12 March 2021

Director, Policy and Rules
AUSTRAC
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Dear Director,

Proposed amendments to Chapters 3, 6, 7 and 10 of the AML/CTF Rules

The Australian Financial Markets Association (**AFMA**) represents the interests of over 120 participants in Australia's wholesale banking and financial markets. Our members include Australian and foreign-owned banks, securities companies, treasury corporations, traders across a wide range of markets and industry service providers. A significant proportion of AFMA's members are reporting entities for the purposes of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (**the AML/CTF Act**). We are pleased to make a submission to the Draft Rules (**the Draft Rules**) prepared by AUSTRAC to support the amendments in the *Anti-Money Laundering and Counter-Terrorism Financing and Other Legislation Amendment Act 2020*, (**the Phase 1.5 Reforms**).

AFMA has actively engaged with the Department of Home Affairs in relation to the Phase 1.5 reforms, particularly in the areas of reliance and information sharing. In supporting the Phase 1.5 reforms, as they relate to AFMA members, our objective is to advocate for initiatives that enhance the robustness and the efficiency of Australia's AML/CTF framework, by removing duplication of processes and facilitating the sharing of information in a manner that disrupts serious financial crime. We have adopted a similar objective in relation to the Draft Rules.

Transition and Implementation

As AUSTRAC would be aware, many of the amendments in the Phase 1.5 Bill, alongside amendments to the Rules, will necessitate significant changes for reporting entities in terms of systems, processes, updating of documentation and contract renegotiation, all of which will require substantial deployment of resources and training of affected staff. Under the commencement provisions of the Phase 1.5 Act, the changes to CDD/reliance, correspondent banking and tipping off take effect from six months after Royal Assent, namely 18 June 2021. We further note the comment on the AUSTRAC website in respect of the current consultation that "there will be a transition period for businesses to implement the reforms, and we will provide guidance during this time to support you."

Given changes will generally require a minimum of 18 months lead-time from final specifications to be implemented, AFMA is very keen to understand from AUSTRAC what is envisioned by the proposed transition period and the compliance approach that AUSTRAC will take during that transition period.

Correspondent Banking

Assisted Compliance

It is noted that the proposed amendments to the Draft Rules regarding Correspondent Banking relationships will require AFMA members to change systems and deploy additional resources. On this basis, an assisted compliance period of at least 18 months from the finalisation of the Rules is requested.

In addition, to the extent that there are requirements imposed in relation to ongoing reviews of correspondent banking relationships, clarity is sought around the commencement period of the review cycle. While AFMA's preference is that the review period is not prescriptive (refer below), to the extent that there is a specified time period then guidance is sought as to how this is applied to existing correspondent banking relationships.

Regulatory Consistency

It is noted that a number of AFMA members utilise the Wolfsberg Group Correspondent Banking Questionnaire to obtain information from respondents. Given that this questionnaire is a global standard, we submit that AUSTRAC consider aligning the factors set out in the due diligence requirements to that questionnaire, so as to reduce the fragmentation of requirements in different jurisdictions.

Due Diligence Assessment Factors

Proposed Rule 3.1.3 specifies a number of factors that will need to be considered by a correspondent in entering into a correspondent banking relationship with a respondent. The feedback from AFMA

members is that the regulatory burden imposed by the required due diligence assessment is high, particularly where there is no relationship between the correspondent and the respondent's parent.

We ask that AUSTRAC clarify the following matters:

- Where assessment is required in respect of a "parent entity", is this reference to the ultimate parent of the respondent or each intervening parent in the corporate chain?
- Can AUSTRAC confirm that, for the purpose of 3.1.3(3)(b) that the requirement extends only to the location of the parent's home jurisdiction and not other jurisdictions in which it operates?
- Where there is a due diligence obligation in respect of "related bodies corporate" (such as 3.1.3(6)), please clarify the scope of this term? Does it extend only to 100% members of the corporate or is there another threshold that needs to be applied? This may be a particularly onerous requirement, insofar as global banks may have a number of related bodies corporate in the global group that undertake activities entirely unrelated to the correspondent banking relationship;
- For the purpose of 3.1.3(6), please confirm that the term in 3.1.3(6)(c), i.e. "relating to money laundering, financing of terrorism or other serious crimes" may be applied equally to the investigation (3.1.3(6)(a)) or the adverse regulatory action (3.1.3(6)(b));
- Under proposed 3.1.3(5), the correspondent is obliged to consider the adequacy and effectiveness of the respondent's anti-money laundering and counter-terrorism financing systems and controls. Given this information will not be in the public domain, can AUSTRAC please clarify its expectations as to how the correspondent practically obtains comfort on these criteria;
- Can AUSTRAC please clarify the expectations where a correspondent banking relationship may be established with a branch/subsidiary of an entity with which the correspondent already has a correspondent banking relationship? Are the existing due diligence requirements sufficient in those circumstances?; and
- We note for completeness that the current specific due diligence requirement to determine whether a PEP has ownership or control of the financial institution has been removed, although it may be included in 3.1.3(1). Can AUSTRAC please clarify the expectation with regard to PEPs?

Ongoing Assessments

In respect of proposed Part 3.2, and particularly the requirement that the assessment be undertaken at least every two years, AFMA's view is that the frequency of correspondent banking due diligence should be one that is based on a risk based approach and not to prescribe a specific time period. To the extent that a prescriptive time period is imposed, it is submitted that this be considerably longer than two years. This would acknowledge the complexity of such assessments, particularly for those AFMA members that are providing AUD clearing services.

In the absence of prescription, AFMA would support a Rule that required the assessment to be at least conducted both at the commencement of the correspondent banking relationship and then on material change to the relationship and/or the risks associated with the relationship, with the potential for more frequent assessments where higher risks are present. Imposing a prescriptive and short review cycle for low-risk correspondent banking relationships may have the unintended consequence of de-risking banking relationships where the due diligence assessment burden is higher than the commercial benefit. A risk-based approach that takes into account the "size, nature and complexity" of the respondent would be consistent with other AML/CTF requirements.

Can AUSTRAC clarify if there are any requirements for the Senior Officer with respect to the ongoing assessments of the correspondent banking relationship under Part 3.2, particularly given the requirements under Section 96(3)(d) of the AML/CTF Act?

Vostro Accounts

AFMA notes the existing Rule 3.2.2 which has the effect of limiting the ambit of scope of a correspondent banking relationship to vostro accounts. Can AUSTRAC please confirm that the scope of a correspondent banking relationship for the purpose of the Rules has not changed, and accordingly that the due diligence requirements imposed by the Rules apply only to vostro accounts?

In addition, AFMA would support an expansion of the definition of "financial institution[s]" that are permitted to open vostro accounts to better align the Australian definition with those adopted in other jurisdictions. Under the AML/CTF Act, a correspondent banking relationship is the provision of services of one "financial institution" to another. The term "financial institution" is then defined as being an ADI, bank, building society, credit union or a person specified in the Rules. By so limiting the definition of financial institution, correspondent banking relationships cannot capture entities such as investment banks and broker dealers that are in scope for correspondent banking relationships in other jurisdictions. Accordingly, we recommend that sub-paragraph (e) of the Act is used by AUSTRAC to specify a broader class of entities that are financial institutions.

Payable Through Accounts

Proposed Rule 3.1.3(7) imposes additional due diligence requirements with respect to "payable-through accounts", which require specific approval by the senior officer under proposed Rule 3.1.5. On this basis, a specific definition of a "payable-through account" and/or the types of clients that could provide a payable-through account may assist reporting entities in determining whether such additional obligations apply to the reporting entity's circumstances.

Senior Officer

The proposed Rules impose obligations on the "senior officer of the correspondent" with respect to approval of correspondent banking relationships and also payable-through accounts. We are not aware of a definition of the term "senior officer" and request guidance as to which representative of the correspondent would qualify.

