members note that irrespective of a broader definition, reporting entities are required to determine and apply a risk-based approach in establishing correspondent banking relationships and, as such, any implications arising from an

expansion to the definition will not necessarily imply a broadened offering of such services for entity types considered of higher risk.

The Draft Regulatory Guide should confirm that, in order to ensure payments being made in a non-disrupted manner, determination as to whether there has been misuse of messaging types that has given rise to a reporting obligation be determined on a risk-based approach and based on established controls. It is also noted that the current schema of the MT202 does not align with the IFTI requirements as set out in Chapter 16 of the AML/CTF Rules and we request a change to the Rules to align the reporting requirements to the schema.

Finally, AFMA notes and supports the proposed Rule to remove any reporting obligation where a financial institution is acting on its own behalf and seeks clarity as to whether the ambit of the proposed exemption is where one or both parties are financial institutions.

4. Trade Finance/Syndicated Loans

The engagement between AFMA and AUSTRAC has highlighted that the reportability of trade finance scenarios is, in AFMA's view, the area of the least alignment between reporting entities and AUSTRAC under the current legislative framework. Our view is that in the absence of guidance from AUSTRAC on reporting trade finance scenarios specifically, reporting entities have not taken the view that the scenarios result in a reporting obligation (noting that AUSTRAC guidance may have been provided bilaterally to a sub-set of reporting entities).

This is the case because, for trade finance scenarios involving guarantees, the legal nature of the relationship is one whereby the ordering institution is providing an independent guarantee to the payee through the beneficiary institution, as opposed to just facilitating a transfer. The nature of this relationship results in differences which are fundamental from a reportability perspective, such as:

- The issuing bank has the personal obligation to pay and may do so prior to receiving funds from the importer, and has no recourse should the importer default and becomes insolvent, calling into question whether there is an instruction by a payer to transfer money controlled by the payer;
- It is up to the ordering institution and not the importer to determine whether the conditions of the LC have been satisfied.

The scenario is best thought of as a transfer of the financial institution's own money to fulfil a contractual obligation and, as noted in the Draft Regulatory Guide, where a transfer is at the complete discretion of the financial institution, then the money cannot be construed as being controlled by the payer. In other words, it is difficult to see how the control criterion is satisfied for transaction scenarios where it is fundamental that the payer does not have control over the funds.

AFMA acknowledges the intelligence value associated with trade finance transactions. However, this does not, of itself, give rise to a presently existing legal obligation to report. To the extent that the legal framework is to be aligned to the desire for intelligence to be provided to AUSTRAC, AFMA's clear preference is for this to be considered holistically (i.e. not just through the consideration of IFTIs) as part of the Phase 2 Simplification Project. At a minimum, AFMA requests that AUSTRAC

articulate with specificity the legal position that it believes results in a reporting obligation in relation to trade finance transactions.

In the interim, AFMA suggests that AUSTRAC issue guidance setting out clear indicia in trade finance transactions that would require a reporting entity to lodge a Suspicious Matter Report (**SMR**).

The other issue of concern with respect to reporting of trade finance transactions (which we reiterate industry's view are not currently reportable) also gives rise to specific issues based on the existing messaging infrastructure, such as:

- There may be a significant lag between the commencement of a trade deal and the MT700 and separate instructions that may not be matched;
- MT400s in respect of Documentary Collection do not contain payer or payee details and hence these will need to be sourced elsewhere.

Finally, AFMA notes the conclusion of general non-reportability of syndicated loans is appropriate, although clarification is sought as to the reporting requirements in circumstances where a member of the syndicate is not a "financial institution" under the AML/CTF Act definition.

5. Foreign Exchange

AFMA supports the proposed exemption with respect to foreign exchange swap transactions and the advice from AUSTRAC that the ambit of the proposed exemption is based on the scenario put by AFMA. On this basis, we would support expansion of the proposed exemption to include scenarios where there is an onshore transaction with an institutional offshore leg, such as asset classes traded on global markets, including derivatives. The drafting of this proposed exemption on a principles basis as opposed to being prescriptive as to the type of instrument should also ensure that the exemption is agnostic as to transaction type. There are limitations in identifying transactions to exclude in order to rely on the current drafting of the exemption, including the "legs" may be with counterparties that are not financial institutions for the purpose of the AML/CTF Act and the "legs" are not associated by a common identifier.

Additionally, AFMA requests that AUSTRAC adopt an accommodative compliance approach with respect to existing transactions that fall within the scope of the proposed exemption.

With respect to the existing reporting obligation, AFMA seeks clarity from AUSTRAC as to how the "transfer" condition is satisfied in an FX transaction where there is a sell leg and a buy leg of the different denominations and how "control" should be applied to FX trades, particularly those governed by a ISDA Master Agreement.

Lastly, we would also be interested in understanding if AUSTRAC would expect to see FX settlements to third parties included for IFTI reporting purposes or whether they would also be exempt.

