Stockbrokers Association of Australia
Incorporating SDIA

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Discussion Paper – Customer Due Diligence Reform
International Policy
Legal and Policy Branch
AUSTRAC
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Dear Sir/Madam

DISCUSSION PAPER – ENHANCEMENT TO REQUIREMENTS FOR CUSTOMER DUE DILIGENCE
COMMENTS BY STOCKBROKERS ASSOCIATION OF AUSTRALIA

INTRODUCTION

The Stockbrokers Association of Australia Limited ("the Stockbrokers Association") appreciates the opportunity to provide these comments on the Discussion Paper "Consideration of Possible Enhancements to the Requirements for Customer Due Diligence".

The Stockbrokers Association is the peak industry body representing institutional and retail stockbrokers and investment banks in Australia. Our membership includes stockbroking firms across the spectrum, including the largest wholesale global investment banks, stockbrokers who are part of local major banking groups, and domestic broking firms from medium-sized firms and down to the smallest retail firms. Accordingly, there are a range of responses and practices relating to the issues that are the subject of the Questions in the Discussion Paper, representing the range of different

customer types, differing levels of money-laundering risk, and different scales of business.

The Association appreciates that the proposals in the Discussion Paper emanate from standards being pursued on a global level through the work of the Financial Action Task Force. The Association has a strong commitment to the growth of Australia's markets, particularly the Cash Equities Market, and to fostering Australia's role as a regional financial centre. In this regard, it is critical that Australia has a robust regulatory framework that fosters innovation and competition whilst at the same time maintaining the integrity and high standing of Australia's securities and financial markets.

It is important to ensure that Australia does not acquire a reputation as a jurisdiction where money laundering is easy or where standards are not broadly consistent with reasonable standards applied globally.

Having said this, the stockbroking industry has been enduring a prolonged period of intense structural and regulatory change at the same time as it has endured a prolonged economic downturn resulting from the Global Financial Crisis. Market activity has not yet recovered to pre-GFC levels, and market turnover and capital raising activity remains weak.

Notwithstanding this, the industry has been saddled by a very significant cost burden resulting from a number of factors, including increased market regulation in response to the GFC; rapid technological change within the industry, including the growth of electronic, algorithmic and high frequency trading; the introduction of competing stock exchanges; further regulatory change introduced to deal with all of these matters; and lastly the introduction of cost recovery for ASIC's market supervision costs. It should come as no surprise that these additional costs, coming at a time of weakened market activity, has placed enormous financial pressure on stockbrokers, and job losses in the industry in the last three years have been high.

The Stockbrokers Association stresses the vital importance that the rapidly rising cost of regulation be kept under control. We urge that any additional requirements need to be the subject of a rigorous cost benefit analysis to ensure that they will deliver a significant enough benefit that justifies the additional burden. Additional costs coming at this time will threaten to either weaken Australia's markets even further, or if the costs are able to be passed on, impose a transactional friction cost that impacts on all investors. This can amount to significant sums of money when translated across funds under management for investors, including superannuation funds for Australians.

In relation to the current proposals dealing with enhancing due diligence required for customer identification, Australia ought not automatically follow black letter obligations stemming from overseas without question, when a locally effective and relevant

standard could reasonably deal with the risks at stake in an equivalent and less costly way.

Notwithstanding any assessments that have been made regarding Australia's conformity with global standards, the Australian AML/CTF regime has worked well, and we question whether any nation has a better record in combatting money laundering than has Australia. The Association has concerns whether additional due diligence obligations under consideration will sufficiently advance this country's effectiveness in this regard to the extent that would justify what are likely to amount to a significant additional regulatory cost burden at a time when the industry is least able to afford it.

Set out below are comments relating to the specific questions in the Discussion Paper in the order in which they are set out in the Paper.

Deficiency 1: There is no requirement to take reasonable measures to understand the control structure of a customer that is a legal person or arrangement.

Questions

1. To what extent are reporting entities already assessing the concept of 'control' as part of the beneficial ownership procedures and what information is being sourced from customers?
2. To what extent are reporting entities obtaining and verifying information on the powers that bind a customer?

There are a broad range of approaches being followed by Stockbrokers Association members.

Many stockbroking firms already assess "control", although the approach to what is meant by "control" differs amongst firms that consider it. It is certainly the case that firms that are part of global groups consider control. Also many domestic firms do so, particularly firms that are part of major banking groups.

As mentioned, there is a range of approaches to what is involved in assessing "control". The term "control" itself is a loose term, and a range of views can arise as to what it means in practice. Our members that did assess control generally did do so in terms of ownership. They will generally undertake ASIC searches in the case of corporate entities. Some firms indicated that they trace ownership down to the level of a natural person, however this would not be common. It is more commonly the case that ownership will be traced down to a certain level, which is usually 25% ownership of the client.

No members indicated that they request or obtain management structures. It was indicated that some entities did not have a formalized management structures. With those that may have such a structure, this was likely to change regularly over time. There was also the question of what can be deduced simply from a management structure diagram. Hence, assessing "control" in terms of management structure was not seen as being a worthwhile exercise, and is generally not undertaken by stockbrokers to any significant degree.

This observation applies equally to trust structures and also to natural person clients. In relation to trust structures, firms generally sought information about the underlying beneficial owners of the trust as a measure of control as well as a measure of who was beneficially entitled to the account.

Members did not ascertain whether a natural person's actions were being directed or controlled by another person or entity. This was considered as being logistically next to impossible to ascertain with any certainty. If a customer did not proffer such information, it would be impossible to find this out through any independent means of enquiry. In the context of clients assigned as low-risk, this enquiry was not seen as warranted or a meaningful enhancement of the overall AML program.

Where a customer acted through a third party authority granted to another person, it was commonly the case that members verified the identity of the authorized person. It was commonly the case that a formal power of attorney or some such written authority was required to be signed to evidence the terms of the authority. Likewise, lists of signatories for structures such as partnerships, not-for-profit organizations, unincorporated bodies, were generally treated in the same way. However, this is not quite the same situation as that where the client itself was being directed by a principal or some such person.

One major difficulty that would be presented by any attempt to introduce a rule-based requirement to consider "control" would be settling on a clear definition of the term, and applying this as a practical matter. Determining which persons or entities "control" a client could present enormous difficulties if there was an onus on the stockbroking entity to determine the matter.

Requiring the entity to engage in factual or legal analysis of a potential array of different circumstance would not be a practical outcome. Things are working well at the moment because there is the latitude to adopt a practical and risk-based approach to determining what steps need to be taken, however this would not be the case if a black letter rule was applied to this question.

Deficiency 2: There is no comprehensive requirement to identify and verify beneficial owners of a customer that is a legal person or arrangement.

Questions

1. To what extent are reporting entities already assessing the beneficial ownership of customers that are legal persons or arrangements?
2. Is the element of control taken into account?
3. In seeking to understand the beneficial ownership of a customer, do you go beyond the first layer of ownership?
4. Do you consider the cascading measures outlined by the FATF standards provide a reasonable approach to identifying beneficial ownership that balances the risks and practicalities? If not, do you have an alternative approach to suggest?

We refer to the comments relating to the question under Deficiency 1, which are also relevant here. To the same extent as is applicable to considerations of control, members also took steps to ascertain who is the beneficial owner of an account. This is done by asking the question of the account holder at the time the account is opened.

It is impossible to identify beneficial owners in any way other than by asking the account holder. It is impossible to verify the accuracy of the answers given. There is no database of beneficial interests available to be searched that could enable this to be ascertained independently of the information offered by the client.

It is common for members to ask for beneficial owners holding a 25% or more interest to be nominated. Some members do ask for details below this threshold, and members also indicated that they were considering lowering the threshold to 10% in conjunction with the potential introduction of measures to comply with the FATCA legislation currently under consideration.

To the extent that persons are nominated as beneficial owners, there was a range of approaches as to whether stockbrokers verify the identity of the persons so nominated. Some did not go beyond collection of the information. A particular logistical issue is the cost and difficulty in verifying the identity of beneficiaries who were overseas. The high cost and time consuming nature of those enquiries and the interpretation of the resulting information were a serious impediment to carrying out such enquiries.

It is not common for beneficial owners to be identified beyond this first layer of information. No members indicated that they sought information from the beneficial owners nominated as to any further layers of beneficial ownership below that level.

Some members indicated that they adopted a risk based approach to the question of verifying the identity of beneficial owners, with the result that they did not verify beneficial owners of accounts which were designated as low risk in the first place.

Questions

Deficiency 3: There is no requirement for reporting entities to determine whether the customer is acting on behalf of another person and, if so, to take reasonable steps to verify the identity of that other person.

Questions

1. Are reporting entities already considering whether a person in acting on behalf of the customer is attempting to conceal or disguise the true 'owner' of the transaction? If so, to what is extent is this being considered and how is this achieved?

The response to this question is implicit in our comments relating to the Questions under Deficiencies 1 and 2 above. It is clear from the information given that there is a genuine attempt being made by stockbrokers to ascertain whether a customer is attempting to act on behalf of an underlying principal or beneficial owner whose identity they may be endeavouring to conceal.

At the very least, aside from any obligations arising under Anti-Money laundering legislation, stockbrokers seek to ascertain this for reasons of potential reputational risk as well as counterparty risk, and often pursuant to global standards that are applied in the case of members of a global business group.

It is commonly the case that Terms and Conditions applicable to the client agreement will contain a warranty by the client that they are acting as principal and not on behalf of any other person (except as nominated).

Deficiency 4: There is no specific requirement for reporting entities to identify and verify the settlor of a trust.

Questions

1. To what extent are reporting entities already identifying and verifying the settlor of a trust?

Some members indicated that they requested information as to the identity of the settler of a Trust. Other members did not attach any significance to this information, and did not request it. In the experience of some stockbrokers, the Settlor of a trust was commonly an accountant or legal representative acting in a professional capacity for the ultimate owner of the account. Identifying the Settlor was not regarded as a meaningful step in terms of managing AML risk.

Deficiency 5: There is no specific requirement to apply a range of measures in high-risk situations and some enhanced due diligence measures are not clearly distinguishable from normal CDD measures. Reporting entities are not required to take specific additional measures for customers (or their beneficial owners) who are politically exposed persons (PEPs).

Questions

1. To what extent do reporting entities already undertake a range of measures under enhanced CDD in 'high-risk' situations? (that is, more than one measure)?
2. What measures are reporting entities commonly applying in high-risk situations?
3. To what extent do reporting entities already apply enhanced measures for a) foreign PEPs, b) domestic PEPs, and c) international organisation PEPs?
4. What measures are reporting entities commonly applying in relation to PEPs?

Many stockbrokers indicated that they already sought to ascertain in their client identification process whether an account was connected to a politically exposed person. Members commonly subscribed to data services from external providers for details of PEPs. Some members did not subscribe to PEP lists, but instead, ascertained PEP status through establishing the client's occupation.

It was generally the case that stockbrokers designated PEPs as a higher risk. There was not a universal view that all PEPs were "high risk", and some members considered that there were grounds to consider some PEPs in appropriate cases to be "medium risk". In those instances, the additional level of KYC relevant to those designations would be performed.

As a result, there was a range of approaches to the customer due diligence applied to accounts for PEPs. A number of firms indicated that, as with foreign accounts generally,

information was sought as to the source of the funds; anticipated volumes of transactions; and reasons for investing in Australia.

In relation to domestic PEPs, recent events that have figured prominently in the media in relation to actions involving public officials and politicians have underlined that potential risk are not limited to foreign PEPs. As mentioned earlier, identifying domestic PEPs would occur through the client occupation information obtained at the account opening stage. The appropriate risk designation applicable to the individual would be effective in practice to determine the level of enhanced due diligence that should be applied to the account.

Deficiency 6: There is no requirement to collect information on the purpose and intended nature of the business relationship.

Question

1. To what extent do reporting entities already include processes and procedures to understand the 'purpose' of the business relationship, for example, as part of commercial and other risk-management requirements?

Some stockbroking firms indicated that they sought this information. However, many indicated that they did not. Firms have indicated that they not infrequently encounter resistance from clients to answering a question about the nature of the client's business, with the client considering that the issue is not one that is relevant to the broker's provision of service to the client and/or that the broker does not have a need to know.

Some members indicated that this could be an area where AUSTRAC could assist in raising client awareness as to the purpose of asking for this information, and that AUSTRAC's contribution could include a client brochure that explained the significance of many of these requests for information.

Deficiency 7: The obligations on reporting entities concerning record-keeping requirements regarding documents collected as part of the processes of identification, verification and updating of customers are inadequate.

Question

1. On what basis are reporting entities already updating the records arising from the obligations to obtain and collect documents as part of the processes to identify and verify customers?

Some Stockbrokers Association members indicated that they reviewed and updated documentation relating to clients, but did so on a risk–based approach. The client identification information would be updated on a periodic basis where a client is assigned a high risk category. A review may also be triggered in the event of a significant change relevant to the client, which may result in a change of risk categorization of the client from that originally assigned. Re-activation of an account that had become inactive due to non-trading is another example of a trigger for re-identification of the client.

Where account details changed e.g. the address of the account, then it was common for measures to be in place to verify that the change request was valid.

Members did not routinely update records relating to all clients regardless of risk. The administrative burden of cost of doing this as a matter of routine for all clients would be huge.

Changes of personnel at client firms can be frequent. There needs to be a sensible constraint on the need to continuously update relevant client information.

In the case of a stockbroking firm with a retail client base that exhibits low risk characteristics, a requirement for regular updating and verification of client identity records is seen as an example where the significant additional financial and administrative cost to the industry would be unnecessary and would not deliver any meaningful benefit.

We submit that this is a perfect example where the requirements should be entirely risk based, having regard to the risk profile of a particular client.

OPTIONS TO MINIMISE REGULATORY BURDEN ASSOCIATED WITH THE POTENTIAL REFORMS

Questions

1. What circumstances would be appropriate for up-front exemptions?
2. What benefits and problems may arise from a self-attestation model for the purposes of identification of beneficial owners and control structures?
3. In what circumstances would the provision of a greater flexibility in the current AML/CTF Rules provisions for reliance assist reporting entities to undertake CDD measures in a cost effective way?
4. To what extent do reporting entities currently use simplified due diligence measures? What options may be considered to extend the use of simplified due diligence measures?

5. What independent and reliable sources of information are used by reporting entities to verify beneficial ownership and control? What are the issues and concerns of reporting entities in meeting this obligation and what alternatives may be considered?
6. If the AML/CTF regime was extended to address the deficiencies outlined at Part 2 of this paper, what is a sufficient lead time for reporting entities between the changes to the regime and the commencement of the obligations?
7. What other options may be considered to minimise or reduce potential regulatory burden on reporting entities in meeting their obligations for beneficial ownership and control, if the AML/CTF regime was extended to address the deficiencies outlined at Part 2 of this paper?

As already indicated, the Association questions whether additional requirements to enhance the AML/CTF regime are necessary at this point in time.

The existing risk based approach provides a valuable level of flexibility to tailor what is done to the level of risk perceived for the particular client, such that the issue of up-front exemptions is not a pressing one (although it would become significantly more important if additional obligations were to be imposed at the conclusion of this Review).

If additional requirements were to be introduced, members indicated that a 12 month lead time should be the minimum period prior to commencement of new obligations, particularly in view of the high level of regulatory and structural changes to which the stockbroking industry has been subjected over the last three years. There also was support for a longer period of 2 years, for these same reasons.

One mechanism that some members indicated could assist with the regulatory burden of new requirements would be for AUSTRAC to provide industry specific education programs, in conjunction with the Stockbrokers Association, to assist brokers with identification of the types of transactions that could be a cause for concern.

We would be happy to discuss any issues arising from our submissions on this issue. Should you require any further information, please contact Peter Stepek, Policy Executive, on (02) 8080 3200 or email pstepek@stockbrokers.org.au

Yours sincerely,

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