Reliance

Regulatory Burden

AFMA is supportive of the objective of the reliance changes, namely to expand the types of entities that a reporting entity is able to rely on to conduct ACIP/other specified processes on its behalf. In this light, it is important that the requirements under the Act and the Rules are not so onerous such that the easier path for reporting entities is not to utilise the new reliance provisions and continue to conduct ACIP themselves. The comments below in respect of the particular requirements under the proposed Rules seek to ensure that the reliance changes are, on balance, utilised by reporting entities.

In general, AFMA's members are very supportive of the ability to allow for reliance within a corporate or designated business group. The ability to rely on ACIP conducted by an offshore related party that is a FATF member will improve operational efficiency and detect and disrupt serious financial crime.

<u>Joint and Several Liability</u>

AFMA's consistent position with respect to the reliance amendments has been that the amendments will not achieve their objective to the extent that there is no relief from joint and several liability for the relying party for one-off failures by the party being relied upon. Note 1 to the proposed Rules states that "(I)f the first entity relies on applicable customer identification procedures or other procedures (as specified in paragraph 7.2.2) undertaken by another person under Part 7.3, the first entity retains ultimate responsibility for ensuring that all relevant obligations relating to customer identification, verification and ongoing due diligence under the Act and Rules are met." AFMA understands that this note seeks to replicate similar FATF language.

In AFMA's consultation with Home Affairs in advance of the enactment of the Phase 1.5 Bill, it was agreed that to the extent that the relying party remained jointly and severally liable for all of the acts or omissions of the party being relied upon, then there would be no incentive for the proposed reliance measures to be used. As such, it was further agreed that the relying party would only be liable for systemic breaches but would not be responsible for individual failures where the primary reporting entity had undertaken appropriate due diligence. This approach is reflected in the Explanatory Memorandum to Subsection 37A(2) of the Phase 1.5 Act, which states that "New Subsection 37A(2) gives effect to the "CDD arrangement" by providing relying parties with a safe harbour from liability for breaches of Section 32." Further, the Explanatory Memorandum states that

where the requirements of the CDD arrangement are satisfied, then "the relying party would not be held liable for isolated breaches of compliance with the ACIP (or other customer identification procedure) requirements committed by the relied on party."

In our view, Note 1 undermines this approach by apparently making the relying party liable for all relevant obligations, including one-off breaches. As such, AFMA's view is that the note should either be re-worded to reflect the agreed position or removed.

Financial Advisers

The amendments appear to remove the existing ability for reporting entities to rely on ACIP being conducted by licensed financial advisers. This would infer that reporting entities now have the requirement to conduct initial and ongoing assessments of financial advisers. Clarity from AUSTRAC is needed to confirm whether there is a change to the existing practice and, if so, we suggest that AUSTRAC consider a specific carve-out in the Rules for licensed financial advisers.

Other Procedures That May Be Relied Upon

Proposed Rule 7.1.3 sets out the procedures that may be relied upon for customer information and includes the identification of a person acting on behalf of a customer. Our view is that this Rule applies in circumstances where the customer is an individual. Can AUSTRAC confirm that it the proposed Rule applies equally to customers that are companies and confirm what authority is provided with respect to the person acting on behalf of the customer?

Reliance on Reporting Entities

AFMA notes that under proposed 7.2.2(3)(a) & (b), the party needing to be relied upon needs to be a reporting entity or a foreign entity that provides services akin to designated services (see for example the requirements set out in paragraph 7.2.2(2)). This would unnecessarily limit the entities on which reliance could be placed, including the ability for a KYC-utility to be developed as such a utility would not appear to be carrying on designated services.

In addition, this wording would appear to prevent reliance where the party being relied upon is a service entity in a centralised hub that undertakes the identification procedures on behalf of the entities providing the services and which form part of a corporate group.

Accordingly, we submit that the Rules should include flexibility that allows the AUSTRAC CEO to specify a particular entity or class of entities as capable of being relied upon. This could include defining such an entity as being one that forms part of a corporate group and provides ACIP or other specified services to the reporting entities in the corporate group.

