

Outcomes and findings of the AUSTRAC IFTI Proof of Concept Project

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PART A – INTRODUCTION

1 Background

In late 2017, AUSTRAC engaged the services of King & Wood Mallesons (“**KWM**”) to develop a design plan for a smart contract Proof of Concept focusing on transaction reporting, in particular, reporting of international fund transfer instructions (“**IFTIs**”). This followed a series of discussions between AUSTRAC and KWM on potential applications for regtech-focussed smart contract applications.

The objectives of the project were to identify whether automation of processes provides any regulatory benefits and efficiencies to reporting entities and AUSTRAC and to consider the extent to which the IFTI reporting process can be, and should be, automated.

The first step in this project was for KWM to translate the detailed IFTI reporting obligations in the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) (“**AML/CTF Act**”) and *Anti-Money Laundering and Counter-Terrorism Financing Rules Instrument 2007 (No. 1)* (Cth) (“**Rules**”) into decision trees consisting of binary Yes/No questions. The decision trees consolidated the test for determining what was reportable and the information to be reported. This allowed KWM to identify whether it was possible to completely automate IFTI reporting and, if not, the points at which manual input was required (ie the points at which a response could not be given automatically because it requires some element of human judgment).

Although not part of the original project objectives, the creation of the decision trees has also provided an opportunity to consider how the IFTI reporting obligations may be simplified and streamlined while also enhancing the information provided to AUSTRAC’s agency partners.

To test whether the results of the translation of the IFTI reporting obligations reflected how industry participants interpreted the legislation, AUSTRAC and KWM met with key industry participants (namely Australia & New Zealand Banking Corporation (“**ANZ**”), Commonwealth Bank of Australia (“**CBA**”), Macquarie Bank Limited (“**Macquarie**”), National Australia Bank Limited (“**NAB**”), TransferWise Ltd (“**TransferWise**”) and Westpac Banking Corporation (“**WBC**”)) both individually and then collectively in a one-day workshop (“**Workshop**”) to discuss some key themes and issues surrounding the IFTI reporting process.

Before the Workshop, AUSTRAC explained to participants that the Proof of Concept project is part of the Fintel Alliance Innovation Hub and that the Workshop would be conducted in accordance with Chatham House Rules and would not be a compliance exercise; rather it would be for the purpose of collecting regulatory intelligence.

The Workshop considered a number of questions including:

- determining whether there was scope to achieve a shared interpretation of the AML/CTF Act and Rules, especially where a Yes/No response is currently not appropriate to answer a question;
- understanding the methods by which the participants currently perform their IFTI reporting obligations and whether there is any appetite to adopt a regulator developed automated system;
- identifying those provisions of the Rules for IFTI reporting that may require refinement or revision in order to provide reporting entities with greater clarity or certainty; and
- discussing and considering the feasibility and approach to simplify and streamline the IFTI reporting obligations commensurate with the recommendations at Chapter 6 of the report of the statutory review of the AML/CTF Act and Rules.

2 Executive Summary

There have been two key outcomes from the project. The first is that KWM has determined that it should be possible to automate IFTI reporting provided that a shared understanding can be reached on certain IFTI reporting requirements which are currently not clear. The second outcome is that it has been shown there is little support from major reporters for the development of a tool by the regulator unless it is done in conjunction with the creation of a pool of data over which the tool could be applied.

The project has revealed significant complexities in both the test for determining whether something is an IFTI and the content of the report itself.

The Workshop demonstrated that the participants experienced common “pain points” in interpreting the current legislation. However, the manner in which they addressed those issues and their IFTI reporting obligations more generally diverged significantly from each other. Accordingly, participants have requested that AUSTRAC provide guidance on the interpretation of some of the key terms in the existing legislation, and consider simplifying the reporting requirements in the future.

