

# News

**August 2006**

## Banking and Finance Newsletter

### Anti-Money Laundering and Counter-Terrorism Financing Bill 2005

The Attorney-General's Department has completed the initial public consultation process on the exposure draft of the *Anti-Money Laundering and Counter-Terrorism Financing Bill* ("AML/CTF Bill") which was released in 2005. Revised exposure drafts of the AML/CTF Bill 2006 and draft AML/CTF rules were released on 13 July 2006 for a period of public consultation.

Once the Bill is enacted, it will have implications for financial services providers including lenders.

Over time, it is intended that the new legislation will replace the *Financial Transaction Reports Act 1988*. Until then, the *Financial Transaction Reports Act 1988* will continue to apply.

Under the new provisions, an entity which provides designated services will be required to comply with certain obligations.

The revised version of the AML/CTF Bill introduces the concept "designated business group" which will allow members of a business group to share identification information and to subscribe to one joint anti-money laundering and counter-terrorism financing program.

Designated services include the making of a loan, supplying goods under finance, lease or hire purchase, issuing credit or debit cards or traveller's cheques, providing custodial services and opening deposit accounts. Entities that provide a designated service will be required to comply with certain requirements in the new legislation. This is different from the *Financial Transaction Reports Act* which regulates cash dealers primarily in accordance with type of institution rather than the type of transaction in question. This change will increase the number of entities that are subject to reporting obligations.

**MAKINSON & d'APICE**  
— L A W Y E R S —

Level 12 135 King Street Sydney NSW 2000 • GPO Box 495 Sydney 2001 • DX 296 Sydney  
**Telephone 02 9233 7788 • Facsimile 02 9233 1550 • Email [mail@makdap.com.au](mailto:mail@makdap.com.au) • [www.makdap.com.au](http://www.makdap.com.au)**

# News

**August 2006**

Entities that are subject to the new legislation because they provide a designated service will have certain key obligations under the legislation including obligations to verify the identity of new customers, monitor customers and their transactions, report specified transactions and suspicious matters, maintain appropriate records, and establish and maintain anti-money laundering and counter-terrorism financing programs.

Entities covered by the legislation must have an anti-money laundering/counter-terrorism financing program which meets rules developed by AUSTRAC and to fail to do so will be an offence. As indicated above, the first draft of the AML/CTF rules was released on 13 July 2006. The rules set out detailed obligations of relevant entities in relation to customer and agent identification and ongoing due diligence amongst other things.

Each entity covered by the legislation will be required to have a program which is designed to identify and materially mitigate the risk of the reporting entity providing a designated service involving or facilitating a transaction connected with a money laundering offence or the financing of a terrorism offence. The AML/CTF rules set out in detail the requirements for AML/CTF programs. The program will need to include the following things:

- risk identification;
- a customer due diligence program;
- an anti-money laundering counter-terrorism financing risk awareness training program for employees;
- an employee hiring due diligence program;
- a third party due diligence program;
- a compliance program; and
- an audit function to test the system/system of independent review of the program.

The program must be approved by the governing board and senior management of each entity.

# News

**August 2006**

The scope of the new legislation means that many lenders who were not previously caught by the operation of the *Financial Transaction Reports Act 1988* will now most certainly be covered by the AML/CTF package and all lenders will need to have a program in place which is compliant with the AML/CTF rules once the Bill is enacted.

## The risk of asset lending and failing to obtain disclosure of the purpose of a loan

The NSW Court of Appeal recently held that a loan agreement was an "unjust" contract, in part due to the fact that a lender did not have adequate regard to the ability of the borrower to make the loan payments and failed to obtain information from the borrowers regarding the purpose of the loan. The relevant case is *Perpetual Trustee Company Limited v Khoshaba* [2006] NSWCA 41.

### **The Facts**

Mr & Mrs Khoshaba were pensioners who spoke English as a second language and were not experienced in business or investment and sought to invest in a trolley collecting business which was part of a pyramid scheme.

