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## Consultation on draft outsourcing guidance

### Introduction

The Financial Services Council (FSC) is a peak body which develops policy for more than 100 member companies in one of Australia's largest industry sectors, financial services. Our Full Members represent Australia's retail and wholesale funds management businesses, and superannuation funds.

The FSC is supportive of providing more guidance to business on outsourcing arrangements. As a general comment, however, our view is that the guidance would benefit with the inclusion of more detail to provide industry with more insights that will enable reporting entities across the regulated population to effectively implement the requirements with a clear understanding of AUSTRAC's expectations.

The FSC acknowledges that the guidance includes practical examples of how reporting entities can conduct oversight over its outsourcing arrangements. It would be beneficial if the document materially expanded on the issues that it touches on, as well as setting out factual, worked examples that could assist reporting entities to better understand the best approaches to take in a given situation. While we note that the guidance does include some hyperlinks to other AUSTRAC material, these are limited and more can be done to signpost the reader to other substantive guidance. For example, there is a reference to Outsourcing in the [Employee Due Diligence guidance](#) on the AUSTRAC website.

Our more detailed comments follow.

### Consultation period

The FSC submits that the consultation period is too short. While recognising that there is a certain amount of urgency attached to this guidance given it is a regulatory priority for AUSTRAC in 2024, it is disappointing that only a 3-week period was granted to undertake this consultation, noting it included a long-weekend in Victoria.

[Best practice guidance on consultation issued by DPM&C](#) provides, among other things:

*Depending on the significance of the proposal, between 30 to 60 days is usually appropriate for effective consultation, with **30 days considered the minimum**. Longer consultation periods may be necessary when they fall around holiday periods. (Our emphasis).*

While we are of course appreciative that AUSTRAC has provided the FSC with an extension to submit comments up until 1 April, we submit that at least this amount of time should have been provided to industry more generally. Depending on the amount and level of detail of commentary that AUSTRAC receives, it may wish to consider extending or refreshing this consultation.

### **Introductory paragraph**

Page 1 should include a short paragraph explaining the context, and the purpose of why this guidance is being published. For example, it could include acknowledgement that reporting entities outsource certain obligations to better manage the costs of compliance, and access AML/CTF and financial crime knowledge and expertise. It should be made clear that this guidance has been developed to better manage these relationships in the absence of any prescriptive legislative requirements.

### **Definition of Outsourcing**

We refer to the definition of Outsourcing on page 1, which reads:

*Outsourcing means engaging an external provider to help you meet your AML/CTF obligations, for example:*

- *reporting to AUSTRAC*
- *developing and maintaining your AML/CTF program*
- *carrying out an independent review of you AML/CTF program*
- *carrying out applicable customer identification procedures*
- *employee due diligence, AML/CTF risk awareness training and transaction monitoring.*

The FSC submits that this explanation is quite broad, while at the same time it appears to be inconsistent with the description of outsourcing used in the AUSTRAC Compliance Report. Similarly, it is not consistent with the definition of “outsourcing” in APRA CPS231<sup>1</sup> (which notably is limited to “material business activities”). AUSTRAC should adopt a consistent definition of outsourcing, having regard to the description contained in the AUSTRAC Compliance Report 2023 and APRA CPS231. It would also be helpful to further explain certain key terms, notably the concept of “external provider” .

### **Agency principles**

In addition, we believe it would be useful for AUSTRAC to explain in the guidance that the legal authority concerning outsourcing is (generally) derived from the common law principles of agency, which apply to the AML/CTF Act. Accordingly, it would be beneficial to include a short paragraph explaining that 'agency' is the legal relationship that exists between a principal and a person appointed (the agent) authorised with the power to act on their behalf, and that such an agent has the power to legally bind a principal to

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<sup>1</sup> Under CPS 231, Clause 10 describes outsourcing as follows: “.....involves an APRA-regulated institution, or an institution within a group that is not an APRA-regulated institution, entering into an arrangement with another party (including a related body corporate) to perform, on a continuing basis, a business activity that currently is, or could be, undertaken by the institution itself” (see also the description of ‘materiality’ at Clause 14).

arrangements - hence the principal is legally liable in circumstances where serious and systemic non-compliance is detected in relation to compliance with AML/CTF law.<sup>2</sup>

This can be an important issue that parties may wish to bear in mind before entering into an outsourcing agreement so that their rights and obligations are as intended. For example, we note that it is not uncommon to include in a contract that the principles of agency do not apply to the outsourcing arrangements.

### ***Making arrangements and Item 54***

The FSC also notes that under item 54 of the AML/CTF Act an agent (such as a financial adviser) may also be a reporting entity in its own right. Item 54 covers a person “acting in the capacity of holder of an Australian financial services licence, making arrangements for a person to receive a designated service (other than a service covered by this item)”, which could cover the actions of advice providers as well as other entities such as an outsourced registry or administration service. The FSC recommends that AUSTRAC address this issue in the guidance, in particular the concept of “making arrangements” for the purposes of this item, noting that AUSTRAC used to have a compliance guide available on its website (that appears to have been removed) which addressed this point.

### **External providers**

On page 2 the draft states “*Your external provider could be a consultant or another reporting entity you work with under a reliance or designated business group arrangement*”.

The FSC submits that this sentence requires additional clarification in the context of the separation of the role of a consultant and another reporting entity (or indeed a non-reporting entity) member of a designated business group (DBG) and the nexus with reliance.

Outsourcing is commonly conducted with third-party agents such as administrators or dedicated service providers in the delivery of functions under the AML/CTF Act.

In this context, it is unclear how the full scope of this guidance applies to the engagement of an external independent reviewer, particularly where it involves a reporting entity conducting the full suite of oversight and quality assurance. The existing guidance on the AUSTRAC website addressing the engagement of external independent reviewers is consistent with industry best practice.

