Stockbrokers Association of Australia
Incorporating SDIA

24 January 2014

Director
Rules
PO Box 13173
LAW COURTS
MELBOURNE VIC 8010

By email: aml_ctf_rules@austrac.gov.au

Dear Sir/Madam

## DRAFT AMENDMENTS TO AML/CTF RULES RELATING TO 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 Draft Amendments to the AML CTF Rules Relating to 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 Stockbrokers Association appreciates that the proposals in the Draft AML/CTF Rules are designed to address perceived deficiencies identified by FATF in its assessment of Australia's AML/CTF rule framework. As indicated in our previous submission dated 30 September 2013 to AUSTRAC on the Discussion Paper on Customer Due Diligence, 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 market.

We also noted in our previous submission that 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.

The Association also stresses its overarching comments that additional requirement that may be imposed regarding customer due diligence should be sensible and should be the subject of a rigorous cost benefit analysis, having regard to the rapidly rising cost of regulation and the impact this was having on investors and on the economic health of markets across the world.

Set out below are our comments in relation to the Draft AML/CTF Rules.

**Comment 1: Simplified Company and Trust verification procedures.**

The proposed Simplified Company Verification Procedure and Trust Verification Procedure are useful measures and are welcomed. They are sensible proposals for entities whose ownership and control are matters of public record, and where additional administrative procedures imposed on reporting entities would have been an unnecessary burden and cost.

**Comment 2: Rule 4.12.2**

Our members have expressed uncertainty about how Draft Rule 4.12.2 is meant to operate. We are supportive of a recognition that in the vast bulk of cases involving ordinary natural persons, the risk of Money laundering or terrorist financing is low. The existing risk-based approach allowed a commonsense approach to customer due diligence procedures for that class of customer, and the cost/benefit equation of that approach has generally been acceptable.

It is not certain from our reading of the wording of Draft Rule 4.12.2 how it is meant to interact with Rule 4.12.1. Is it the case that the general obligations arising from 4.12.1

would require an entity to ask individual clients in every case whether or not they are acting for another person or are not the beneficial owner? Or is it the purpose of 4.12.2 to allow the entity to assume that a natural person client is also the beneficial owner of the account if there are reasonable grounds to believe that they are not acting for another person. If the latter is correct, then does it follow that it is not necessary to ask the question of the individual client in every case?

The Explanatory Statement appears to support the latter interpretation at Page 7, however the wording of the EM does not seem entirely consistent with 4.12.2. The EM states that the "… reporting entity may assume that a customer who is an individual and the beneficial owner are one and the same, **unless the reporting entity has reasonable grounds to consider otherwise**."

On the other hand, 4.12.2 states that the reporting entity may assume that there is no other beneficial owner "in the case of a customer who is an individual and who the reporting entity **has reasonable grounds to believe is not acting on behalf of another person**…."

The wording of 4.12.2 therefore would seem to say that the assumption can only be made once reasonable grounds are identified to form the belief that the person is not acting for someone else. This is significantly different to the wording of the EM.
In our submission, the wording of the EM is to be preferred, and Draft 4.12.2 should be amended to be consistent with it. An entity should be entitled to assume that a "two legged" client is acting for themselves unless there is something to indicate that they are acting for someone else.

In the case of both interpretations, there needs to be some clear guidance given as to what will amount to "reasonable grounds" in each case, as this can potentially be quite uncertain. If a natural person is, for example, a schoolteacher, a nurse, etc, then is it reasonable to assume that they are the beneficial owner absent some other information? If those professions are not considered reasonable, then which ones would be? Are there any professions about whom reasonable grounds could be said not to exist?

Are certain ethnic backgrounds material to determining whether reasonable grounds do or do not exist? If so, would that mean that all persons having the same ethnic background should be treated the same way?

It would not be fair to enact obligations expressed in very broad language carrying regulatory liability without clear guidance to assist entities to determine what is required in order to comply.

**Comment 3: Settlor of Trust**

In our submission of 30 September, 2013, the Association expressed concerns about the significance of the settlor of a trust in the Australian context, and the imposition of additional due diligence measures in that regard. Whilst the identity of the settler may be of more significance in other jurisdictions, it was not so in a great many instances in the local situation.

We note that the Draft Rules now apply a threshold test of $10,000 before due diligence of the settlor is required. This is welcomed, and may be a sufficient threshold to remove the need for enhanced customer due diligence in situations where it was not relevant. It may be that issues could arise with the level of the threshold, and this should be flagged for review at an appropriate time after the Rules have been in operation.

**Comment 4: Implications of defining "Control" as beneficial ownership**

In our submission of 30 September, 2013, the Association identified a number of difficulties that would arise if there was a requirement to assess the persons who "control" a client. It was those difficulties that led to the Association's members commonly approaching the concept of "control" in terms of degree of ownership of the client, as opposed to exercising influence.

We note that the term "beneficial owner" will now be defined under the Draft Rules to include "control". The term "control" is to be defined in extremely broad terms, including "… **control as a result of arrangements, understandings and practices, whether or not having legal or equitable force** " and "……**exercising control through the capacity to determine decisions about financial and operating policies**;…."

We reiterate that this requirement will cause serious difficulties and cost for reporting entities. We note that the introduction of the Simplified Company and Trust verification procedures already referred to above will mitigate these difficulties for a number of classes of client, there remain a considerable universe of clients that will not benefit from this "safe harbour", and where control will present serious difficulties.

The number of persons who might satisfy the broad definition of "control" in 1.2.1 can run into hundreds in many cases. It can include various tiers of management, order placers, and so on. Organisational charts and client personnel can change frequently, and the extent to which a reporting entity must regularly update its KYC and due diligence material for such changes is a serious issue. For clients who are overseas entities, this can present an enormous logistical challenge. The process of customer identification could drag on for a considerable time, and could consume a sizeable

resource budget. As commented in our Previous Submission, there needs to be a sensible constraint on the need to continuously update relevant client information

Ultimately, this type of obligation threatens to add a significant amount to the cost of business, which costs will need to be borne by clients and investors.

In order for this type of regulatory framework to operate with the least drain on resourcing, regulators must provide some key assistance. The first such assistance is to provide some clear practical guidance on what needs to be done and how far entities need to go in carrying out due diligence in relation to beneficial owners (in the broad sense defined by the Draft Rules).

Secondly, regulators need to work together on a global basis towards establishing some form of efficient mechanism to enable information about ownership and control of clients to be readily accessible to reporting entities. Multiple reporting entities around the world may be faced with the same task of identifying the same client, which is a duplication and waste of resources for all of those entities, not to mention for the client who will be faced with answering the same requests a multiple of times.

If the global regulatory community can work towards a globally consistent set of regulatory requirements for customer due diligence, then it would assist if the same community can work to identify an efficient way of enabling reporting entities to meet those obligations.

**Comment 5 – Rule 15.3 Ongoing Customer Due Diligence**

Members are extremely concerned at the level of uncertainty that has been introduced by the introduction of the revised obligation in Draft Rule 15.3 to "...**undertake reasonable measures to keep, update and review the documents, data or information collected under the applicable customer identification requirements ..... and the beneficial ownership identification requirements**....".

The drafting of the obligation in these terms in place of the former obligation to have in place appropriate risk-based systems and controls is extremely vague and uncertain, and creates a potentially open-ended obligation that could consume vast amounts of time and resources. Everything hinges on the definition of what is "reasonable".

Given the significant regulatory risk that arises from this obligation, some clear guidance is needed so that reporting entities know what is required of them in order to comply with the obligation, and in order to avoid consuming inordinate resourcing in order to avoid a breach. The best place for clarification of a legislative obligation is in the legislation itself rather than in the form of a Guidance Note, however the latter would be preferable to allowing the obligation to stand in its proposed form with nothing else to aid in its interpretation, if legislative re-drafting proved to be an issue.

**Comment 6 – Client Brochure**

Whilst not directly related to the drafting to the Proposed Rules, we reiterate our comment in our previous Submission of 30 September 2013 that Stockbrokers Association members have expressed the view that AUSTRAC can assist in raising client awareness of enhanced customer due diligence requirements that come into effect by way of a client brochure that explained the significance of these additional requests for information and verification that will result.

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,

**David W Horsfield**
**Managing Director/CEO**