Australian Banking Association

11 March 2021

Director
Policy and Rules
AUSTRAC
aml_ctf_rules@austrac.gov.au

Dear Director

# Explanatory Note for Consultation and draft amendments to Chapters 3,6,7 and 10 of the AML/CTF Rules

The Australian Banking Association (**ABA**) welcomes the consultation on the draft amendments of the AML/CTF rules to support the implementation of the Phase 1.5 reforms under *the Anti-Money Laundering and Counter-Terrorism Financing and Other Legislation Amendment Act 2020*. The ABA advocates for a strong, competitive, and innovative banking industry that delivers excellent and equitable outcomes for customers. The ABA promotes and encourages policies that improve banking services for all Australians, through advocacy, research, policy expertise and thought leadership.

The ABA strongly supports the objects of the AML/CTF regime. It also strongly supports that the obligations be simplified, streamlined, and clarified, and the regulatory burden reduced where possible. The ABA supports a risk-based approach, consistent with Financial Action Task Force (**FATF**) recommendations, to enable banks to efficiently use and allocate resources proportionate to the level of assessed risk.

The ABA's key issues are:

- Timing and implementation
- Clarification of terms
- Size of the regulatory burden on correspondent banking, and
- The prompt finalisation of previous draft rules consultation.

### Timing and implementation

The ABA recommends AUSTRAC issue a formal instrument providing effect to an 18-month implementation period. The ABA understands that the provisions in the *Anti-Money Laundering and Counter-Terrorism Financing (2006)* (**AML/CTF**) Act will commence no later than 18th June 2021 and the AML/CTF Rules made under section 229 of the Act will become effective at the same time. However, as the AML/CTF Rules are yet to be finalised (consultation on the proposed amendments continue through March 2021), it will not be possible for Reporting Entities (**RE**'s) to implement changes to systems, processes and controls by 18th June 2021. Given this, the ABA recommends that an assisted implementation period of no less than 18 months be provided to enable the required changes to RE's operational systems, processes and controls.

This timeframe also considers anticipated impacts arising from future amendments to Chapter 46 of the AML/CTF Rules regarding Section 32 of the AML/CTF Act. We note that significant system changes would be required to either prevent accounts from being opened until the applicable customer identification procedure (**ACIP**) requirement has been completed or to restrict deposits beyond an initial deposit. Banks will need to undertake a review of all systems and processes following their receipt of the final Chapter 46 requirements to fully understand the scope of the changes and timeframe required. In addition, system changes may also need to consider any requirements for back book remediation where required.

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**Clarification**

Meeting AML/CTF requirements is a high priority for banks. Given this, the current drafting of the AML/CTF rules and guidance plays a key role in the understanding/interpretation of legal compliance requirements. However, the ABA find some references are unclear and require more specific guidance or definition. The ABA have identified where further clarification and guidance would be helpful in the detailed Chapter feedback attached.

**Size of regulatory burden for correspondent banking.**

The ABA is concerned that the proposed amendments for correspondent banking will require significant changes to practices. Implementing the proposed amendments such as limiting account activity will require significant investment in systems upgrades and the ABA questions whether this is the most effective way to achieve AML objectives.

**Finalisation of previous draft rules consultation**

In mid-August 2020, ABA made a submission to AUSTRAC on the proposed amendments to Chapter 46 of the AML/CTF Rules (Special circumstances for the applicable customer identification procedure). An updated draft of Chapter 46 is yet to be released and we note that changes cannot be made in isolation from the amendments to Chapter 46 of the Rules. That is, it appears that amendments to Chapter 46 may have a significant impact, requiring significant changes to systems and controls; the required changes need to be understood to be integrated with any changes required from amendments, particularly to Chapter 6 – Verification of identity.

The ABA requests that AUSTRAC prioritise finalising the proposed amendments to Chapter 46 following the change to Section 32 of the AML/CTF Act. Without the special circumstances there is a risk of investing in system builds may not align with the requirements. The ABA would also welcome further discussions on the proposed final Section 32 ahead of its finalisation.

The ABA's specific feedback on the relevant chapters of the Explanatory Memorandum and Amendments is attached.