Page 2 then goes on to state “*You may choose to outsource services on an ongoing basis or procure a product that will help your business maintain its AML/CTF controls, such as an automated system to carry out transaction monitoring*”.

The FSC submits that AUSTRAC should distinguish between an outsource arrangement and the use by an RE

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<sup>2</sup> The High Court in *International Harvester of Australia Pty Ltd v Carrigan's Pastoral Co* (1958) noted - “[a]gency is a word used in the law to connote an authority or capacity in one person to create legal relations between a person occupying the position of principal and third parties”. [100 CLR 644 at 652].

of a technology solution/software (such as but not limited to politically exposed person (PEP) screening tools, electronic verification platforms e.g. greenId (now GBG) or Equifax and so forth, or transaction monitoring tool). Paying for a licence to use software or subscription services is generally not understood as ‘outsourcing’. This is because the use of the tool is largely under the control of the purchaser and the third-party provider is generally not doing anything on behalf of the purchaser.’.

The FSC also suggests that requirements in the guidance relating to due diligence, oversight and monitoring of outsource providers could potentially be reduced for application vendors, with higher expectations for service providers performing a process/function on behalf of the RE (where the RE has less control of the activities of the application vendor).

The FSC suggest that the guidance assist reporting entities in understanding AUSTRAC's expectations around the procurement of IT solutions and products to automate certain AML/CTF obligations, such as transaction monitoring programs and applicable customer identification procedures, as opposed to outsourcing to a third party the conduct of these obligations as the agent of a reporting entity.

### **Update your AML/CTF program**

The regulatory requirement is to ensure *material* changes in a reporting entity or DBG’s *Part A program* “must” be approved by board or senior management. The obligation as set out in the draft is beyond the legislative requirement for approval of any update to the AML/CTF Program. The FSC recommends that AUSTRAC update the wordings relating to approval and limit them to Part A program for material changes in Page 4 - Your board or senior management must approve any <insert> “material” update to your AML/CTF program.

### **Understanding information sharing restrictions**

At page 5 the draft states “*Before you outsource, you may want to obtain legal advice on whether outsourcing arrangements involve the sharing of restricted information..... Criminal penalties apply....*”

We understand that this is a major challenge for reporting entities in the context of outsourcing because there is a lack of clarity around these requirements and how it applies in these situations. We also understand that there is an expectation that planned legislative reforms may address these issues. In the absence of a legislative reform agenda, we submit that this issue be considered in the context that AUSTRAC has communicated outsourcing as a regulatory priority in 2024.

This current section does not provide useful guidance or indeed clarity to assist reporting entities in this situation and they face a considerable impost in obtaining legal advice, which may also lead to inconsistent interpretations of this complex area of law. It is desirable that the guidance includes more detail and clarity on what the key issues are in respect of suspicious matter reports (SMR) and the legal obligations of reporting entities where it involves an agent.

While suggesting that an RE should obtain legal advice is understandable, the reality is that many businesses will not obtain legal advice, or at least not as much legal advice as they might be expected to usefully rely on. This is particularly true of small businesses. Another significant problem is that different businesses can and sometimes do receive legal advice from different legal advisers that is inconsistent, which can lead to further

uncertainty. The guidance is an opportunity for AUSTRAC to provide its view of the particular legal issues at hand and provide considerably more detail and clarity in this area so that it can at least to some extent reduce the need to obtain legal advice. We note that the provision of guidance is in any event a legal obligation of AUSTRAC under section 212 of the AML/CTF Act.

The guidance could also make it clear that AUSTRAC does from time to time provide exemptions to entities outsourcing the preparation of SMRs to third parties -e.g., Exemption No.1 of 2024.

### **Examples of good and bad practices**

On page 9 the draft provides a table showing “*examples of good practices when using outsourcing arrangements, and examples of practices that may lead to non-compliance and increase ML/TF risks to your business*” .#

These examples would benefit from the inclusion of more granular detail. The draft guidance provides AUSTRAC with the opportunity to communicate its regulatory expectations through the use of practical and operational examples which it has identified through its supervisory activities. That said, the guidance should still make it clear that reporting entities have flexibility to do what is appropriate for them in the circumstances and that the granular examples should not be taken as prescriptive in all situations.

For example,

- The first row (*developing an AML/CTF program that identifies, mitigates, and manages ML/TF risks, including from outsourcing*) suggests that a reporting entity must include as part of its ML/TF risk assessment consideration of outsourcing risks. (See paragraphs 8.1.6 and 9.1.7 of the AML/CTF Rules.) Examples could be provided related to frequently encountered high risks or the factors that could be assessed.
- In the second row (*senior management has oversight of outsourcing arrangements.....*), the guidance could also go into some detail as to how a reporting entity might demonstrate board/senior management oversight. Consideration may be given, for example, to including various alternative approaches such as reporting on performance and breaches, feedback from engagement and attendance at meetings, Board approval of the outsourcing arrangements and any variations etc..
- In the last row (*proactively monitoring your outsourcing provider...*), additional granularity of what might constitute proactive monitoring could include, depending on the particular situation, regular scheduled meetings with vendors using agendas and action items, annual quality assurance processes, reviewing and tailoring of KPIs, the conduct independents reviews, etc.

**Next steps**

If you have any questions about this submission, please do not hesitate to contact me on [adavies@fsc.org.au](mailto:adavies@fsc.org.au).

Sincerely,

A handwritten signature in black ink, appearing to read 'Ashley Davies', is positioned below the 'Sincerely,' text.

**Ashley Davies**  
Policy Director  
Legal