Each organisation did report that it had taken steps to automate, to some degree, its decision-making process around whether an IFTI is reportable, although the sophistication of these processes was not high. Automation appears to be limited to identification of particular SWIFT messages and code types to determine whether to report, and other transaction types which did not use SWIFT messaging were often left to be manually identified and reported.

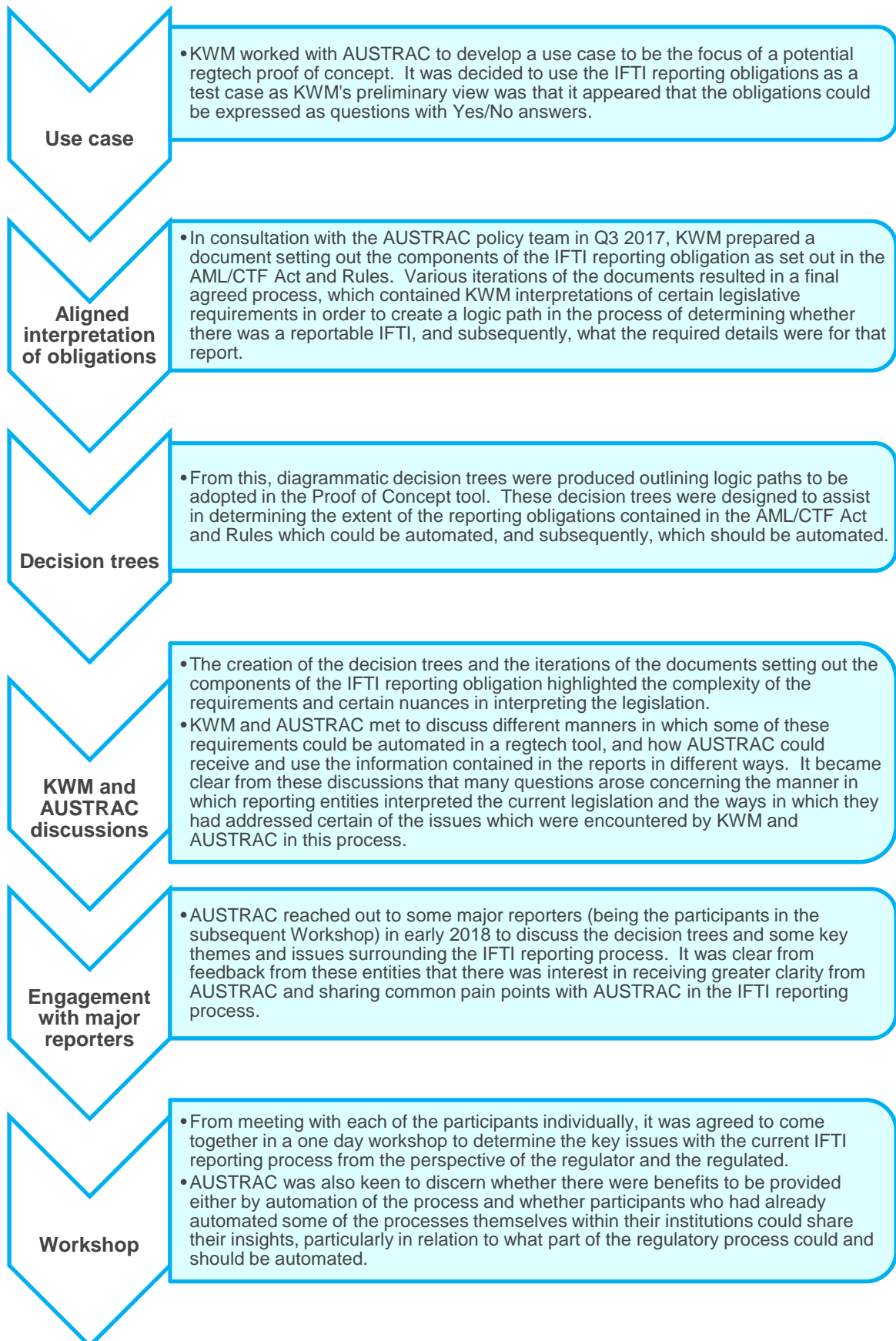
There was little appetite from participants in the Workshop to use an automated tool built by AUSTRAC as this would have significant cost implications for their businesses. A common theme from participants was around the lack of a central “pool” of data over which any automated tool could be applied to identify and report IFTIs. However, there may still be value in building an automated tool for smaller reporting entities if it is possible to reach a shared understanding of certain IFTI reporting requirements (which may be achieved through additional AUSTRAC guidance or through changes to the IFTI reporting requirements).