The ABA welcomes further engagement with AUSTRAC as part of the finalisation of the Phase 1.5 amended rules and explanatory notes. Please contact myself on 0450 615 148 or karen.obrien@ausbanking.org.aui in regards to this submission

Yours sincerely

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Karen O'Brien

Policy Director

# Introduction

As noted previously, the ABA strongly supports the objects of the AML/CTF regime. It also strongly supports that the obligations be simplified, streamlined, and clarified, and the regulatory burden reduced where possible. The ABA supports a risk-based approach, consistent with Financial Action Task Force (**FATF**) recommendations, to enable banks to efficiently use and allocate resources proportionate to the level of assessed risk.

Given this, we have provided detailed feedback by Chapter below.

# Chapter 3 – Correspondent Banking

The ABA understands that AUSTRAC is seeking to strengthen protections on correspondent banking by prohibiting financial institutions from entering a correspondent banking relationship with another financial institution that permits its accounts to be used by a shell bank. The amendments require banks to conduct due diligence assessments before entering, and for the duration of, any correspondent banking relationship.

As noted earlier, the ABA considers that the proposed rules need to better consider the operational difficulties of implementation and the regulatory burden.

Please see below the ABA's more detailed feedback on Chapter 3.

## Implementation clarification

In addition to the 18-month assisted compliance period, the ABA is seeking confirmation of its understanding that the new obligations for ongoing assessments only apply when the correspondent banking assessment becomes due for review, as per the current review cycle. This is an important clarification as the review cycle may be greater than two years. ABA suggests that this clarified in the Rules.

## Part 3.1- Entry into a correspondent banking relationship

As noted earlier, the ABA seeks clarification/definition of a number of terms set out in in Chapter 3 of the draft Rules and explanatory notes. The ABA strongly supports the development of AUSTRAC guidance, particularly in regard to terms such as 'senior officer' and 'governing board' in the context of correspondent banking relationships, and around mechanisms to assess the adequacy and effectiveness of the respondent's AML/CTF controls. This will ensure there is a consistent application of interpretations across industry.

**Carrying out an initial assessment**

***Serious Crime risks (3.1.2)***

The ABA is seeking clarification in relation to the assessment of '…*other serious crime risks associated..*.'. More specific detail is needed regarding AUSTRAC's expectations in terms of additional due diligence assessments required, beyond AML/CTF and the factors stipulated in the Rules. At present, it is unclear to banks what is needed in the context of the global nature of correspondent banking activity and various regulatory regimes for what is considered a serious crime.

***Vostro accounts (3.1.3(2)***

The ABA understands that the draft Rules do not make any reference in relation to the existing Part 3.2.2 in the Rules (*"For the purposes of paragraph (e) of the definition of correspondent banking relationship in section 5 of the AML/CTF Act, all banking services that do not involve a vostro account are specified"*).

The ABA is seeking confirmation that there will be no change to existing obligations under the draft Rules, which limit the scope of a correspondent banking relationship (CB) to vostro accounts (accounts maintained for an overseas Financial Institution to facilitate cross border payments and clearing

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activity). It is the ABA's understanding that the due diligence assessments required under Chapter 3 of the Rules are limited to the types of transactions carried out in such vostro accounts (as per 3.1.3 (2) (b)), and do not apply to other types of accounts that may be maintained by foreign financial institutions. For example, corporate style accounts for deposits or other banking operations maintained by a subsidiary of a foreign financial institution in Australia.

In addition, in relation to section 95 (1) (c) from the Amendment Act ("the other person is a financial institution that permits **its accounts** to be used by a shell bank."), ABA is seeking clarifications on the term 'its accounts', whether this relates to Vostro accounts only or more broadly. If related to Vostro accounts only, please clarify how does this differ from paragraph (b) and if it is more broadly, please clarify the scope (what types of accounts may be covered).

Further, the ABA requests that AUSTRAC consider expanding the definition of a financial institution allowed to open Vostro accounts to reduce the gap between current Australian legislation and the global definitions of financial Institution and vostro applicability. For example, in the current definition, reference is made to authorised deposit-taking institutions (ADIs) regulated by APRA and excludes financial institutions regulated outside of Australia. Expanding the definition will also assist in 'future proofing' the legislation given the broader application in a global context.

