



**CHARTERED SECRETARIES
AUSTRALIA**

Leaders in governance

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**SECOND TRANCHE OF AML/CTF REFORMS:
IMPLICATIONS FOR COMPANY FORMATION BUSINESSES**

CSA is appreciative of the opportunity to comment on the second tranche of the anti-money laundering and counter-terrorism legislative reform (AML/CTF reforms).

CSA is the peak professional body delivering accredited education and the most practical and authoritative training and information on governance, as well as thought leadership in the field. Our members are all involved in governance, corporate administration and corporate compliance with legislative and regulatory obligations.

CSA recognises that closing the channels through which money intended to support terrorist activities could enter the Australian economy is essential. However, CSA is concerned that the proposed second tranche of AML/CTF legislation, which will bring company formation businesses and ASIC compliance document lodgement agents into a money laundering detection and prevention role, has been drafted in such a fashion that unintended consequences will result. Those unintended consequences will not achieve the policy objective of the legislation for the reasons set out on the following pages.

Moreover, CSA contends that the second tranche of AML/CTF legislation will have an overly burdensome impact on small to medium-sized enterprises (SMEs), as company formation businesses and ASIC compliance document lodgement agents are by their nature SMEs. They are not large corporations, such as banks and insurance companies, with substantial staff resources dedicated to meeting compliance obligations.

Background to CSA submission

The second tranche of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* will cover real estate agents, dealers in precious metals and precious stones, and a range of non-financial services provided by accountants, lawyers and trust and company service providers.

A number of CSA members fall into the latter category in that they provide company formation services and ASIC compliance document lodgement. Recently, the issue of the second tranche of AML/CTF reforms was raised with the Australian Securities and Investments Commission (ASIC), at a Business Advisory Committee meeting. ASIC reported to CSA (and other participants) that¹:

“Designated services” do not include the registration of new companies and maintenance of the national company register (see section 6 of the Act). Therefore ASIC is not a venture or concern in trade or commerce. ASIC is a statutory agency with functions, amongst others, to act on the requests of applicants to register companies and to maintain a database of those companies and to make information regarding those companies publicly available.

A reporting entity is defined as meaning “...a person who provides a designated service” (section 5 of the Act). As ASIC does not provide a designated service, therefore ASIC is not a reporting entity.

ASIC does not have any increased or changed responsibilities for company registration as a result of the AML/CTF legislation.

It appears that the new legislation will impact Information Brokers. Information Brokers are ‘company service providers’ [and as] services...who apply for the registration of companies will be within the ambit of “a service provider” as they are in a “venture or concern in trade or commerce...”.

Issues of concern

a) Verification of identity

Company formation businesses and ASIC compliance document lodgement agents as captured by the second tranche of the legislation will be required to undertake identity verification (assuming that the current Rules will apply to the designated services listed in the second tranche). There are questions as to whether the objective of the legislation is being achieved by this requirement.

One question is whether the objective of the legislation is being achieved if a person approaching a company formation business is asked for original documents to verify their identity, yet can incorporate companies by lodging a Form 201 over the counter at an ASIC business centre without having to undergo any verification of identity processes. Moreover, ASIC has indicated that its technology upgrade could introduce the ability for promoters to incorporate companies directly via the ASIC website. If this proceeds, promoters will not be asked to provide identity verification.

This will result in some company promoters being asked for identity verification (if they incorporate via a company formation business) while others are not. In turn this means that ASIC’s database, which reporting entities are permitted to rely upon in the identity verification process, will include entities and individuals whose identities have not been verified. CSA contends that this does not achieve the objectives of the legislation.

This contradiction also applies to existing companies, which will be able to make arrangements for persons to act as a director or secretary by lodging the appropriate forms either over-the-counter at an ASIC business centre or electronically through ASIC’s website without having

¹ ASIC Business Advisory Committee, May 2008, Action Item # 69 (from October 2007 minutes), ASIC to investigate if the Anti-money Laundering and Counter Terrorism Bill comes under the scope of ASIC

identities verified, yet which will be required to provide identity verification if such arrangements are undertaken through an agent for lodging ASIC compliance forms.

Another issue is whether those persons seeking to incorporate by using the services of company formation businesses will be prepared to submit original documents to company formation businesses. For example, a person living overseas seeking to set up a company in Australia is most unlikely to agree to provide an original passport to the Australian company formation business. A person living interstate is equally unlikely to be willing to provide an original passport with a business in another state.

The outcome of this is twofold. It is likely that persons seeking to do business in Australia will be deterred from doing business here. It is also likely that, if persons from outside Australia do pursue business in this country, they will nominate persons in Australia to act as a direct, but potentially ill-informed, interface with ASIC (that is, an agent acting on their behalf). This in turn will result in further non-disclosure of the beneficial ownership of companies, which works against the objective of the legislation.

A further complication is that there is no national database against which company formation businesses and ASIC compliance document lodgement agents can verify any original identity documents provided to them. There is no expertise in this industry, as there is in the financial service provider industry, in verifying identification. For example, CSA members note that they would be unable to ascertain if a passport was valid or forged. Added to this is the complication that identity verification would require processes such as police checks, for domestic company formation, and Interpol checks, for international applicants. Requiring police checks for people seeking to establish a local milk bar or newsagent would involve additional costs which would have to be passed on to the clients. CSA cannot point to the public benefit in requiring such undertakings, which would increase the cost of doing business in Australia and contends that such requirements will not achieve the policy objective of the legislation.