This document is only a summary of some key learnings so far in the project. It is not legal advice or a report on any enquiries or investigations, of which none have been conducted by KWM.

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PART B – PROCESS TO DATE



PART C – KEY THEMES, FINDINGS AND OBSERVATIONS

Part C of this report sets out some of the key themes and findings arising from the project and in particular the Workshop.

The Workshop revealed that the participants experienced common “pain points” in interpreting the current legislation. However, the manner in which they addressed those issues and their IFTI reporting obligations more generally diverged significantly from each other. This divergence was often as a result of systems constraints within each organisation.

It is clear that major reporting entities have developed their own tools and mechanisms for meeting their IFTI reporting obligations. Each organisation did report that it had taken steps to automate, to some degree, its decision-making process around whether an IFTI is reportable, although the sophistication of these processes was not high. Automation appears to be limited to identification of particular SWIFT messages and code types to determine whether to report, as further discussed below, and other transaction types which did not use SWIFT messaging were often left to be manually identified and reported.

The development of the decision trees along with discussion with participants has revealed the complexities in the IFTI reporting process. The major reporters requested that any amendments be technology-neutral, but have the flexibility to change over time as new technologies develop, both in the method of transferring value, and in the ability to capture new data types and information. Participants were open to reporting more (or less) information, provided that the information has intelligence value, but highlighted the importance of delivering a positive customer experience and that any amendments to the IFTI reporting process would need to take this into account.

However if changes to the legal requirements will not be made in the short to medium term, the participants expressed an interest in utilising any guidance AUSTRAC develops around the interpretation of some of the key terms in the existing legislation. There was interest in using the decision trees prepared by KWM (or a similar representation of the requirements) to align organisations’ IFTI reporting processes with AUSTRAC’s expectations.

There was little appetite from participants in the Workshop to use an automated tool built by AUSTRAC as this would have significant cost implications for their businesses. However, there may be value in building an automated tool for smaller reporting entities if it is possible to reach a shared understanding of certain IFTI reporting requirements (which may be achieved through additional AUSTRAC guidance or through changes to the IFTI reporting requirements).

Finally, AUSTRAC may wish to consider other methods for capturing the data provided in an IFTI report, instead of requiring the submission of reports from institutions.

1 Participants automate the IFTI reporting process where possible

Almost every participant had constructed a proprietary automated IFTI reporting process within their own internal systems, with one institution using software from a third party provider. For most, this system sat alongside, but was not part of, their payments systems. Additionally, this automated system was separate from other reporting obligation tools the participants employed such as those for suspicious matter reports and sanctions lists.

However, each of the bank participants noted that they assumed that certain SWIFT messages were all reportable – namely 103 messages – as this was easier for them to implement on an operational basis rather than considering each instruction individually. They also assumed that

other types of instruction were reportable but these varied between institutions. The assumption that certain types of instruction were all reportable ties back to the assumptions that participants make when interpreting the AML/CTF Act and Rules, and the ways in which the requirements are implemented in an automated system. The reliance on SWIFT messages creates risk because some foreign banks can use the wrong SWIFT message types and this may not get reported.

Some participants acknowledged that they had conducted a review of all instruments in the organisation that facilitate the transfer of value internationally to determine whether an IFTI reporting obligation applies to the instrument. However, each noted that the constant development of new instruments and products did lead to difficulties particularly as the IFTI reporting process currently operates as a very prescriptive, as opposed to principles-based, set of regulatory requirements.