***Entry - Factors for risk assessment (3.1.3)***

Throughout the section, terms such as 'any parent' or 'parent' or 'related bodies corporate' are used. The ABA seeks clarification on whether this relates to the ultimate parent of the respondent or <u>any</u> parent in the chain of ownership, and what other related bodies corporate will need to be covered by the assessment (if any). This has implications for various subsections in terms of information to be collected at (1), (3)(b), (4), and (6). The ABA asks AUSTRAC to clarify the following through relevant changes in the Rules and/or further guidance:

- For (1), confirm that there is no prescription in relation to the percentage which determines ownership, this being left at a regulated entity (**RE**) discretion to decide.
- For (3), confirm the understanding that, if the parent company of the respondent <u>does not have</u> group-wide AML/CTF systems and controls or if the respondent <u>does not</u> operate within the requirements of those controls, there is no obligation to collect the country/countries in which the respondent's parent operates or resides.
- For (4), confirm the understanding that, whilst the existence and quality of AML/CTF regulation and supervision is required in circumstances under (3), the compliance practices are only to be collected in relation to the respondent.
- Suggest AUSTRAC issues further guidance on how a bank can assess the risk for the factors mentioned in this section, in relation to (4), (5):
  - quality of AML/CTF regulation and supervision and the respondent's compliance practices in relation to those regulations.
  - adequacy and effectiveness of the respondent's AML/CTF systems and controls.
- For (6) - clarification is sought on the reasons for inclusion of <u>any related bodies corporate.</u> This is a very broad concept; the structure could be quite complex for global banks and there might be related bodies corporate in the structure that are not involved in activities related to the Vostro account. This has an impact on which related bodies corporate must be included in the assessment for this factor. Clarification is sought if the intent is to limit this to ultimate parent (also linked to the question about 'any parent' above). Also, please confirm the understanding that:
  - Paragraphs a), b), c) relate only to respondent.
  - Paragraphs a), b) must only be related to ML/TF or other serious crimes, like paragraph c).

- For scenarios where the new CB relationship is with an entity which is, for example, a foreign branch and/or subsidiary of an existing CB relationship that already maintains a Vostro account, clarification is sought whether the due diligence of the existing CB relationship is sufficient, or a new assessment is required.

The ABA notes the removal of the obligation to determine if PEPs have ownership or control. The ABA understands that no such prescription is being made through the Rules and this being left at the discretion of REs to determine the extent of PEP involvement and due diligence measures, according to the risk.

***Payable through accounts (3.1.3 (7))***

The ABA recommends including a definition of a 'payable-through account' in the Rules and providing more guidance about what constitutes a 'payable-through account. For example, clarify if permitting affiliates (related entities) of a parent which maintains a Vostro account, to have a debit authority over the Vostro account owned by the parent constitutes a "payable-through" facility.

## Part 3.2 -Ongoing assessments of a correspondent banking relationship

**Timing of ongoing assessments**

The ABA does not support a prescriptive limit on the frequency of reviews of '…at least two years…' Instead, the ABA recommends guidance be developed to include the factors REs should apply to determine a higher-risk CB relationship and allow REs to determine the appropriate review period. At present, REs may apply a much shorter review period than proposed where a CB relationship is considered higher risk and a longer review period for those relationships that are lower risk. This is a more proportional approach to regulation in relation to the risk and more consistent with a FATF guideline approach.

However, if indicating a frequency is preferred, the ABA suggests that the frequency of review be included in the guidance, as recommendation, rather than in the rules; and that the frequency to be changed from the proposed two years to three years. This is to allow more flexibility in managing the risk, considering the complexity of such assessments, involvement of counterparts from multiple jurisdictions with different regulatory regimes as well as additional controls performed on a more frequent basis, such as transaction monitoring or event triggered reviews.

The ABA recommends that any guidance provided on the frequency of review should clarify when the time-period begins (the trigger point). It is unclear from the proposed rules whether the frequency of two years is calculated the day after completing the assessment or after the date when the senior officer made the decision.

The ABA also considers that any guidance should outline how review delays should be handled by an RE. It is unclear what AUSTRAC's expectations are in terms of dealing with overseas respondents that do not respond to due diligence requests and may cause delays in completing the assessments.

**References to days and specified time periods**

The ABA notes that there are a number of references to "business days" and "days" in the Amendment Act. For the avoidance of doubt, it would be useful if AUSTRAC could confirm that the term "20 days" in s. 95 (2) and (3) in the Amendment Act refers to "20 business days".

The ABA is also seeking clarification through guidance on when the prescribed timeframes begin and/or end in the following cases.

- Termination for shell banks (s. 95 (2) and (3): in circumstances where paragraph (c) applies, the timeframe for termination is within 20 days after becoming aware. In other words, point 2 (d) applies in circumstances mentioned in 2 (a) and (c).
- s. 96 (2): Clarification is sought regarding what date is considered 'the day of entering into relationship'. ABA understands that this is the day when the Vostro account is opened.

- S 96 (3): The ABA understands that 'The day of completing the assessment' is the day when all information required has been received and clarified with the respondent. If this is the case, confirmation in guidance would be useful. The ABA also understands that the timeframe for the 'written record of the assessment within 10 business days after the day of completing the assessment' is only for ongoing assessments, not for initial due diligence.

## Chapter 6 – Verification of identity

The ABA understands that the draft AML/CTF Rules amend Chapter 6 to specify the requirements of a reporting entity when it has doubts about the veracity or adequacy of previously obtained know your customer information. The ABA considers that the rules could provide more clarity as set out below.

**Clarification of note**

Clarification is sought in relation to the purpose of Note 3 in order to resolve the conflicts identified. Note 3 is a new inclusion to this section and directs the reader to Section 41, Report of suspicious matters. The inclusion of Note 3 is initially understood to create a linkage between the completion of the ACIP and the obligation to submit an SMR where an RE suspects on reasonable grounds that the person is not who they claim to be. However, this is not consistent with the Explanatory Memorandum to the AML/CTF Amendment Bill 2019 which states the following in relation to Note 3;

*"14. This item rectifies both of these deficiencies by making the operation of section 32 more explicit, and by providing a note that links section 32 to section 41 (the obligation to submit a SMR) if the ACIP cannot be performed".*

### Part 6.1 – Re-verification of KYC information

The ABA considers that further guidance is needed in relation to 6.1.3 (1) & (2) if an ACIP is found to be deficient. More detail is needed on AUSTRAC's expectations regarding whether or not an RE is to permit a customer to continue operating an account whilst steps are being taken to complete the requirements set out in 6.1.3 (1) and (2). Changes to systems and controls will at a minimum require an 18-month implementation period.

Given the interaction between Chapter 46 and part 6.1, the ABA requests that AUSTRAC prioritise the finalisation of Chapter 46. Amendments to Chapter 46 will result in significant changes to systems and controls to implement the proposed re-verification of know your customer (**KYC**) information.

The ABA seeks confirmation of what "the person" refers to in 6.1.2 (2). It is unclear from the proposed rules whether the section refers to the customer; or the beneficial owner(s) of the customer; or a person purporting to act on behalf of the customer however the closed sentence refers only to 'the person'.

### Part 6.2 – Verification of identity of pre-commencement customers

The ABA notes that the section applies to pre-commencement customers. However, it is unclear to industry whether this section only apples to those pre-commencement customers who have not subsequently been subject to an ACIP. We suggest amendments be made to make it explicit that once ACIP has been applied to a pre-commencement customer, the customer can thereafter be dealt with under Part 6.1 of the AML/CTF Rules and no longer considered a pre-commencement customer.

**Application of the Note**

The ABA is seeking clarification of the scope of application of the Note**.** The Note states 'A reporting entity is not required to take any measures that would contravene the tipping off offence in section 123 of the Act.' Whilst AUSTRAC may hold the view that broad application of the 'Note' is implied, confirmation of this is sought in order for RE's to apply this approach to other areas of the Rules such as Chapter 15.

**14-day period may be inadequate**

At 6.2.3 the proposed rules note that “The reporting entity must take the required action or actions within 14 days…” The ABA considers that the prescribed 14-day time-period for conducting ACIP for a pre-commencement customer may not allow adequate time in some cases. There are a range of factors that may present practical challenges in completing the required action under para 6.2.2. For example, the customer may be located / travelling overseas which presents difficulties in contacting the customer and obtaining documentation. The ABA understands that this has been raised as an ongoing issue over an extended period and that the proposed amendments to the rules provides an opportunity for this issue to be addressed by amending the rules to require actions “as soon as practicable” instead.