6. Credit Cards/Push & Pull Payments

AFMA is supportive of the proposed Rule to provide an exemption for card based e-commerce pull payments. Broadly, the submission points in relation to the pull payments section of the Draft Regulatory guide seek clarity in relation to a number of issues, namely:

- Can AUSTRAC confirm AFMA’s view that there are no pull payments that fall outside the scope of the proposed exemption and consequently give rise to a reporting obligation;
- Can AUSTRAC confirm that any genuine refunds arising from a pull payment are not reportable;
- In relation to the proposed Rule to expand the definition of “ordering institution” and “beneficiary institution” to include foreign remittance businesses, AFMA is generally supportive of the consolidation but seeks clarity on the entity that has responsibility for reporting and that the expansion is contained to IFTI reporting without impact to other AML/CTF obligations;
- To the extent that instructions that are provided through the cards network are reportable, given that the IFTI reporting requirements correlate to the SWIFT fields which are not provided for payments made via the cards network, is AUSTRAC intending to provide a schema or separate fields to facilitate the reporting of such instructions? Specifically, AUSTRAC guidance is sought as to the reporting obligations where the necessary information is not provided.

7. *Incomplete, Cancelled and Aborted IFTIs/Systems & Controls*

The comments in the Draft Regulatory Guide with respect to incomplete, cancelled and aborted IFTIs and systems and controls highlight, in AFMA’s view, the difficulties imposed upon reporting entities and the appropriateness of the obligations of reporting entities to be considered as part of the Phase 2 Simplification Project, with consideration of the intelligence value information contained in reports balanced against practical limitations and the desire of other financial regulators for payments to be made more quickly and with less disruption. In AFMA’s view, adhering to AUSTRAC’s expectations as expressed in the Draft Regulatory Guide is operationally burdensome. This is particularly the case in circumstances where the amendment or cancellation occurs after the IFTI-E has been sent to AUSTRAC.

The Draft Regulatory Guide requires that, in circumstances where there is the cancellation or amendment of an instruction subsequent to the lodgement of the IFTI report, then the reporting entity is required to lodge a new IFTI in respect of the updated instruction and then request the return of the initial IFTI report to the reporting entity to amend the original report. Given that AFMA estimates that there are tens of thousands of instructions that are cancelled and the IFTI report in respect of the cancelled/amended instruction may have been provided to AUSTRAC in an xml file format with many other reports, adherence to these expectations will be both very challenging and disproportionate to the intelligence value obtained from the re-reporting of the initial instruction, particularly given the ten-day reporting period.

In circumstances where the funds are transferred and then returned (i.e. a cancellation), AFMA would support a position where each leg was reported separately under a separate IFTI-E report without the requirement to amend the initial report to address the cancelled instruction.

The other particular concern that AFMA would like to raise with respect to operational challenges with adhering to AUSTRAC’s expectations is in the area of systems and controls, especially in relation to the comments on p21 of the Draft Regulatory Guide. The particular issues arise in relation to not being able to control the quality of the information received on one hand, and the requirement to

report appropriately within ten days of the instruction on the other, particularly in circumstances where, as noted by AUSTRAC, the volume of incoming IFTIs is immense.

The Draft Regulatory Guide states that the obligation of the reporting entity goes beyond ensuring that a report is made but also “extends to ensuring that the information contained in the reports is accurate and that it contains the required information.” It is noted that this statement, in AFMA’s view, goes beyond the current legal requirements under the AML/CTF Act and/or Rules. The FATF Mutual Evaluation of Australia called out that the Australian legal framework “does not yet require the new elements of Recommendation 16: verification of the accuracy of the information.” In AFMA’s view, the Draft Regulatory Guide should be amended to reflect the legal requirements. Additionally, even to the extent that the Phase 2 Simplification Project considered systems and controls and updated the legal framework to incorporate Recommendation 16 (which AFMA would support), it may not be the case that the jurisdiction from where the inbound message originated has adopted the Recommendation 16 requirements. These issues are exacerbated by unstructured/free-form data included in reports that pose additional challenges from an assurance perspective. As such, Reporting Entities have limited ability to control the quality of the incoming information.

Further, it is not clear whether the requirement to ensuring that the information contained in the reports is accurate extends to the validation of information contained in free text fields. The regulatory burden associated with such a requirement is significant, particularly given difficulties associated with operationalising such a requirement.

The Draft Regulatory Guide is silent on the practical approaches that should be adopted by Reporting Entities to ensure that the incoming message contains the required information and that the appropriate message type has been used, merely stating that the “reporting entity should address this matter with the overseas counterpart.” Given the obligation for the report to be lodged within a ten-day period from the time of instruction and the regulatory approach from AUSTRAC historically appearing not to consider incomplete reports as being preferable to no report from an enforcement perspective, AFMA’s view is that this is an area where some accommodation may be provided to reporting entities to allow reasonable action to be undertaken in accordance with the reporting entity’s risk-based approach. This may include reporting entities developing a control framework that allows for review/remediation after the fact, thereby allowing payments to continue to flow. Flexibility in terms of the commencement of the ten-day period to when complete information is received (as opposed to the time of the instruction) and expanding the ability of reporting entities to report on an “if known” basis.