Observation – Guidance on the application of IFTI requirements to particular products may assist major reporters to move away from their reliance on SWIFT message types to determine what is a reportable IFTI.

2 Lack of consistency of data provided creates difficulties

All participants noted that the data provided in incoming payment transfer instructions was highly inconsistent. Participants and AUSTRAC noted that this was often due to the fact that offshore entities were not subject to similar reporting obligations and therefore there was a wide interpretation of data fields and differing levels of diligence in completing the required information.

Most participants were heavily reliant upon SWIFT messaging systems whose data fields were often open to interpretation. Each participant attempted to repair this data where possible (such as by supplementing the data with information in the participant's systems), but each noted that they were reluctant to do so unless it was specifically required as it increased risk within their systems (because human intervention in the data creates risk). Certain participants also noted that if they did not need to repair the data received in order to receive a payment into a particular account, they would not do so and highlighted the fact that a participant's view of what constituted required data within an instruction for their own purposes was often different to the information AUSTRAC may consider to be required.

Participants discussed the large role that SWIFT messaging plays in international funds transfers, and considered some of the difficulties in developing automated systems which attempted to be technology neutral whilst accommodating existing messaging formats such as SWIFT. Participants highlighted examples of how they each used the SWIFT messaging system in a slightly different manner, which was then exacerbated by offshore institutions also employing their own interpretations. Two participants noted the difficulties around character limits in certain fields and how institutions compensate for this by truncating messages and splitting information across line fields. They noted that there was no industry consensus as to how this was done which led to consequential discrepancies in the manner in which IFTI reporting was conducted.

Observation – There could be benefits in involving SWIFT in any discussion as to the content of the reports to see if they can assist in improving the quality of information received from financial institutions.

3 Difficulties in interpreting the AML/CTF Act and Rules lead to assumptions which may be clarified by guidance from AUSTRAC

All the participants in the Workshop agreed that there were some difficulties around interpreting the AML/CTF Act and Rules and in being able to answer some of the questions it posed.

For example, each institution noted that there were significant difficulties in determining what was an “instruction” and that there were numerous scenarios to which the definition of “instruction” could apply (for example trade finance, foreign exchange and margining). Each institution noted that such a large number of potential scenarios meant that it was extremely difficult to implement a set of automated rules within their institution in order to accurately capture every situation where an “instruction” is made for the purposes of IFTI reporting obligations. For example, one institution queried whether an attempted instruction was an “instruction” for the purposes of the AML/CTF Act and Rules, and also whether an instruction which was later rejected by a foreign bank would also constitute an “instruction”. In light of these difficulties in interpretation, all the institutions assumed that there was always an “instruction” when a request for transfer of funds was made.

Additionally, participants assumed that a person requesting a transfer of funds had authority to do so. Participants also noted that they had a number of internal controls around who is able to direct transfers of money which were managed by separate processes (for example KYC on account opening). Consequently, for the purposes of the IFTI reporting obligations they would always assume the requisite level of control by the instructing person and not consider whether the money was “controlled” by the person separately on an instruction by instruction basis.

Finally, participants found it difficult to interpret the phrase “if known” in the AML/CTF Act and Rules. Certain participants noted that it would be useful to have some guidance from AUSTRAC from a policy perspective as to the meaning of the phrase and what was required from institutions to determine whether they held relevant information which they could use to populate an IFTI report. Examples were given as to whether an institution was required to obtain information from their offshore branches, whether they were required to only include information from available systems or information held elsewhere (such as records in hard copy), and whether they should be populating data available from publically available information – such as conducting an internet search to determine a street address for a PO Box number. There was no consensus of approach in dealing with these issues. Participants also observed that there are inconsistencies between the requirements of the Rules and the fields in AUSTRAC’s published IFTI reporting schema.