## Chapter 7 – Reliance on third parties

The ABA understands that the purpose of the new reliance measures is intended to assist industry by expanding the types of entities that an RE can rely on to conduct ACIP on its behalf. However, the cost of expanding the types of entities under the proposed rules would be prohibitive and therefore deliver limited or no benefit to industry. This is because:

- Proposed rules require the RE to conduct initial and ongoing assessments of other RE's in combination with strict timeframes. As a result, some RE's may consider that conducting their own ACIP is a more practical and less costly approach.
- Introduction of the new reliance requirements removes the existing ability for RE's to rely on ACIP being conducted by licensed financial advisers without the need for initial or ongoing assessment. Whilst the intent of the new reliance arrangements is to assist RE's, the introduction of the need to conduct initial and ongoing assessments of licensed financial advisers is considered to have the opposite effect to that intended. On this basis, the ABA would also welcome clarification on the applicability of this requirement to licensed financial advisers and if it does apply to these advisers, if REs can conduct the initial and ongoing assessments of licensed financial advisers as a class, rather than as individual third parties.
- Reliance is now restricted to RE's (in an Australian context) or foreign equivalents. This prohibits an RE's reliance on any other 'person' outside of the definitions set out in 7.2.2 (3) (a) and (b). This may have a limiting impact in future as providers such as KYC utilities and other non-regulated service offerings progress.

The ABA requests that AUSTRAC confirm the above interpretation of the proposed rules, and exempt financial advisors from ongoing assessment requirements which reflects practices that have been in place since the introduction of the Rules.

The ABA also welcomes further amendments which could simplify and reduce costs to the proposed approach thereby enabling further use of third parties when it is most efficient to do so.

The ABA would also welcome guidance from AUSTRAC on the definition of ‘reliance’ and how it differs to ‘agency’ agreements, captured under Section 37 of the AMLCTF Act, where the ‘agent’ is a reporting entity.

### Part 7.1 – Reliance

The ABA requests further clarity be provided in relation to Part 7.1.3(3) on “identifying a person acting on behalf of the customer”. For example, referring to this person as an agent, however this might be interpreted differently in a foreign country. For example, Authorised Signatories in Hong Kong.

**Requirements relating to agreements or arrangements for reliance**

The ABA would welcome guidance on the following:

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- AUSTRAC's expectations in relation to the content of assessments. Guidance in the form of examples to inform REs on the level of scope and detail required. In particular, guidance on the factors AUSTRAC considers should be assessed.
- The nature of breaches which would be considered 'isolated'.
- Appropriate consideration of a foreign entity at 7.2.1 (3)(b). For example, guidance could clarify whether consideration of a foreign country's inclusion or absence from the list of high risk and other monitored jurisdictions would be sufficient.
- The extent to which there is an expectation to align to FATF standards/terminology and AUSTRAC's view on how changing international circumstances may be adequately incorporated.

- The ABA recommends amending reference to "Senior Managing Official" to "Senior Officer" in Part 7.2. This amendment would reduce complexity by aligning Chapter 7 with Chapter 3 which refers to "Senior Officer".

**Regular assessment of agreements or arrangement for reliance**

The ABA requests that the term "competent authority" is defined in guidance to ensure consistent interpretation across industry. The ABA understands that this is a term that is applied globally. However, it is not clear that this term is interpreted consistently across industry.

The ABA would like to highlight a potential drafting error at 7.2.1 which refers to 38(b) (1) which is not a relevant section within the proposed Rules.

The ABA recommends that the prescribed time-period in section 38 & Parts 7.2.3, 7.2.4 and 7.3 be increased to 20 business days. Amending the time period to 20 business days will reduce complexity and improve consistency with the Correspondent Banking requirements in relation to preparation of written record of assessments.

The ABA notes that in Part 7.2.4 that a two-year timeframe (minimum) has been set for the regular assessment of agreements or arrangements for reliance. We suggest that a minimum timeframe of at least every 3 years may be more appropriate where the AML/CTF risk is low. This may be particularly the case where the third party is an Australian reporting entity dealing with domestic customers for the purposes of the applicable customer identification procedure. Other factors which may contribute to this low risk assessment may be the provision of all applicable documentation, data and information to the reliant reporting entity which assists in evidencing that an applicable customer identification procedure has been completed.