AFMA member comments on draft AML/CTF rules relating to customer due diligence – January 2014

Draft rule	Comment
Reasonable measures	The draft rules contain a number of references to "reasonable measures" (4.1.2(5)(d), 4.12.1, 4.12.9, 4.13.2(1), 15.3). The term "reasonable measures" is not defined in the AML/CTF Act or Rules. The terms "reasonable measures" is defined by FATF as "appropriate measures which are commensurate with the money laundering and terrorist financing risks". A definition of "reasonable measures" that is consistent with the FATF definition should be inserted into the AML/CTF Rules.
1.2.1 Change in definition of Beneficial owner	The existing definitions of "beneficial owner" and "ultimate beneficial ownership" within the Rules defines those terms "in respect of a company". The Explanatory Statement indicates that the new definition in the draft rules is based upon the FATF definition. However, there are key differences between the FATF definition and that in the draft rules insofar as the former refers to "the natural person who *ultimately* owns or controls a customer" and the latter "an individual who owns or controls (*directly or indirectly*) the customer". The burden for industry with the proposed definition is when it is applied to the obligation under Part 4.12 to collect and take reasonable measures to verify the full name and address of each beneficial owner, resulting in the need to collect/verify beneficial owner details at each level in a chain of ownership. The definition and Part 12 requirements should not be applied to entities such as associations, co-operatives and Government bodies because the ML/TF risk does not warrant the regulatory burden that this change in definition would otherwise impose. Refer also to later comments on 4.12.

1.2.1 Change in definition of PEP	The Australian Government should provide industry with a list of who (individuals) or what (roles) or both they consider to be domestic PEPs under the revised rules and keep this list up to date to allow REs to screen. The Government should also include personal information, e.g. date of birth, to verify identity of a domestic PEP (and facilitate de-identification in the case of common names). The definition of "politically exposed person" in rule 1.2.1 should be amended to be an exhaustive definition rather than an inclusive definition by removing the two instances of the word "including" as shown below: ***politically exposed person*** **means an individual:** **(1) who holds a prominent public position or function in a government body or an international organisation~~, including~~:** **(a) Head of State or head of a country or government; or** **……** **(2) an immediate family member of a person referred to in paragraph (1)~~, including~~:** **(a) a spouse; or** **....**
4.1.2 Additional prescription on ML/TF risk to be considered before providing a designated service	It is unclear whether the intent of the draft rule is to require a reporting entity: • to consider the ML/TF risks (including those related to the items details in sub-paragraphs (a) - (e)) for <u>every</u> new customer before providing a designated service to that customer; or • to consider the ML/TF risks (including those related to the items details in sub-paragraphs (a) - (e)) for the purposes of its AML/CTF Program in order to determine under what circumstances it will collect or collect and verify information relating to the items detailed before providing a designated service to a particular customer. The ambiguity is in part due to the various references within rule 4.1.2 to "a customer" and "the customer"; and the fact that sub-paragraphs (1) - (4) require a reporting entity to consider matters relating to ML/TF risk on an

	enterprise-wide basis whereas sub-paragraph (5) requires consideration of matters relating to ML/TF risk as they relate to a particular customer. Also note, if the intention is the first construction detailed above, this would make the obligations under rule 4.13.2(1) redundant. The second construction is to be preferred.
4.3.8 Simplified company verification procedure	The rule should be expanded to include the other categories specified in the Interpretative Notes of the FATF 40 Recommendations, namely: o Financial institutions…where they are subject to requirements to combat money laundering and terrorist financing consistent with the FATF Recommendations; o Public companies listed on a stock exchange and subject to disclosure requirements…which impose requirements to ensure adequate transparency of beneficial ownership; o Public administrations or enterprises. Rationale for our position: o FATF explicitly permits the above categories to be included in simplified CDD; o Applying beneficial ownership rules to these entities will not assist in the fight against financial crime; o This is the standard adopted in other major financial centres, such as HK, Singapore, the UK and the EU – placing Australia outside of international norms will lead to a competitive disadvantage; o Our client base is institutional and global – failure to allow simplified CDD to offshore low risk entities is not commensurate with the risk, and wasteful of internal resources better allocated to higher risk areas.
4.3.13 Risk based systems	Existing rule 4.3.13 allows REs to take a risk based approach to determine whether to collect and verify beneficial owners (if any) of foreign public companies. It is not clear whether this approach is still allowed under the new