In consultation with AUSTRAC, KWM created decision trees to represent the requirements in the AML/CTF Act and Rules relating to whether something is reportable as an IFTI and, if it is reportable, what must be reported. These decision trees were circulated to AUSTRAC and Workshop participants as working drafts and were not to be relied on as legal advice. Some participants said that they found value in utilising the decision trees (or a similar representation of the requirements) to ensure that their own automated tools “matched” or otherwise incorporated any AUSTRAC view of the workflows and decisions included in an automated tool for the IFTI reporting requirements. KWM suggests that this could be an important step in harmonising the reporting process across institutions, in conjunction with providing further clarity on the reporting requirements and simplifying the IFTI reporting process (see further below).

Observation – AUSTRAC could consider providing further clarity on the IFTI reporting requirements.

Participants consistently requested clarity from AUSTRAC on the meaning of several concepts in the AML/CTF Act and Rules. Guidance on certain concepts relating to whether something is reportable as an IFTI and what information must be included in the report could improve the understanding of what is a reportable IFTI:

- What is an “instruction” to transfer money or property?
- How should attempted or rejected transfers be treated?

- For transfer mechanisms that do not involve SWIFT, how should the reporting entity determine whether the transfer is reportable as an IFTI? Are there any particular products or instruments that AUSTRAC considers involves a reportable IFTI?
- Are there any particular instances, in addition to loans before drawdown, where AUSTRAC considers that a person does not “control” the funds they seek to transfer?
- What does “as appears in the instruction” and “if known” mean?

AUSTRAC may wish use the decision trees prepared by KWM to help develop and express its guidance for reporting entities.

4 **KWM decision trees have demonstrated that it is possible to automate IFTI reporting, although the automation process would require assumptions to be made about the legal requirements and major reporting entities may not have an appetite for an automated IFTI reporting tool developed by AUSTRAC**

In developing the decision trees KWM was able to translate the various legal requirements into Yes/No questions. However this was only possible on the basis of several assumptions that KWM made, for example:

- In order to translate the requirements into Yes/No questions it was necessary to choose a certain point in time in the transfer process when a user may be completing the decision trees (as this affects the tenses used in the Yes/No questions). For outbound instructions, KWM assumed that the instruction has already been accepted from the payer and the user is considering sending the instruction out of Australia in the future. For incoming instructions, KWM assumed that the user has already received the instruction from outside Australia and is considering making the money available in Australia.
- For incoming IFTI-E, KWM deleted the requirement that the money to be transferred was controlled by the payer in the foreign country, as from a practical perspective it should be assumed that this is the case. Some participants confirmed that they also make this assumption.
- Where the Rules provide that the information must be reported “as appears in the instruction”, KWM has taken this to mean that if the instruction does not include that information, the information does not need to be reported.¹ Some participants confirmed that they also make this assumption.

In addition to these assumptions decisions must be made as to what certain provisions require and these decisions must be built into the solution. For example, a decision is required as to what information an organisation must have regard to in determining whether information is “known” to allow the tool to “pull” that information in generating the report.

However, if these decisions are made KWM is of the view that the process should be able to be automated.

The Workshop established that there is currently no appetite from the participants for AUSTRAC to build an automated IFTI reporting tool for their own use because each participant already has a

¹ For example, KWM included the question “Does the instruction include the name or identity of any interposed institution in the funds transfer chain?” If the response is “Yes”, the instruction that follows is “Provide the name or identity of any interposed institution in the funds transfer chain, as appears in the instruction”. If the response is “No”, no instruction appears and the next question is asked.

proprietary automated IFTI reporting process within their own internal systems, with one institution using software from a third party provider. Any change to their existing systems would have significant cost implications for each institution. Further, a common theme from participants was around the lack of a central “pool” of data over which any automated tool could be applied to identify and report IFTIs. An AUSTRAC-built tool may not be suitable for major reporting entities to use because the participants indicated that they populate IFTI reports using multiple sources of data and it would be difficult to configure the tool so that data feeds into it appropriately.

