AFMA

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Dear Ms Thomas

Anti-Money Laundering and Counter-Terrorism Financing Amendment Bill 2018 Exposure Draft and Indicative Draft AML/CTF Rules Phase 1.5

Thank you for the opportunity to provide comments on the *Anti-Money Laundering and Counter-Terrorism Financing Amendment Bill 2018* Exposure Draft (the Bill) and the Indicative Draft AML/CTF Rules Phase 1.5 in relation to reliance and correspondent banking (the draft Rules).

The Australian Financial Markets Association (AFMA) represents the interests of over 100 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. Our members are the major providers of financial services to Australian businesses and investors who use the financial markets. The majority of AFMA's members are reporting entities for the purposes of the AML/CTF Act.

The amount of time provided for industry to review the Bill and the draft Rules is quite limited; however we appreciate the opportunity to provide comments on the areas that are of particular interest to our members as set out below.

1. Reliance

As a fundamental point, in our view reliance should be able to be facilitated without any ongoing assessment, but supported by a contractual arrangement that the terms and full extent of the AML/CTF Act and Rules are complied with. This would carve out the ongoing assessment and other ongoing due diligence aspects envisaged by the Bill and would be more operationally effective for reporting entities.

Overall, we welcome enhancements to the AML/CTF Act in order to expressly provide for an arrangement or agreement-based reliance framework other than through the operation of agency principles (section 37) and the existing deeming provision in section 38.

The proposed changes to section 38 that will permit a reporting entity to rely on the applicable customer identification procedures conducted by a member of the corporate group will simplify customer due diligence for group customers and these changes are welcomed.

However, we have identified a number of areas where the drafting of the proposed amendments could be clarified in order to provide greater certainty to reporting entities in relation to their obligations under the proposed framework.

1.1. Proposed section 37A – identification procedures

Proposed section 37A permitting reliance on applicable customer identification procedures carried out by another regulated entity is quite stringent in terms of the requirements to enter into an agreement, monitor the other reporting entity/another person/another body and carry out a regular assessment of the agreement or arrangement, and appear to go beyond the requirements of FATF Recommendation 9. The requirements make the proposed reliance framework similar to an agency agreement which is already provided for under current section 37 of the AML/CTF Act, although without the attaching liability.

Some AFMA members are therefore uncertain whether proposed section 37A will be beneficial in a practical sense to their business.

1.2. Proposed section 37A(3) – level of reliance

Where the requirements of section 37A are met, subsection 37A(3) provides that the Act has effect as if the relying entity had carried out the applicable customer identification procedure in respect of the customer. A note to section 37A provides that if subsection (3) applies, the relying entity will not be liable to a civil penalty under section 32 or 34 for providing a designated service to the customer without carrying out the applicable customer identification procedure in respect of the customer.

A better approach would be to include an express provision that entitles the relying entity to absolute reliance on the arrangement or agreement (provided the requirements of sections 37A and 37B are met), together with an express provision relieving the relying entity from a civil penalty offence under sections 32 or 34, rather than addressing this by way of a deeming provision and interpretive note.

1.3. Proposed section 37A(2) – compliance with the requirements of the AML/CTF Rules

Subsection 37A(2) provides that the relying entity may enter into the agreement or arrangement "only if the requirements prescribed by the AML/CTF Rules are met". It is unclear whether this is intended to refer to the amendments to the AML/CTF Rules specifically in relation to reliance (ie. proposed Chapter 7 of the Rules), or whether the provision requires more broadly that the agreement or arrangement meets the customer identification procedure rules. Therefore the extent of 'compliance with the Rules' is unclear.

1.4. Proposed section 37A(4) – requirements of the AML/CTF Rules cease to be met

Proposed subsection 37A(4) provides that subsection 37A(3) does not apply where the relying entity becomes satisfied that the requirements of the AML/CTF Rules prescribed for the purposes of subsection 37A(2) "cease to be met". As noted at point 1.2 above, the drafting is ambiguous as to whether it is the proposed Chapter 7 of the Rules or the AML/CTF Rules relating to customer identification and verification procedures more generally, that "cease to be met". Further, do the Rules "cease to be met" when *any one* of the applicable Rules for this purpose cease to be met, or all such applicable Rules cease to be met?

We suggest that the drafting could be clarified to better reflect the intention of this provision should subsection 37A(3) no longer apply to protect the relying reporting entity from exposure to civil penalties under sections 32 and 34.