Foreign Countries

Proposed Rule 7.2.2(3)(b) permits reliance on offshore entities to the extent that such entities are "regulated by one or more laws of a foreign country that give effect to the FATF recommendations relating to customer due diligence and record keeping." This test will be difficult to apply in practice given the absence of clarity around the meaning of "regulated by." AFMA would suggest that the requirement be that "the entity is incorporated or operates in a foreign country that gives effect to the FATF recommendations relating to customer due diligence and record keeping." Can AUSTRAC confirm that Guidance Note 09/02 "Assessment of comparable AML/CTF laws in foreign countries" may be utilised for the purpose of determining the foreign entities that may be relied upon?

Further, we note that while foreign entities may be located in jurisdictions that have adopted the FATF recommendations, the ACIP requirements may not be identical to those required under Australian regulation. For example, known areas of difference are: document-based and electronic-based verification procedures, simplified verification procedures (SVP), beneficial ownership requirements, ultimate beneficial owner thresholds and PEP identification. Our understanding is that where the relied upon party is located in a foreign country, then adherence to the standards of the foreign country regulations will be sufficient for the relying party.

Reliance Agreements/Arrangements

Under proposed Rule 7.2.2(1)(c), the written agreement needs to be entered into by the "governing board or senior managing official." Can AUSTRAC please clarify whether the term "senior managing official" is synonymous with the "senior officer" for the purpose of approval of correspondent banking arrangements and, if so, provide a definition? In particular, is it possible that this person could be located offshore? Further, is the requirement that the approval come from a governing board or a senior managing official (i.e. they are interchangeable) or is the requirement to go to a governing board and then, only in the absence of such a board, to the senior managing official?

In addition, proposed Rule 7.2.2(1)(c) requires that the relying party is able to obtain "all required KYC information" under the agreement/arrangement. At first instance, this appears to be a very broad requirement and clarity is sought as to the scope of what this information may be. In this regard, we note that Sections 37A(2)(d) and 38(c) of the Act require information to be obtained "about the identity of the customer."

Finally, can AUSTRAC confirm our understanding that the senior managing official is required to approve each individual agreement as opposed to approval of an amendment to Part A of the AML/CTF Program?

Ongoing Assessments

Rule 7.2.4 requires, in respect of reliance agreements/arrangements, that the relying party must carry out regular assessments to ascertain whether the requirements of the arrangement continue to be met at regular intervals, but at least every two years. AFMA submits that this timeframe should not be prescriptive, and be determined by reporting entities based on their risk-based approach. AFMA would support a Rule that required the assessment to be at least conducted both at the commencement of the agreement/arrangement and then on material change to the relationship and/or the risks associated with the relationship, with the potential for more frequent assessments where higher risks are present. To the extent that prescription in the Rules is required, AFMA would support a longer time-frame given the matters that need to be undertaken with respect to the assessments.

Case-By-Case Reliance

Proposed Rule 7.3.2 sets out the requirements for case-by-case reliance. There are two requirements, depending on whether an agreement is in place for the management of relevant documents and electronic data relating to identification and verification, whereby the information needs to be made available immediately; if not, within five days. AFMA submits that there should be consistent timing under both scenarios and further that five days may be a short timeframe, especially where the other party is offshore and/or retains such information in physical form. Additionally, the requirement should refer to "business days" as opposed to "days."

Clarity is also sought on the requirements for the "written record" for the purpose of proposed Rule 7.3.4, whether this extends to an electronic copy or extract and whether there are any governance or approval requirements or expectations for such a record, particularly to the extent that it is internal.

It is noted that proposed Rule 7.3.2 refers to "customer identification procedures or other procedures (as prescribed in paragraph 7.2.2) carried out by the other person." Can AUSTRAC confirm that this reference should be to Rule 7.1.2 as opposed to Rule 7.2.2? We seek similar clarity in respect of the drafting for proposed Rule 7.3.5(1).

Reliance Within a Corporate or Designated Business Group

The requirement in proposed 7.3.5(4) is that the risk-based system and controls are supervised or monitored at a group level by a "competent authority." Can AUSTRAC please provide a definition of the term "competent authority?"