The relevant loan application was submitted via a mortgage broker to Australian Mortgage Wholesalers Pty Limited who was required to assess the application in accordance with specific guidelines including verifying the employment and income of the borrowers and ensuring the purpose of the loan was stated on the loan application.

Without Mr Khoshaba's knowledge, the loan application incorrectly described him as an employee earning a salary of \$43,000.00 when he was in fact a pensioner and the purpose of the loan was not stated on the application.

The loan was approved and Perpetual Trustee Company Limited as trustee of a securitised mortgage program lent the Khoshabas \$120,000.00 which was invested in the pyramid scheme and secured by a mortgage over their family home.

The pyramid scheme collapsed, leaving the Khoshabas without the expected income flow and an inability to repay the debt to the lender.

The Khoshabas sought relief from the loan agreement as an "unjust" contract pursuant to the *Contracts Review Act 1980*. The loan agreement was found to be unjust both at first instance and on appeal but for several different reasons.

MAKINSON & d'APICE  
LAWYERS

# News

**August 2006**

## **The Court of Appeal decision**

The Court held that in determining whether a contract was unjust it must consider various things including the purpose of the loan and found that it was unjust for a lender to be solely focused on the loan security as being the means by which a loan, secured against a family home, would be repaid.

The Court held that it was entitled to give significant weight in determining whether the loan agreement was unjust to the fact that the purpose of the loan was left blank in the application. The Court inferred that because the lender failed to observe its own internal guidelines and ascertain the purpose of the loan and verify the borrowers' income stated in the loan application, the lender was solely concerned with whether the value of the property was enough to repay the debt and was not concerned with whether the borrowers could afford to repay the loan.

It was the failure on the part of the lender to even inquire as to the purpose of the loan to the Khoshabas which was determinative in the case against the lender. Had the mortgage introducer verified the income of the Khoshabas as required by its guidelines and disclosed the purpose of the loan on the loan application, the conclusion drawn would not have been a negative one for the lender.

## **Implications for lenders**

It is clear from this case that to engage in pure asset lending, that is, lend money without regard to the capacity of the borrower to make the loan repayments on the basis that there is sufficient security to repay the loan will put a lender at risk of having such a loan set aside on the basis that it is unjust.

## **Failure to check identity can affect enforceability of Mortgages in Queensland**

The *Natural Resources and Other Legislation Amendment Act 2005 (the Act)* commenced on 6 February 2006 and places an onus on all Queensland mortgagees to take "*reasonable steps*" to verify the identity of a mortgagor prior to lodging a mortgage or a transfer of mortgage for registration.

MAKINSON & d'APICE  
LAWYERS

# News

**August 2006**

The consequences of non-compliance with the Act are serious as if a mortgagee fails to verify the identity of a mortgagor and it is established that the mortgage was obtained by fraud, a mortgagee may lose its indefeasibility of title. In those circumstances, the mortgage will be defeasible and other interests including that of a later registered proprietor or a subsequent mortgagee could take precedence over the interest of the mortgagee.

Prior to the amendment, a mortgage that was registered obtained indefeasibility if the mortgagee had not been fraudulent within the meaning of the Act, notwithstanding that there was identity fraud in providing the mortgage. In other words once registered, a mortgage would take priority over all subsequent dealings.

The "*reasonable steps*" required under the Act are outlined in guidelines listed in a Land Title Practice Manual Update. The reasonable steps are similar to the steps required to be taken under the *Financial Transaction Reports Act 1988* (Cth) and associated regulations, that is, the usual 100 point check and identification reference. In addition, the mortgagee is required to keep a written record in the approved form of the steps taken to verify the identity of the mortgagor. Records must be kept for at least seven (7) years.