1.5. Proposed section 37A(5) – termination of agreement or arrangement

Subsection 37A(5) requires the relying entity to terminate an arrangement or agreement as soon as practicable (but no later than 5 days) after becoming satisfied that the requirements prescribed by the AML/CTF Rules for the purpose of subsection 37A(2) cease to be met. However:

(a) as above, it is unclear which Rules should be considered for the purposes of assessing non-compliance by the other person;
(b) it is unclear whether the obligation to terminate is intended to operate upon a *single instance* of non-compliance with any of the Rules considered applicable for the purposes of this section, or whether more systemic non-compliance is intended to be addressed by this obligation;
(c) there is no curative mechanism by which non-compliance can be remedied before the obligation to terminate arises; and
(d) is the effect of the termination obligation also intended to require termination of customer accounts that are the subject of the reliance arrangement or agreement?

The termination obligation would also appear to introduce a quasi-breach reporting approach into the legislative framework that does not otherwise exist.

The absence of a mechanism for remediation is, in our view, a significant omission that has the potential to render reliance arrangements or agreements practically ineffectual and undermine the purpose of introducing an express reliance framework into the legislation. We strongly recommend that this is addressed in order for the framework to function appropriately.

Clarification is needed in relation to the assessment of non-compliance that relying entities are expected to undertake in becoming satisfied that the requirements of the Rules "cease to be met". As noted above it is unclear whether this relates to 'one-off incidents' or requires more of a subjective assessment of systemic or ongoing failures.

1.6. Proposed section 37B – regular assessment of agreements or arrangements

Section 37B requires relying entities to carry out regular assessments of the agreement or arrangement while it is in force, in accordance with the Rules, and to prepare a written record of each assessment within 10 business days after the day of completing the assessment.

Draft Rule 7.1.5 allows a risk based approach to be adopted in carrying out such assessments (having regard to the factors specified in Rule 7.1.2), but in any event an assessment must be carried out at least every 2 years.

As currently drafted, the obligation to undertake an assessment of the agreement or arrangement appears to go beyond the areas of reliance placed on the other party. In particular:

(a) draft Rule 7.1.5 seems to require an assessment of equivalence of the other party's regulatory supervision in relation to AML/CTF obligations relating to customer due-diligence and record keeping, without any guidance as to how reporting entities are expected to conduct assessments of equivalence to FATF recommendations;
(b) the assessment of the other party's "appropriate measures for compliance" with FATF-equivalent customer due diligence and reporting obligations is not limited to the specific customer identification procedures in respect of which the reporting entity places reliance on the other party;
(c) Rule 7.1.2(b) does not include as a relevant factor the nature, size and complexity of the *relying entity's* business – only these factors in relation to the other party's business, which may not be relevant to the reliance arrangement or agreement; and
(d) Rule 7.1.2(b) seems designed to address a scenario where reliance is placed on customer identification procedures carried out by that party in respect of designated services it provides to the customer (eg. in an 'Open Banking" reliance scenario) rather than as a result of obligations arising specifically under the agreement or arrangement to carry out customer identification procedures for the relying party in respect of designated services the relying party provides to the customer.

Significantly, there is an absence of any legislative or rule-based obligations requiring the other party to co-operate with the relying entity for the purpose of the assessment. If these obligations are to have any meaningful practical effect, we suggest obligations on the 'other party' to co-operate (including the obligation to provide relevant documentation to the relying entity upon request) are necessary in order for the reporting entity to meet its own obligations under the proposed reliance framework.

The requirement to prepare a written record of each assessment within 10 business days after the day of completing the assessment is unlikely to be able to be met in practice by reporting entities given the broad scope of the assessment that appears to be required under draft Rules 7.1.2 and 7.1.5.

1.7. Draft AML/CTF Rule 7.1.3(2)(a)(i) – requirements to be met before entering into an agreement or arrangement

The Rule as drafted requires that the reporting entity must be satisfied on reasonable grounds that the other party is subject to, and supervised or monitored by a competent authority responsible for, AML/CTF obligations relating to customer due diligence and record-keeping *in line with the FATF Recommendations*.

This clause puts the burden on the reporting entity to validate that the CDD and record-keeping obligations of the other entity's home country regime are currently "in line" with FATF's recommendations. A country's compliance with FATF Recommendations can vary from time to time.

Further clarification is needed as to how AUSTRAC expects a reporting entity to reasonably demonstrate this assessment. For example, does a reporting entity need to review how the country's AML regime scored in its last FATF Mutual Evaluation? Or would the country just being a member of FATF be considered sufficient?

1.8. Draft AML/CTF Rule 7.1.5 – regular assessment of agreement or arrangement

Draft Rule 7.1.5 requires assessments to be carried out at appropriate and regular intervals having regard to (1) the type and level of ML/TF risk faced by the reporting entity; and (2) any material change in respect of the matters specified in subparagraph 7.1.3(2) of the Rules - but in any event, *at least every 2 years*.