In short, CSA believes that requiring company formation business services to take on a 'gatekeeper' role more suitable to international policing agencies is not appropriate. When such requirements are viewed in the context that people can have direct access to company formation via the ASIC website without any identity verification, CSA contends that such onerous compliance obligations are difficult to justify.

b) Duplication of regulatory requirement

CSA notes that simply incorporating a company does not in itself give rise to the potential for money-laundering activity. The potential for laundering money is heightened when a company opens a bank account or undertakes financial transactions.

CSA further notes that financial service providers have processes in place for seeking identity verification, not only due to their obligations under the first tranche of the AML/CTF legislation but due to their own requirements in relation to credit risk. As a result, banks already have a business model in place that requires a risk-based approach to identify verification.

CSA queries why a promoter is being asked for identity verification at the point of company formation and then being asked for identity verification again when the promoters open a bank account in the name of the company. CSA suggests that this is a duplication of the regulatory requirement for little benefit.

c) Impact on SMEs

CSA notes that the Federal Government has publicly declared that it sees deregulation as an important tool for improving Australia's productivity. The Government is revisiting the recommendations of the Banks Review of the regulation of business to ensure that the recommendations have been fully implemented and is also checking that these actions have indeed reduced the regulatory burden on business.

The Government is keen to ensure that regulation is fit-for-purpose and does not wish to introduce regulation that may be ineffective, overly burdensome or duplicate other regulation.

CSA contends that the second tranche of AML/CTF legislation will have an overly burdensome impact on small to medium-sized enterprises (SMEs), as company formation businesses and ASIC compliance document lodgement agents are by their nature SMEs. They are not large corporations, such as banks and insurance companies, with substantial staff resources dedicated to meeting compliance obligations. CSA has already raised the issue of the duplication of regulation above.

d) Loss of confidence in Australian e-commerce

CSA notes that it has been the policy of ASIC over many years to appoint agents for the purpose of the lodgement of ASIC compliance forms. Over the last decade, ASIC has also sought to reduce manual over-the-counter lodgements and encourage electronic lodgement processes. The result of this is that agents have invested heavily in the creation of software programs to facilitate and expand electronic lodgement of ASIC compliance forms, including those relating to company formation. The nature of such businesses is increasingly internet-based. The vast majority of instructions received by ASIC agents are made via websites, email, telephone or facsimile. Very few company formation businesses or ASIC compliance form lodgement agents meet with their clients face-to-face.

This movement has accorded with a general shift to e-commerce in the Australian economy. One of the expectations attached to e-commerce is that it will be relatively instantaneous. Australians now expect to be able to form a company as soon as the need for one is identified. For example, a person may receive advice that property should be purchased and that this is best effected through a company vehicle. The company is formed immediately the advice is given.

Moreover, the Corporations Act is national and, as a result, company formation businesses receive instructions to incorporate a company from 'promoters' or their agents who reside in states and territories other than the one in which the business is based, as well as from overseas.

CSA notes that 42,000 companies are incorporated annually in Australia.

CSA is concerned that the requirement to undertake identity verification by company formation businesses will have the following consequences:

- A number of businesses will close as they are pure e-commerce businesses, without an office, and will not be able to undertake identity verification that will involve meeting the clients in person.
- Those businesses that continue will have to modify their operations and move from e-commerce businesses to ones that meet clients face-to-face.

CSA understands that the e-commerce business model is not unique to this industry. For example, there are online banks that face similar challenges in identity verification. However, CSA contends that customers do not expect instant responses when opening bank accounts, as they understand that banks need to check information and assess credit risk. The expectation from clients is quite different when forming companies or lodging ASIC compliance forms.

CSA is concerned that moving Australian company formation from an e-commerce model to a bricks and mortar model is not in the public benefit. Currently, being able to form companies through agents quickly and expeditiously, including from a distance, is one of the attractions of doing business in Australia. CSA is further concerned that slowing down the process of company formation will result in the perception that doing business in Australia is unattractive.

CSA recommendations

a) Identity verification

CSA members note that they could assist in countering money-laundering activity and terrorism financing by:

- requesting copies of documents relating to identity verification (for example, a copy of a passport)
- scanning such documents and retaining them on file for cross-referencing purposes.

CSA notes, however, that any obligation to collect and scan copies of document will have the effect of delaying the provision of services to Australian and overseas clients, which in turn will affect their perception of the ease of conducting business in Australia. Moreover, any such obligation to collect and scan documents does not provide any guarantee of accuracy in the identification process.

On this basis, **CSA recommends** that company formation businesses and ASIC compliance document lodgement agents be exempted from:

- the verification of identity rules
- the rules requiring sighting of original identification.

b) Relationship between principal and agent

Currently, company formation businesses and ASIC compliance document lodgement agents obtain information from both lawyers and accountants in relation to servicing client needs.

Under the second tranche of AML/CTF legislation, lawyers and accountants will have obligations to carry out identity verification checks on their clients. CSA notes that the second tranche legislation needs to clarify who has ultimate liability. CSA believes that the principal, that is the professional adviser who outsourced the application process to an agent, should have liability, and not the agent who submitted the application for a new company.

CSA recommends that the second tranche AML/CTF legislation clarify that liability sits with the principal and not the agent when company formation processes are outsourced to agents by professional advisers.

CSA also recommends that the second tranche AML/CTF legislation clarify that, if lawyers or accountants have verified identity, their agents can rely on such verification. Furthermore, where lawyers and agents are permitted the benefit of not having to check an existing database of clients, this benefit is passed on to agents. That is, **CSA recommends** that the second tranche legislation clarify the relationship between principal and agent, to ensure that only the principal is responsible for obligations under the legislation.

CSA would welcome further contact during the consultation process and the opportunity to be involved in further deliberations.

Yours sincerely

A handwritten signature in black ink, appearing to read "Tim Sheehy". The signature is written in a cursive, flowing style.

Tim Sheehy
CHIEF EXECUTIVE