As the Draft Regulatory Guide currently discusses only a limited set of specific scenarios, AFMA seeks clarity from AUSTRAC of principles able to be applied to a complete set of scenarios such that members can consistently report, giving consideration to factors such as:

- Whether cancellations/amendments occur before or after funds are under the control of the beneficiary;
- Whether cancellations/amendments occur before or after the transfer of funds from the sending institution;
- IFTI-E reporting of return of funds as a factor of the above, and whether these are conducted as wholesale payments;
- Whether amendments change details that would be present in the IFTI-E or not; and

- The ability of interposed institutions to detect payment transactions as part of the above scenarios.

We have attached a matrix of scenarios as to the timing/methodology of cancellation and amendment for the purpose of seeking clarity as to AUSTRAC's expectations.

In relation to specific points of clarification in relation to this area of the Draft Regulatory Guide:

- We request that the Draft Regulatory Guide include specific definitions of "cancelled," "aborted" and "amended" including the conditions upon which changes and information requests are required to be reported given the intelligence value associated with such changes/information;
- Whether there are changes to the reporting requirements and AUSTRAC's expectations in circumstances where the reporting entity is acting as an intermediary, i.e. neither the originating institution nor the final beneficiary institution. In such circumstances the reporting entity may have less visibility of the amendments;

8. Other Points

Although a point broader than the Draft Regulatory Guide, the removal of the previous Guidance Note and the comment from AUSTRAC regarding non-reliability of removed guidance highlights the necessity of AUSTRAC timestamping when guidance is removed. Reporting entities are required to incorporate AUSTRAC guidance into their respective programs and hence it is necessary for there to be an artefact as to when the guidance was/was not operative.

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Please contact me on (02) 9776 7996 or rcolquhoun@afma.com.au if you have any queries about this submission.

Yours sincerely,



Rob Colquhoun
Director, Policy

Attachment

The below scenarios are provided for consideration of the various outcomes and message types potentially involved with abort/cancel/amend payment flows. In addition to these, scenarios with counterparties should be considered.

Cancel/Abort					
Direction	Ordering	Beneficiary	Scenario Events	Timing	Outcome
Outward	Australian	International	Ordering party instructs cancellation (MT192)	Before payment processed	Transaction cancelled . Return funds via MT103.
Outward	Australian	International	Ordering party instructs cancellation (MTx92)	Before payment processed	Transaction cancelled . Return funds via book credit to Nostro and MT199.
Outward	Australian	International	Ordering party instructs cancellation (MTx92)	Before payment processed	Transaction cancelled . Return funds via MT202 (e.g. UK banks).
Outward	Australian	International	Ordering party instructs cancellation (MTx95)	After payment processed	Cancellation effected by successfully recalling funds from beneficiary. Return of funds via MT103 or, MT202, or, Book credit to Nostro and Mt199 (may depend on original transaction type and relationship with ordering institution)
Outward	Australian	International	Ordering party instructs cancellation (MT192)	After payment processed	Original instruction was already successfully processed. Unable to apply cancellation.
Inward	International	Australian	Beneficiary FI unable to process payment and Beneficiary FI requests amendment (MTx95) Amendment not received (N/A) / unsatisfactory (MTx96 or MTx99)	Before payment processed	Transaction cancelled . No return of funds required.
Inward	International	Australian	Ordering party instructs cancellation (MT192)	After payment processed	Cancellation effected by successfully recalling funds from beneficiary Return of funds via MT103 or, Book credit to Vostro and Mt199 (may depend on AUD or FCY and relationship with beneficiary institution)
Inward	International	Australian	Ordering party instructs cancellation (MT192)	After payment processed	Original instruction was already successfully processed. Unable to apply cancellation.

Amend					
Direction	Ordering	Beneficiary	Scenario Events	Timing	Outcome
Outward	Australian	International	Ordering party provides amendment (MTx95/99)	Before payment processed	Amendment may or may not have been used in processing the payment successfully , depending on the specific detail changed.
Outward	Australian	International	Beneficiary FI requests amendment (MTx95), and Amendment provided (MTx96 or MTx99)	Before payment processed	Amendment may have been used in processing the payment successfully ; and may or may not be changes to details in the payment message.
Outward	Australian	International	Ordering party provides amendment (MTx95/99)	After payment processed	Original instruction was already successfully processed. Unable to apply amendment.
Inward	International	Australian	Ordering party provides amendment (MTx95/99)	Before payment processed	Amendment may or may not have been used in processing the payment successfully , depending on the specific detail changed.
Inward	International	Australian	Beneficiary FI requests amendment (MTx95), and Amendment provided (MTx96 or MTx99)	Before payment processed	Amendment may have been used in processing the payment successfully ; and may or may not be changes to details in the payment message.
Inward	International	Australian	Ordering party provides amendment (MTx95/99)	After payment processed	Original instruction was already successfully processed. Unable to apply amendment.