All other things being equal, an entity that is regulated by a competent authority whose regime is in line with FATF's recommendations would likely be rated low risk, if it was a customer itself, and therefore should follow the standard review cycle commonly adopted by industry for clients of a similar risk ranking, which would be every 3 years for low risk, rather than every 2 years. There are some reporting entities whose entire business model is designed around reliance and there could be hundreds of agreements in place. An assessment interval of 2 years would be a very large additional cost to this type of business.

We suggest that where the entity relied upon is assessed as low risk and nothing has changed, a 3 year interval is more appropriate.

2. Correspondent Banking

2.1. Proposed section 96(2) – due diligence of correspondent banking relationships

Proposed subsection 96(2) requires the first institution that is in a correspondent banking relationship with another financial institution to carry out a due diligence assessment in accordance with the AML/CTF Rules and to prepare a written record of each assessment within 10 business days after the day of completing the assessment, as per paragraph (c).

It is not clear what the rationale is for including the 10 business day requirement and what risk is mitigated by the short timeframe. It is suggested the timeframe could be extended to 30 days.

2.2. Draft Rule 3.5 – ongoing due diligence assessments

The obligation in draft Rule 3.5 to conduct a due diligence assessment at least every 3 years lessens the ability of a reporting entity to take a risk based approach to customer due diligence.

We suggest that the interval is increased to up to 5 years which would be consistent with an ongoing periodic review for low risk customers. Some financial institutions may still conduct more frequent reviews.

2.3. Requirement for senior officer approval

We assume the rule listed as Rule 3.4 in the draft Rules relating to senior officer approval should be Rule 3.6.

It is suggested that clarification about the definition of "senior officer" for the purposes of the Rules would be helpful.

For example, the New Zealand *Anti-Money Laundering and Countering Financing of Terrorism Act 2009*, Part 1 Section 5 Interpretation says that:

> *senior manager (and senior management correspondingly) means —*
>
> *(a) in relation to a reporting entity that is a company, a director within the meaning of section 126 of the Companies Act 1993; and*
> *(b) in relation to a reporting entity that is not a company, a person who occupies a position comparable to that of a director (for example, a trustee or partner); and*
> *(c) any other person who occupies a position within a reporting entity that allows that person to exercise an influence over the management or administration of the reporting entity (for example, a chief executive or a chief financial officer).*

3. Tipping Off

3.1. Exceptions for members of a corporate group and members of a designated business group

The proposed exceptions in section 123(7) and section 123(7AB) for members of a corporate group and members of a designated business group (DBG), respectively, have been drafted slightly differently, which means that a disclosure to a member of a corporate group can only be made where a reporting entity (the first entity) has been told by the corporate group member that the corporate group member is dealing with, or has dealt with, the customer. It is not clear how or why the corporate group member would have informed the first entity about this. It also pre-supposes that the person is already or has been a customer of, or is or has dealt with, the body corporate, which may not be the case. However, the first entity still has a need, for example, to report suspicious matter cases and SMR metrics to its head office risk and compliance function for wider risk management, governance and oversight, as well as for regulatory reporting purposes.

Surprisingly, the corporate group member can disclose to another corporate group member without the same restriction.

The disclosure to members of a DBG does not have the same restriction.

From our point of view the preferred outcome would be for the exception for members of a corporate group to mirror the exception for members of a DBG.

Clearly, financial crime is an international activity and it is a common methodology for criminals to move proceeds of crime from the jurisdiction in which they were generated to overseas accounts. As international financial institutions, AFMA members are aware that criminal networks operating through branches and subsidiaries in other countries – often with no prior knowledge of the bank before a suspicion is formed.

The limit to being able to disclose a suspicious matter to those members of a corporate group who have already told the first entity that they have a relationship with a customer that is the subject of an SMR seriously hampers the ability to fight financial crime on a holistic basis by seeking to prevent customer access to the financial system outside of Australia where the Australian bank operation has identified a financial crime risk.

Financial institutions need to have the ability to pre-warn their corporate group members where a suspicion has arisen so that they can be pro-active in managing the risk, in the same way that a member of a DBG can. One way this is achieved is through global financial crime case management systems in which the information is contained and confidential to personnel within group members who have financial crime prevention and monitoring functions. Where SMR disclosure is prohibited or limited, it means that this information cannot be shared with other group members and the intelligence value is lost.

We strongly urge the Government to reconsider this aspect of the proposed changes.

3.2. Proposed requirement to give a written undertaking

Under proposed paragraph 123(7)(f), a body corporate must give the first entity a written undertaking about protecting the confidentiality of information, controlling the use of the information, and ensuring the information will only be used for the purpose for which it is disclosed.

It is not clear whether a written undertaking is required for each individual SMR that is shared, or whether a blanket undertaking may be given for any SMR that may be shared with a corporate body.

We look forward to discussing these comments further with you. In the interim, please contact me on 02 9776 7997 or tlyons@afma.com.au if you have any queries about this submission.

Yours sincerely

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