Please confirm our understanding that there is no requirement for an agreement for reliance within a corporate or designated business group.

Drafting

For completeness, we note that Rule 7.2.1 refers to Subsection 38B(1) of the Act. We believe this to be a drafting error and that the correct reference is Subsection 37B(1). Clarification on this point is sought.

Customer Due Diligence

General Comments

AFMA notes that the Phase 1.5 Act amended Section 32 of the AML/CTF Act through prescribing that a reporting entity must not commence providing a designated service to a customer unless the reporting entity has carried out the applicable customer identification procedure in respect of the customer. This will not apply where there are "special circumstances" which justify the carrying out of the customer identification after the commencement of the designated service. These special circumstances are to be set out in the Rules (practically, Chapter 46 of the Rules), as per Section 33 of the Act.

AUSTRAC and industry have been consulting on proposed amendments to Chapter 46 Rules and AFMA provided feedback to AUSTRAC in August 2020 regarding proposed changes to the Chapter 46 Rules. In AFMA's view, given the changes to Section 32 imposed by the Phase 1.5 Act, it is appropriate for AUSTRAC to conclude the consultation on the changes to the Chapter 46 Rules and then to determine whether there need to be consequential amendments subsequent to the Phase 1.5 Act.

It is further noted that any amendment to the Chapter 46 requirements, either due to the amendments to Section 32 or otherwise, will require systems and process changes for AFMA members and hence there will need to be an assisted compliance period while this occurs.

Re-Verification of KYC Information

Under proposed Rules 6.1.3, there is an obligation on reporting entities to either obtain and verify or update and verify additional KYC information where the reporting entity either suspects that the customer is not the person the customer claims to be or has doubts as to the adequacy of documentation. Can AUSTRAC clarify whether the reporting entity is able to allow the customer to continue operating the account while the additional documentation is obtained/updated and verified? In addition, can AUSTRAC provide further clarity as to the requirements for "a person purporting to act on behalf of the customer," given that this is an additional requirement? In particular, does this provision extend to persons purporting to act for a customer that is a company?

Verification of Identity of Pre-Commencement Customers

Can AUSTRAC clarify that, to the extent that the circumstances that result in the suspicious matter reporting obligation result in the reporting entity ceasing to provide designated services to the customer, then the reporting entity is not obliged to carry out the steps in Rule 6.2.2?

We note that the requirement in 6.2.2(1) to carry out ACIP does not arise where the reporting entity has previously carried out, or been deemed to have carried out, that procedure or a comparable procedure. Can AUSTRAC confirm that where a reporting entity has placed reliance on another entity conducting ACIP under the Phase 1.5 amendments that this constitutes a "comparable procedure?"

The requirements in proposed Rule 6.2.3 for a pre-commencement customer that has had a suspicious matter reporting obligation arise need to be met "within 14 days, starting after the day on which the suspicious matter reporting obligation arose." Given that the customer is, by definition, a pre- commencement customer, then our view is that this timeline is very tight, and consideration be given to either extending the period or reframing the requirement as the reporting entity must commence undertaking the required action within 14 days. This approach would be consistent with that adopted in 6.1.3, which requires that the obtaining/updating and verification of the KYC information occur "as soon as practicable." We note that the same point arises for low-risk service customers under 6.3.3.

Can AUSTRAC please confirm our understanding that once ACIP has been completed on a pre- commencement customer then the customer is no longer treated as "pre-commencement?"

In addition, clarity is sought on the specific meaning of the Note below 6.2.3, that is, that "a reporting entity is not required to take any measures that would contravene the tipping off offence in Section 123 of the Act."

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Thank you for the opportunity to make a submission in relation to the Draft Rules. It is acknowledged that our submission seeks clarity on a number of points and AFMA is happy to participate in further consultation with AUSTRAC to refine the Draft Rules prior to their finalisation. Please contact me at rcolquhoun@afma.com.au or on (02) 9776 7996 with any specific queries.

Yours sincerely,

Rob Colquhoun
Director, Policy