Michael Anastas Partner
manastas@hwle.com.au

Elizabeth Singleton Trainee Solicitor

HWL Ebsworth, Brisbane

Australia: SVC risk and regulation

The Australian Transaction Reports and Analysis Centre ('AUSTRAC') has recently published its first 'Money Laundering and Terrorism Financing Risk Assessment: Stored Value Cards' ('SVC Assessment'), which analyses the potential of stored value cards ('SVCs') to be used for money laundering or terrorism financing ('ML/TF') purposes. In the SVC Assessment, AUSTRAC assesses the ML/TF risk posed by the use of 'above the threshold' SVCs[1] to be 'medium' and the Australian Minister for Justice, Michael Keenan, has stated that "the report serves as yet another tool [...] to identify where preventive measures can be strengthened[2]." Michael Anastas and Elizabeth Singleton of HWL Ebsworth explain how, while the SVC Assessment highlights certain threats and vulnerabilities on the basis of whether an SVC is 'above the threshold' or 'below the threshold,' factors such as reloadability, cross-jurisdictional use, ability to load with cash and acceptability all impact on an SVC's risk rating. With the SVC Assessment identified as a potential catalyst for improvements in measures to combat ML/TF, Michael and Elizabeth ask if an ML/TF risk rating based on the stored value 'threshold' test is too broad, and instead whether other SVC features that contribute to the level of risk could serve as the basis for further reform.

The risk rating in the SVC Assessment was determined by considering the extent and nature of the criminal threat environment observed during the sample period in connection with 'above the threshold' SVCs (a medium threat) and the vulnerability of 'above the threshold' SVCs to further criminal misuse (high).

An issuer of an above the threshold SVC has an obligation, among others, to submit Suspicious Matter Reports ('SMRs') to AUSTRAC. An issuer of a below the threshold SVC is not subject to the relevant requirements under the Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (Cth) ('AML/CTF Act').

The SVC Assessment risk rating only takes account of 'above the threshold' SVCs due to the lack of reporting obligations on issuers of 'below the threshold' SVCs. However, the SVC Assessment includes an extensive qualitative analysis of the risks relating to 'below the threshold' SVCs.

Criminal threat environment

To arrive at a risk rating for the criminal threat environment, AUSTRAC looked at the 916 SMRs submitted within the sample period and found that the offences most likely to involve SVCs are money laundering, followed by cyber enabled fraud, followed by other types of fraud, scams and tax evasion. Only 12 SMRs submitted within the sample period were likely to relate to terrorism financing, and all 12 related to funds remitted in countries that border Syria.

The value of the 916 SMRs had a total reported value of $72.3 million. AUSTRAC considers that this amount largely understates the actual value of these SMRs as more than 5% of SMRs did not state a value and AUSTRAC considers that the data in relation to value differs according to how a reporting entity interprets the 'amount' field[3]. This assessment also does not capture 'below the threshold' SVCs as such SVCs are not subject to the SMR requirements.

Vulnerabilities

The vulnerability level of SVCs has been assessed in the SVC Assessment as high. This is due to the characteristics they possess that make them susceptible to criminal exploitation. These characteristics vary between SVCs depending on their capabilities, not the value threshold alone. Importantly, this category of assessment does not distinguish between 'above the threshold' SVCs and 'below the threshold' SVCs. Characteristics indicative of vulnerability include:

- reloadability;
- ability to use cash to load/reload the SVC;
- ability to redeem SVC value in cash;
- ability to redeem at a wide range of merchants (acceptability);
- ability to redeem internationally; and
- high storage limits.

The AML/CTF Act currently sets the threshold for an SVC designated service at a minimum monetary value. It ignores

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the reality that high risk SVCs are attributable to other factors and could be below the threshold and unreportable. AUSTRAC comments that an SVC that has none, or only one, of the features above is likely to be low risk (likely to be closed-loop), whilst an SVC that has many of the above features is high risk (likely to be open-loop). Below the threshold SVCs can embody a number of vulnerable features and provide a convenient vehicle for the anonymous financing of terrorism or money laundering. For example, the SVCs used in the Paris attacks were loaded with €750 at a time and as such were exempt from customer identification requirements.

Operational vulnerabilities

AUSTRAC is aware that outsourcing of AML/CTF obligations is common and is concerned that the distance between the provider and AML/CTF manager could compromise the effectiveness of the program. AUSTRAC considers that a contractual arrangement between the parties would formalise the arrangement and commit the parties to fulfil their obligations.