There may be value in building an automated IFTI reporting tool for smaller reporting entities to use. This tool could be built based on the decision trees prepared by KWM. Although AUSTRAC may wish to build a tool after issuing guidance on the meaning of certain IFTI reporting requirements (see above) or after the IFTI reporting requirements are simplified (see below).

Observation – Building AUSTRAC guidance on the issues described above into the decision trees to provide a comprehensive regulator view of what is a reportable IFTI may be of greater value to major reporters than continuing to automate the current decision trees.

5 Participants expressed support for simplified IFTI reporting requirements and are open to reporting more or less information to AUSTRAC, provided it has intelligence value

The decision trees have revealed the considerable complexity of the AML/CTF Act.

Unlike other reporting obligations in the AML/CTF Act it is not possible to determine from one section in the legislation whether something is reportable as an IFTI. Rather, in determining whether something is reportable as an IFTI, the decision trees had to incorporate requirements from five different sections of the AML/CTF Act and one Chapter of the Rules.² The AML/CTF Act also distinguishes between IFTIs that are transmitted between financial institutions (IFTI-E) and IFTIs that are transmitted between non-financiers (IFTI-DRA). In developing the decision trees KWM identified that several key questions for determining whether something is reportable an outbound IFTI-E or IFTI-DRA are the same. For example, both types of reports require the same question to be asked at the outset – “Will you send an instruction for the transfer of money out of Australia?” Similarly several key questions for determining whether something is reportable as an incoming IFTI-E or IFTI-DRA are also the same.

KWM has also observed that the Rules require the information of 20 different parties to be included in an IFTI report.³ In developing the decision trees it was shown that it is not always clear which person’s information must be reported as these parties change depending on the person’s role in the transfer. For example, for an IFTI-DRA, if an entity accepts an instruction for the transfer of money from a customer and sends that instruction out of Australia, that entity’s details may need to be reported for the purposes of providing information about four different parties: the “sender” (the non-financier that accepts the instruction), “person at which money is accepted” from the customer,

² Sections 8, 9, 10, 45 and 46 of the AML/CTF Act and Chapter 51 of the Rules.

³ “Payer”, “ordering institution”, “sender” (transmitter of instruction to beneficiary institution), “beneficiary institution”, “payee”, “interposed institution”, “institution through which the beneficiary institution will be reimbursed”, “person completing the report”, “transferor entity”, “sender” (non-financier that accepts the instruction from the transferor entity), “person at which money or property is accepted from the transferor entity”, “transmitter” (person who transmits the instruction for the transfer of money or property), “person in the foreign country to which the sender and/or transmitter sent the instruction for the transfer of money or property”, “disbursing entity” (person who arranges for money or property to be made available to the ultimate transferee entity), “ultimate transferee entity”, “institution at which the ultimate transferee entity holds an account”, “foreign entity” (person in a foreign country who accepts the instruction from the transferor entity for the transfer of money or property), “entity in Australia to which the instruction for the transfer of money or property was sent by the transmitter”, “receiver” (non-financier who arranges for the money or property to be made available to the ultimate transferee entity) and “person at which the money or property is made available to the ultimate transferee entity in Australia”: Chapters 16 and 17 of the Rules.

“transmitter” (the person who transmits the instruction for the transfer of money) and “person completing the report”.

The participants expressed an interest in the AML/CTF Act adopting a more functional definition of a reportable IFTI based on an actual transfer of funds rather than an instruction. Several possible components of a new definition were suggested in the Workshop, including “settled international payment” or “transfer of value into or out of Australia” between a “non-bank” on one side and a “non-bank” on another or where the payment was “instructed by a customer”.

Further, all participants were keen to understand what data was used from IFTI reports and how it was used. Each were open to changing the reporting requirements to enable AUSTRAC to receive more valuable information from reporting entities. Participants were also keen to discuss the value of different data fields collected and consider how other information they have may be useful to AUSTRAC and its partners.