Some of the more important procedures prescribed by the abovementioned guidelines (which do not exhaustively prescribe the ways of taking reasonable steps) are as follows:

- If the mortgagee is a cash dealer under the *Financial Transaction Reports Act*, the mortgagee may use either a 100 point check or section 21 identification reference to identify a signatory.
- Where the mortgagee is not a cash dealer under the *Financial Transaction Reports Act*, the mortgagee must use the 100 point identification check. The guidelines specifically provide that a section 21 identification reference is unacceptable.
- Where the mortgagor is a company, execution must be by officers who appear on the ASIC register, which is no change to previous practice.
- If there are matters of concern, for example, a change of name or age discrepancy, a mortgagee should not rely on the 100 point check and should make further checks.
- Where a mortgage is signed under power of attorney for an individual, it is the attorney who must be identified.

MAKINSON & d'APICE  
LAWYERS

# News

August 2006

## A new way of financing moveable assets in New South Wales

The *Security Interests in Goods Act 2005* (**the Act**) came into operation on 1 March 2006 and has effectively repealed the *Bills of Sale Act 1898* and the *Liens on Crops and Wool and Stock Mortgages Act 1898*.

The Act has the following effect in relation to moveable assets in New South Wales:

- dispensing with the outdated distinction between traders bills of sale and ordinary bills of sale and introducing a concept of "*security interest*" in goods;
- removing the restriction on the period of registration which was previously five (5) years;
- making registration of certain instruments optional rather than mandatory. Previously if a bill of sale was not registered, depending on the type of bill of sale, the bill of sale would be void as against the trustee in bankruptcy and other third parties; and
- introducing a priority regime confirming priority of registered security interests in goods over unregistered interests and subsequently registered interests over the same goods.

The Act does not apply to security interests over motor vehicles or boats, hire purchase arrangements or other contracts for letting or hireage.

As stated above, the Act also repeals the *Liens on Crop and Wool and Stock Mortgages Act 1898* and provides for three (3) separate forms of agricultural goods mortgages, namely crop, stock and aquaculture, with broader scope, longer registration terms and fewer limitations. A crop lien prior to the Act was limited to one (1) year and farmers who previously had difficulty seeking to secure a loan in relation to an asset yet to be produced, for example, a crop to be planted, have benefited from the introduction of the Act.

The main implication of the Act on lenders is that there is no longer a requirement to register mortgages over non-agricultural moveable assets. However, registration is still recommended where the mortgage is one that is not

MAKINSON & d'APICE  
LAWYERS

# News

**August 2006**

registered at ASIC under the *Corporations Act 2001* (Cth) because the Act introduces priority of registered interests over unregistered interests.

The Federal Attorney-General has called for an Australia-wide seminar to discuss the way forward for a new uniform system so hopefully in the not too distant future there will be a uniform nationwide regime to register security interests in order to remove the ongoing concern for financiers that mortgagors relocate personal properties and chattels from one state to another.

## **Assistance**

If we are able to assist you in any of these areas, or other banking and finance matters, please contact one of our Banking and Finance Practice Group Team:

- Nancy Bramley-Moore – 9233 9009 or [nbramleymoore@makdap.com.au](mailto:nbramleymoore@makdap.com.au)
- Norman Donato – 9233 9031 or [ndonato@makdap.com.au](mailto:ndonato@makdap.com.au)
- Rosemary Carreras – 9233 9012 or [rcarreras@makdap.com.au](mailto:rcarreras@makdap.com.au)

## **Disclaimer**

This newsletter is a non-comprehensive general outline of the law as at 2 August 2006. You should not act upon or rely on any information contained in this newsletter without obtaining specific legal advice.

This newsletter and other publications are available from our website [www.makdap.com.au](http://www.makdap.com.au). If you would like to receive future issues of this newsletter by email or you wish to unsubscribe, please email [mail@makdap.com.au](mailto:mail@makdap.com.au) or contact our privacy officer on (02) 9233 7788.

MAKINSON & d'APICE  
— L A W Y E R S —