Legislative vulnerabilities

AUSTRAC has identified some areas in which there are vulnerabilities in the AML/CTF controls placed on reporting entities:

- lack of identification and verification of customers who redeem value on reloadable SVCs, when that customer was not the person to whom the SVC was issued;
- no requirement to follow up when a customer uses SVCs in suspicious contravention of the terms and conditions;
- the person who is loading funds onto the card does not have to be identified unless they are the person to whom the card was issued;
- it is not common practice for the cardholder redeeming funds to be identified; and
- there are no mechanisms to mitigate 'muling,' where a person may sign up to an SVC and then pass it on to another person for use[4].

What does the SVC Assessment suggest in relation to the current climate surrounding SVCs in Australia?

AUSTRAC noted that as banks and other remittance sectors become subject to more stringent domestic and international regulation, SVCs will become more popular for moving or legitimising illegal funds. The SVC Assessment identifies areas that could be marked for consideration in AML/CTF regulation of SVCs that were also highlighted in other reviews of Australia's AML/CTF regime. The imposing of a risk rating across a broad category of SVCs based on a value threshold fails to recognise the different features of products within the same category, each of which have a different level of ML/TF risk.

The vulnerabilities (listed above) can exist on low value and high value SVCs, and AUSTRAC is aware that both are being exploited for terrorist financing and money laundering. The SVC Assessment indicated that open-loop SVCs that can be redeemed overseas by a third party were most vulnerable for use by criminals as a means of sending funds overseas or laundering illegal money. Lower risk, closed-loop SVCs pose less of a risk due to the limitations on their use.

AUSTRAC acknowledged that vulnerability factors should comprise any assessment on whether an SVC should be subject to the obligations of the AML/CTF legislation, not value threshold alone.

This concession reflects the opinion of the industry on this point. The Report on the Statutory Review of the Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (Cth) and Associated Regulations and Rules published by the Australian Attorney General in 2016 ('Statutory Review') recommends that the threshold for SVC designated services be reassessed. It indicated that a money value threshold was appropriate when the rules were made, but due to the increased usage and accessibility of SVCs other factors are now relevant to a risk assessment of these products. Further, the AML/CTF Measures Mutual Evaluation Report on Australia published in 2015 by the Financial Action Task Force ('FATF Mutual Evaluation') highlighted the lack of a requirement to perform Customer Due Diligence ('CDD') on SVCs below a certain threshold. It comments that issuers of reloadable cards should be required to undertake CDD regardless of the threshold due to the increased availability of low value reloadable cards.

What are the possible implications of the report?

AUSTRAC positions the report as a tool to assist reporting entities in complying with their existing obligations, including when to submit SMRs and identifying where their AML/CTF programs could benefit from a review: "AUSTRAC expects that SVC issuers will use this assessment to refine their own risk assessments and compliance controls, including transaction monitoring and oversight of any agents that discharge AML/CTF obligations on an SVC issuers behalf."

The results of the report, together with the Statutory Review and the FATF Mutual Evaluation, suggest that adaption of the current regime could be imminent.

While there is clearly a push for a revision of the current value threshold test, the regulatory burden of making all SVCs subject to the AML/CTF Act could be non-conducive to the success of the rapidly growing industry. Instead, the vulnerability factors may be a better test for determining the regulation of an SVC, not value threshold alone.

It remains open as to whether a self-assessed risk based approach of a principles-based law will continue in its current form or whether more prescriptive requirements will be set. Regardless, it seems that greater stringency will be placed on a reporting entity to ensure that AML/CTF programs are adequate to cover the vulnerability level of the SVCs it issues.

1. An SVC is 'above the threshold' if the SVC can hold $1,000 or more at any one time and cash can be withdrawn from the SVC or if the SVC can hold $5,000 or more at any one time and cash cannot be withdrawn from the SVC - in all other cases a SVC is 'below the threshold.'
2. Minister for Justice Media Release: AUSTRAC risk assessment of stored value cards - 2 May 2017.
3. Money Laundering and Terrorism Financing Risk Assessment: Stored Value Cards - AUSTRAC - released 2 May 2017 - page 7.
4. Money Laundering and Terrorism Financing Risk Assessment: Stored Value Cards - AUSTRAC - released 2 May 2017 - page 22.