A participant expressed a concern that reducing the number of fields in an IFTI report would have a cost impact on the organisation, whereas another participant said that there would be no cost in changing the number of data fields.

Observation – AUSTRAC could consider proposing amendments to the AML/CTF Act and Rules to simplify reporting requirements.

In light of the difficulties in interpreting some of the legislation, the reliance on assumptions to answer certain questions and the manner in which automation is currently conducted at large institutions, AUSTRAC could consider reviewing and simplifying the IFTI reporting requirements, and to also consider whether a less prescriptive and more principles based form of regulation is more appropriate, supplemented by guidance which could be updated over time. There may also be value in consolidating the IFTI-E and IFTI-DRA report types and the various requirements in the AML/CTF Act relating to whether something is reportable as an IFTI, as well as using consistent terminology so it is clear which parties the Rules are referring to.

For example, participants noted that the rules should be technology agnostic, yet the participants were currently heavily reliant on SWIFT messaging and codes in developing their automated tools for reporting (however they noted that this could change over time). Additionally, amendments to fields in such messages, along with requests for different or new information from AUSTRAC’s partners to be included in IFTI reports as new technologies develop⁴ may be better captured in a flexible form of regulation.

AUSTRAC could also consider whether there is any valuable information that is captured by having the IFTI reporting obligation triggered at the acceptance of the instruction rather than the subsequent transfer.

AUSTRAC could also consider whether the reportable details should change to more closely align with the purposes for which the data is used, including intelligence for law enforcement and statistics used by other bodies such as the IMF.

⁴ For example, it was noted the increase in transfers being initiated from a mobile phone. At present there is no capture of GPS or other data linked to that mobile phone in an IFTI report (or capture of that information necessarily by existing bank systems). Similarly, internet IP addresses were not currently captured. However, if this were possible in the future and requested by an AUSTRAC partner, a principles-based form of regulation supplemented by updatable guidance around the collection of data required to populate an IFTI report could flexibly capture changing behaviours.

6 Customer experience should not be impacted by IFTI reporting

Participants noted that a payment to a customer should not be delayed while missing information is collected for the purposes of an IFTI report. Each participant highlighted that the customer experience should be considered when developing any amendments to the IFTI reporting process. For example, if it was considered that the process be amended so that a transfer of value internationally would not be permitted until all the required data was obtained and an IFTI report submitted to AUSTRAC (whether for an incoming or outbound transfer) this could vastly disrupt and alter the existing customer experience which could be significantly problematic for participants when compared to their offshore competitors who were not subject to such a regime.

Observation – Industry requests that AUSTRAC consider the impact that any changes may have on the customer's payment experience.

7 Participants are open to AUSTRAC viewing the data held by participants rather than requiring reports from participants

In the Workshop, and in previous discussions between KWM and AUSTRAC, the possibility had been raised of obtaining relevant data from reporting entities by viewing the data held by the reporting entities rather than requiring reports from those entities. Participants discussed the nature of the pool of raw data that AUSTRAC could run queries over in this model. Participants expressed preliminary support for the idea insofar as it allowed for the participants to ensure relevant data was available rather than requiring the participants to select relevant data for inclusion in a report (and repair the data where necessary). However a participant raised a concern that it could not hold information in a data pool indefinitely for AUSTRAC to view (for example, the participant may need to delete information in compliance with the EU General Data Protection Regulation).

There was no appetite among participants for real time reporting due in large part to cost, operational and customer experience concerns, although participants acknowledged that reports should be timely.

Observation – AUSTRAC could consider whether a reporting model is appropriate for AUSTRAC's regulatory objectives.

Industry is open to a further discussion around whether AUSTRAC could more effectively obtain data on international funds transfers using methods other than by way of reports provided by reporting entities, such as exploring the concept of a "data lake" or the use of other technologies in order to interrogate data held by reporting entities.

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