	rules. In the absence of a risk based approach, a financial institution would have to undertake some form of assessment for every foreign listed company in relation to major shareholders (or the equivalent) which will create a significant increase in due diligence requirements for these clients. The existing risk based approach allows an FI, for example, to concentrate efforts on listed companies in higher risk jurisdictions. It may be that rule 4.3.9 adequately addresses this and allows the existing risk-based approach to continue. Clarification would be helpful.
4.4.3 Collection of settlor information	Consistent with the Interpretative Note 5(b) to FATF Recommendation 10, the requirement under rule 4.4.5(5) should be "take reasonable measures to identify the full name of the settlor of the trust, unless…." Due to taxation implications under Australian law, the settlor usually contributes a nominal sum only to establish the trust and has no further involvement in the activities of the trust. Accordingly, the requirement to obtain settlor details under draft rule 4.4.5(5) should only apply on a risk based approach, for e.g. to foreign trusts.
4.11 Agents of non-natural customers	It remains unclear whether the definition of an agent applies to *any party* acting on behalf of a non-natural customer (ie. such as employees of the customer). An example is a Chief Financial Officer of a company who requests an RE (that is an ADI) to open a bank account in the name of the company he/she works for. For the purposes of compliance with section 4.11.5-8, should the RE regard the CFO as an agent of the company customer, and obtain his/her name and evidence of authorisation? Clarification would be helpful.
4.12 Collection and verification of beneficial owner information	Any risk-based verification should be of beneficial ownership information, as opposed to verification of information collected about the beneficial owner as proposed under Part 4.12 of the Rules. From a ML/TF risk perspective, the

	issue is the lack of transparency of beneficial ownership information rather than whether a beneficial owner is the person they claim to be. The ability to verify beneficial ownership information from a reliable and independent source is dependent upon the implementation of FATF Regulations on DNFBPs (creation, operation or management of legal persons or arrangements) and transparency of legal persons/arrangements. Imposing the proposed draft rules with respect to beneficial ownership on the existing reporting entity population absent implementation of other measures will not address the deficiencies previously identified for the purpose of the upcoming mutual evaluation. <u>Scenario</u> Customer: ABC Co. Pty Ltd, registered in Australia Shareholders of ABC Co. Pty Ltd: XYZ Co. Pty Ltd, registered in Cayman Islands 45%; Samuel Front, per ASIC company search beneficially held: "No" 55%, per Disclosure Certificate provided by ABC Co. Pty Ltd the beneficial owners of the company are XYZ Co. Pty Ltd 45% and Allan Pincochet 55% Shareholders of XYZ Co. Pty Ltd: Joseph Black 80%; Jane Black 20% <u>Under draft Part 4.12</u> Collect (and take reasonable measures to verify): Samuel Front, Allan Pinochet and Joseph Black <u>Under FATF Recommendation 10</u> Identify (and take reasonable measures to verify): Allan Pinochet and Joseph Black The amendments insert proposed Part 4.12 (requirements for AML/CTF Programs) in relation to beneficial owners. Draft part 4.12 applies to all customer types (that is, all natural persons, legal persons and legal arrangements). The amendments remove current rules 4.3.10 to 4.3.16 relating to collection and verification of beneficial owner information in respect of certain companies. However, the amendments do not remove from Part 4.4 the requirements with respect to beneficiaries of trusts. The burden from a practical perspective would be that reporting entities will be subject to requirements relating to both beneficiaries of trusts and beneficial owners of trusts. 4.12.1 of the draft rules states that REs must take “reasonable measures to verify the full name and address of each beneficial owner.”

	AUSTRAC rightly points out that the FATF interpretation of what constitutes "reasonable measures" to verify the identity of a beneficial owner to mean "..measures which are commensurate with the money laundering or terrorist financing risk." However, 4.12.4 and the safe-harbour procedure in 4.12.7 is worded in a manner which may effectively prohibit a risk based approach, in that it compels REs to always verify the identity of a beneficial owner (e.g. via photo ID or electronic data sources), regardless of the ML/TF risk involved. AFMA members request the AML/CTF Rules to be amended to allow the following flexibility: o Explicitly recognise that the verification requirements between a customer and a beneficial owner can and should be different (based on a risk-based approach); o Afford REs the opportunity to exercise reasonable commercial judgment with respect to the ML/TF risk posed by the clients and the services which we provide; and o Allow flexibility on the need to verify the residential address of beneficial owners. Rationale for our position**:** o FATF permits a risk based approach to be taken, in the determination of the level of verification required; o The current rules are adopting a risk-based approach, which is considered unduly conservative; o A significant portion of our client base includes large privately owned operating companies (e.g. companies engaged in a specific trade/service – not 'shell' companies) – such as manufacturers, producers and consumers of commodities; mining and energy companies; utility companies. Members consider that due to the nature of our institutional client base – a risk-based approach can be considered appropriate, as the primary 'source of funds' for the relationship originates from genuine businesses activities. This is in contrast perhaps with other client types which are more vulnerable to ML/TF risk such as private investment vehicles/Family Office entity structures. o Other major financial centres, which are FATF members allow for a risk-based approach on the verification of the identity of Beneficial Owners – details of which are set out below. All of the below jurisdictions have been assessed as meeting the FATF Customer Due Diligence standards, and removed from the FATF Regular

