19 March 2014

AML/CTF Rules
Director, Rules
AUSTRAC

By Email Only: **aml_ctf_rules@austrac.gov.au**

FSC Submission on third consultation draft AML/CTF Rules relating to Customer Due Diligence

The Financial Services Council (**FSC**) represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, trustee companies and public trustees. The FSC has over 125 members who are responsible for investing more than $2.2 trillion on behalf of 11 million Australians.

We welcome the opportunity to comment on the third consultation draft amendments to the AML/CTF Rules relating to Customer Due Diligence (**CDD**), released for consultation on 5 March 2014. In this submission, we refer to the third consultation draft CDD rules simply as the "**draft CDD Rules**".

FSC supports a risk-based AML/CTF regime. Changes to regulatory regimes (including the AML/CTF regime) should be implemented on a prospective basis with a reasonable transition period. We acknowledge that given the constraints AUSTRAC faces in terms of the upcoming FATF mutual evaluation, AUSTRAC has sought to provide a balance between the FATF mutual evaluation and providing a reasonable transition for industry into the new CDD Rules. We acknowledge AUSTRAC has consulted on its proposals. Nonetheless our members still have significant concerns with some aspects of the proposals, not least of which is the commencement date of 1 June 2014.

Executive Summary

1. The 1 June 2014 commencement date is unreasonable and mis-aligned with an industry that customarily anticipates any operational change having an impact on business processes to commence at the beginning of a new quarter or year. The commencement date of the CDD rules should be two years after the rules are made. See FSC's submission dated 24 January 2014 on the first draft of the CDD Rules.

2. The transition plan requirement should be removed. Transition plans exacerbate the unreasonable commencement date by potentially mandating (in some cases) more than 60 reporting entities in a conglomerate group to prepare board approved transition plans. If AUSTRAC chooses an earlier start date, it can communicate to reporting entities that it expects reasonable efforts to comply as soon as possible but not later than 1 January 2016. The governance and planning to comply and transition into the new CDD rules should be left

YOUR FUTURE FIRST
Financial Services Council Ltd ABN 82 080 744 163
Level 24, 44 Market St Sydney NSW 2000
T. +61 2 9299 3022 F. +61 2 9299 3198
E. info@fsc.org.au W. fsc.org.au

to reporting entities ordinary governance arrangements. However, if AUSTRAC retains the board approved Transition Plan requirements, we urge AUSTRAC to amend those requirements so that it is not necessary for every member of a Designated Business Group to approve a Transition Plan. If the Transition Plan requirement is retained, we request AUSTRAC to amend the requirements so that it is only necessary to obtain approval of the parent board of the Designated Business Group and not other members of the Designated Business Group.

3. A majority of reporting entities will be non-compliant with the new draft CDD Rules from 1 June 2014. The Draft Supervisory Approach is not, and cannot, be a substitute for an unreasonable commencement date. The Supervisory Approach (with an unreasonable commencement date) is better than an unreasonable commencement date without a Supervisory Approach. In the FSC's view industry is being required to bear the cost of the balancing exercise to meet the FATF mutual evaluation.

4. While we have significant concerns with the commencement date of 1 June 2014, as a practical matter the impacts may be ameliorated somewhat if the "back-capture" requirements only apply to new customers which are high-risk customers which become new customers after 1 June 2014. That is, provided the "back-capture" requirements do not apply to any new customers after 1 June 2014 (and up until 31 December 2015) who are not high-risk customers, then the impacts of the early commencement date are moderated. We seek AUSTRAC to confirm that any new customers (between 1 June 2014 or any later commencement date, and 31 December 2015) who are not "high-risk" customers, are not required to be identified ("back-captured") in accordance with the revised CDD rules. Nonetheless, we still consider a reasonable commencement date is appropriate, such as 2 years after the CDD rules are made, or no earlier than 1 February 2015.

Commencement date is unobtainable and unreasonable – a reasonable transition period prior to commencement of the CDD Rules should be provided

5. AUSTRAC proposes the rules commence 1 June 2014. It is inconceivable for industry to be in a position to meet the Rules by 1 June 2014. As a general principle, it is inappropriate for any significant regulatory change to be imposed on the regulated population prior to the time that the regulated population could reasonably meet the change, absent exceptional circumstances.

6. FSC made a submission (on 24 January 2014) to the first draft of the CDD Rules. AUSTRAC has taken up many of the points in our earlier submission but has not accommodated or allowed for what perhaps is the most significant concern among FSC's members in relation to the proposed CDD rules – namely the commencement date/transition period. The CDD Rules are proposed to commence in around 10 weeks (1 June 2014) and this is not a reasonable transition period (putting to one side the Supervisory Approach). We acknowledge AUSTRAC's consideration of the start date involves a balancing exercise. The industry (or at least a significant proportion of industry) could not comply with the new Rules from the start date of 1 June 2014. In FSC's 24 January 2014 submission FSC submitted that the new CDD rules should be subject to a 24 month transition period

YOUR FUTURE FIRST

Financial Services Council Ltd
ABN 82 080 744 163

Level 24, 44 Market St
Sydney NSW 2000

T. +61 2 9299 3022
F. +61 2 9299 3198

E. info@fsc.org.au
W. fsc.org.au

(applying from commencement of the new CDD Rules). The proposals are subject to a very short transition period (from the date of passing the rules until 1 June 2014) with a requirement for reporting entities to prepare a transition plan. Further, this commencement date limits the opportunity the industry has to communicate with customers about the additional legal requirements, and there is a very real possibility of a 'backlash' by some customers. A reasonable transition period (that is, a later commencement date) would put reporting entities in a better position to update documents and procedures to reduce or mitigate customer queries and poor customer experience.

7. It is likely that further impacts or consequences of the draft CDD Rules will only become apparent after or during any implementation of the final CDD Rules. The FSC reserves the right to raise such matters with AUSTRAC in future (acknowledging that AUSTRAC has always been open to engagement with reporting entities and industry groups such as the FSC).

8. As noted in our 24 January 2014 submission, the package of CDD reforms are extensive. A transition period of 24 months would enable a more uniform and orderly implementation of the reforms (without the need for transition plans and a Supervisory Approach). We acknowledge this may have implications for the FATF mutual evaluation. The CDD reforms would require among other matters:

   (a) Updating of AML/CTF Programs;
   (b) Updating of collection documents and disclosure documents and other customer facing documentation;
   (c) Updating of IT systems and search capabilities;
   (d) Updating of business procedures;
   (e) Training of employees;
   (f) Engagement with agent/third party service providers to ensure impacted services meet additional CDD requirements (with the scope of change relating to systems, procedures, collateral, communication, training and review of commercial agreements);
   (g) Education of Australian consumers in relation to the new CDD requirements and managing their expectations as to why consumers need to meet additional CDD requirements; and
   (h) Engagement by AUSTRAC with reporting entities providing AUSTRAC guidance in relation to the reforms.

9. FSC member organisations are currently in the process of implementing a wide range of regulatory reforms, including FATCA, FOFA, SuperStream, Privacy and bedding down APRA Prudential Standard processes. Pragmatically there is very limited capacity to implement any additional material regulatory reforms in the short to medium term. Notwithstanding this, the need for a 24 month transition period is also a function of the depth and complexity of the CDD reforms. FSC's engagement with its members indicates that industry requires a period of not less than 24 months (from when the CDD Rules are made) to make the necessary changes to implement all of the proposed CDD reforms in an orderly manner.

YOUR FUTURE FIRST

Financial Services Council Ltd
ABN 82 080 744 163

Level 24, 44 Market St
Sydney NSW 2000

T. +61 2 9299 3022
F. +61 2 9299 3198

E. info@fsc.org.au
W. fsc.org.au

10. FSC members have concerns in relation to the transition and start dates of AUSTRAC's proposals, including "back-capture" aspects. Ultimately (as we understand that AUSTRAC is not minded to provide for a 2016 start date) we consider a 1 February 2015 start/commencement date is an appropriate compromise in balancing FATF objectives versus the costs and burdens on reporting entities in relation to the transition into the new CDD Rules. We urge a more reasonable commencement date of 24 months after the rules are made or, if not, a commencement date of 1 February 2015 (with the Supervisory Approach applying from that commencement date until 1 January 2016).

11. The significant concern with the CDD proposals is the proposed 1 June 2014 start date, and the related "back-capture" requirements which would require any new client from 1 June 2014 until 31 December 2015 to be remediated subsequently (that is, identified subsequently in accordance with the new CDD rules). This imposes significant costs on industry in needing to revert to clients subsequently to obtain the CDD information required under the new CDD Rules. A better approach which imposes significantly less cost on industry in relation to back-capture is to commence the reforms from (say) 1 February 2015. (FSC previously submitted for a start date of 2 years after the Rules are made, which would be commencement some time in 2016.) While this is a matter for AUSTRAC and FATF, in terms of the review of Australia's AML/CTF regime, a start date of (say) 1 February 2015, would allow the rules to have commenced prior to FATF handing down its mutual evaluation report around February 2015.

12. The 1 June 2014 start date is problematic as product disclosure statement (**PDS**) rolls or process changes are often linked to 1 July changes. In any event, we reiterate our request for a reasonable transition period, rather than an expedited start date supplemented by a Supervisory Approach. A reasonable start date would be 2016, or if not, 1 February 2015.

13. Even a commencement date of 1 July 2014 is problematic given that it will not be possible to update all documents, systems, processes and training by 1 July 2014. We observe that some reporting entities will have recently updated their disclosure and other documents for the privacy changes which commenced 12 March 2014 – the proposed 1 June 2014 start date generates further PDS/product rolls with insufficient time to meet that date. The 1 February 2015 start date (being the earliest start date we consider not unreasonable) would provide more time to update documents and processes.

14. If AUSTRAC does not adopt a later commencement date than 1 June 2014, a better approach than the 1 June 2014 hard start date, is for a soft start of 1 June 2014 from which the provisions commence but the obligation is to use *reasonable endeavours* to comply as soon as practicable, with a later hard date (of say February 2015, if not 2016) from which entities must be compliant. From February 2015 (if not 2016), the new CDD provisions could have a hard application such that they apply from that date. This approach is similar to the transition into the Future of Financial advice reforms.

YOUR FUTURE FIRST

Financial Services Council Ltd
ABN 82 080 744 163

Level 24, 44 Market St
Sydney NSW 2000

T. +61 2 9299 3022
F. +61 2 9299 3198

E. info@fsc.org.au
W. fsc.org.au

Supervisory Approach – General

15. The Draft Supervisory Approach does not preclude a third party from taking action based on non-compliance by an Australian reporting entity with the rules as they apply from 1 June 2014, nor does it permit an Australian reporting entity to certify to third parties (including regulators) that it is compliant with local AML/KYC requirements. The 1 June 2014 start date places reporting entities (and boards and directors) in the invidious position of:

    (a) Knowing, in advance, of 1 June 2014 that the reporting entity will breach AML Laws,
    (b) being exposed to potential claims from third parties (e.g. class actions) and
    (c) not being able to certify to counterparties or regulators, compliance with Australian laws. (Attempting to explain why the reporting entity does not comply with the Australian CDD laws will also be difficult and may not be acceptable from a commercial, legal and risk perspective to those hearing the explanation, e.g. seeking to explain to an overseas lender, which may then stipulate different terms or additional indemnities for regulatory and legal risk relating to the non-compliance). This also may impact on existing contracts in terms of representations required to be made as part of contractual arrangements entered into by a reporting entity.

16. The Draft Supervisory Approach should provide that AUSTRAC will not, prior to 1 January 2016, take any enforcement action of any kind under any Part of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006.*

Right to withdraw Draft Supervisory Approach

17. AUSTRAC reserves the right to withdraw or revise this supervisory approach at any time. As referred above, the AUSTRAC Supervisory Approach is not a substitute for having allowed a reasonable commencement date. Our comment applies with additional force, given AUSTRAC can revise its approach, which in any event provides no defence against third party claims. We consider that AUSTRAC should be required to hold to its announced approach, absent exceptional circumstances specified in advance by AUSTRAC – however this is no substitute for a commencement date which would be achievable by reporting entities (such as commencement two years after the Rules are made, or even a start date of February 2015).

Transition Plans and Remediation of High Risk Customers

18. **Remediation requirement for medium or low-risk customers**: The first condition for the Draft Supervisory Approach is that the reporting entity/DBG "complies with the new obligations as soon as practicable" for any customer on-boarded between 1 June 2014 and 1 January 2016 ***who is assessed to be of high risk***. The condition is silent as to an approach with respect to medium or low-risk customers. FSC members assume that high risk clients need to be remediated (which is reasonable) and, given the reference only to high risk clients, that therefore low or medium risk clients who are new clients between 1 June 2014 and 31 December 2015 are not required to be remediated (or "back-captured") under AUSTRAC's Supervisory Approach, subject to the requirement to make reasonable

YOUR FUTURE FIRST
Financial Services Council Ltd ABN 82 080 744 163
Level 24, 44 Market St Sydney NSW 2000
T. +61 2 9299 3022 F. +61 2 9299 3198
E. info@fsc.org.au W. fsc.org.au

endeavours to comply with the other aspects of the new regime as soon as possible. If this interpretation is not held by AUSTRAC, we request that AUSTRAC advise reporting entities and FSC accordingly.

19. **Requirement to obtain approval from the Board for transition plan**: We consider that it should not be a condition of the transition arrangements that reporting entities prepare board approved transition plans. We request that the transition plan requirement be removed from the Supervisory Approach as it imposes additional reporting requirements which should be a matter for the reporting entities governance processes.

20. Reporting to the board of the reporting entity as to the transition into the new CDD Rules should be a matter for the governance of the reporting entity. While the CDD rule changes are extensive, they are no more or less than AML/CTF Rule changes which occur regularly – in other cases of AML Rule changes, transition plans are not required. AUSTRAC is assisting industry (given industry cannot possibly comply with the new CDD Rules by 1 June 2014) by providing a Supervisory Approach. AUSTRAC is entitled as part of its general supervisory activities to enquire as to action and transition plans but the form of them (and who approves such plans) should not be prescriptively required as a condition of the Supervisory Approach.

21. Some FSC members are members of a conglomerate with more than 60 Designated Business Group members. While we consider that transition plans should not be required and that transition to the new Rules should be a reporting and governance matter for reporting entities, it is extremely burdensome to require every DBG member approve the transition plan. Condition (c) of the draft Supervisory Approach requires that the transition plan be approved by "the Board or similar governing body, or where no board exists, the Chief Executive Officer or equivalent." The condition further states that "in the case of a designated business group, this approval must be obtained from the Board or CEO of each entity in the designated business group." Arguably this is met by obtaining approval of the parent board of the main holding company of the group for related members of a designated business group per AML/CTF Rule 9.4.2. While we consider that transition plans should not be a condition of the Supervisory Approach, we assume that if parent board approval is obtained this is sufficient approval for each member of the DBG. We request AUSTRAC confirm that this is acceptable.

22. We also note that many Boards only meet quarterly – so there is the possibility of not being able prepare and then obtain Board approval in the ordinary cycle of board meetings to meet AUSTRAC's dates which may necessitate a specially scheduled board meeting – which involves additional time and costs– especially for those with external board members.

AUSTRAC guidance relating to new CDD rules

23. **Industry consistency**: We request that AUSTRAC host pre-scheduled quarterly round-table meetings with industry to provide ongoing and timely guidance as to the application, interpretation and implementation of the new CDD rules. It is hoped that this forum will

YOUR FUTURE FIRST
Financial Services Council Ltd ABN 82 080 744 163
Level 24, 44 Market St Sydney NSW 2000
T. +61 2 9299 3022 F. +61 2 9299 3198
E. info@fsc.org.au W. fsc.org.au

enable AUSTRAC and reporting entities to reach a uniform interpretation and application of the new CDD Rules in an orderly manner.

Various other matters relating to the draft CDD Rules

Exceptions when the company may (is permitted to) use the simplified trustee/company verification procedure

24. The draft CDD rules provide exemptions (e.g. an exemption from collecting the name of the settlor in draft CDD rule 4.4.5(5), or from collecting and verifying name and address or date of birth of the beneficial owner in draft CDD rule 4.12.1 where rule 4.12.2 applies) where (paraphrasing various rules for simplicity):

> "*the* [*company/trust*] ***is verified* [*using/under*]** *the simplified* [*trustee/company*] *verification procedure*".

This wording should instead read:

> "*the* [*company/trust*] ***is able to be*** *verified* [*using/under*] *the simplified* [*trustee/company*] *verification procedure*".

This is because the simplified verification procedure may not always be used by the reporting entity (even though it is permitted to).

Electronic Verification safe harbour procedure

25. The electronic verification safe harbour procedures for customers and beneficial owners should be consistent. The electronic verification safe harbour procedures for customers should be replaced with the electronic verification safe harbour procedures for beneficial owners (see draft CDD rule 4.12.7).

We thank AUSTRAC for the opportunity to comment on the third consultation draft of the CDD Rules. If you have any questions on our submission, please contact Stephen Judge on (02) 9299 3022.

Yours sincerely

STEPHEN JUDGE
General Counsel

YOUR FUTURE FIRST
Financial Services Council Ltd ABN 82 080 744 163
Level 24, 44 Market St Sydney NSW 2000
T. +61 2 9299 3022 F. +61 2 9299 3198
E. info@fsc.org.au W. fsc.org.au