	Follow Up process accordingly – which indicates that the FATF would not have objection to Australia adopting the same approach.
4.13 Collection and verification of PEP information	<u>Definition</u> Rules 4.13.1, 4.13.2 and 4.13.3 require an AML/CTF program to include "appropriate systems and controls" with respect to the matters then detailed under the relevant draft rule. This drafting is to be contrasted with the requirement elsewhere in Chapter 4 requiring an AML/CTF program to include appropriate *risk-based* systems and controls". It would be extremely difficult to comply with the requirement in rule 4.13.1 to determine whether any beneficial owner of a customer is a PEP unless the reporting entity identified beneficial ownership details for all customers. Draft rule 4.12.2 specifically provides that an AML/CTF Program be modified so that beneficial ownership details are not required for companies and trusts subject to the simplified CDD procedures permitted under rules 4.3.8 and 4.4.8. Industry is not clear on the reason for the step prescribed at sub-rule 4.13.1(1) being required in circumstances where a reporting entity is at any event under proposed rule 4.213.1 required to determine whether any beneficial owner of a customer is a PEP. Industry is concerned with the prescriptive approach with respect to foreign politically exposed persons with Part 4.13 of the Rules and Rule 15.9(2). If AUSTRAC considers that additional prescription beyond an obligation on a reporting entity to determine whether a particular PEP should be considered to pose a high ML/TF risk (as proposed in draft rule 4.13.1(4)), this should be limited to foreign PEPs from high-risk jurisdictions where the business relationship is conducted in unusual circumstances (for example, where there is a significant unexplained geographic distance between the financial institution and the PEP). Alternatively, industry suggests that the Rules should provide that Part 4.13 and Rule 15.9(2) do not apply to foreign PEPs: (1) from low or medium-risk jurisdictions; (2) who are residents of Australia; or

	(3) who is an ambassador, head or member of staff of a consular post or embassy in Australia or an external territory. <u>Timing</u> Industry is particularly concerned with the practical consequences of the requirements under draft rule 4.13.2 to obtain senior management approval *before commencing to provide a designated service to [a foreign politically exposed person].* For practical purposes, this would impose a requirement on reporting entities to determine whether any prospective customer is a politically exposed person before commencing to provide a designated service. Commercial databases available to assist in the detection of PEPs and open source information available regarding PEPs in many cases do not have sufficient information to assist in the confirmation or de-identification of a potential PEP match. The ability to confirm or de-identify a potential PEP match in such instances is limited to specialist employees such as suitably qualified compliance or financial crime investigative staff. This would mean result in a delay in the ability provide services to any prospective customer who may be a potential match to a PEP record within a commercial database while the matter is referred to specialist staff for investigation. The Interpretative Notes to Recommendation 10 recognise that the timing of verification may be affected by the need to not interrupt the normal conduct of business and further that financial institutions should also adopt risk management procedures with respect to procedures under which a customer may utilise the business relationship prior to verification. The Part 4.12 requirements should apply at the time the reporting entity determines the customer is a PEP rather than before commencing to provide the designated service because at that earlier point the customer may not be a PEP but they may subsequently become one.
8.1.5- Requiring an entity to consider additional information to assess ML/TF as part of Part A	The purpose of Part A is to identify, mitigate and manage the risk a RE might face on a portfolio basis. To therefore superimpose and additional requirement on REs to understand ML/TF risk associated with every customer is misplaced and would be unworkable in practice. Appropriate responses to changes in ML/TF risk for a customer should only be considered for the purposes of on-going and enhanced due diligence.

Chapter 15	The current obligation under rule 15.3 requiring reporting entities to put in place risk-based systems and controls to determine whether and in what circumstances KYC information should be updated and/or verified in respect of customers for OCDD purposes is consistent with the requirements under the FATF Recommendations. Industry submits that the draft rules 15.2 and 15.3 are unduly prescriptive and not required for the purposes of compliance with the FATF standards which provide that Recommendation 10 should be applied to existing customers on the basis of materiality and risk[1]. A mandatory requirement to update due diligence information would be a major impost on REs and would require them to divert resources from higher risk management activities.
15.11 If the circumstances in subparagraph 15.9(2) arise, in addition to any other appropriate measures in para 15.10, a reporting entity must undertake the measures in sub-para 15.10(2) & (6)	Rule 15.11 unduly prescriptive and the current position under the rules where the level of enhanced customer due diligence is applied on a risk based approach should be retained. This would mean, for example, that as a matter of practice a company beneficially owned by a US diplomat to Australia would need to be treated as a high risk customer and subject to the prescriptive and higher standard of measures.
General drafting comments	Given the proposed definition of a "beneficial owner of a person who is a reporting entity" in rule 1.2.1, should the existing definition of "beneficial owner" in rule 63.5(5) be removed? The wording of rule 4.9.3(4) requires revision (albeit not as a result of the draft changes to the rules – refer underlined text as follows), possibly through the addition of the word "or", that is, "by or about":

[1] FATF Recommendations February 2012, p. 15

	(4) in what circumstances a reporting entity will take steps to determine whether a document produced <u>by about</u> **an individual** may have been forged, tampered with… The wording of sub-rules 9.1.5(3) and (4) should be consistent with that of sub-rules 8.1.5(3) and (4), that is: (3) **recognise** such changes in ML/TF risk ~~to be recognised~~ for the purposes of the requirements of the group's Part A and Part B programs; and (4) **assess** the ML/TF risk posed by the following ~~to be assessed~~: