Australian Banking Association

8 June 2021

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Dear Mr Bunting

Phase 1.5 AML/CTF Rules and Guidance

The Australian Banking Association (**ABA**) appreciates the opportunity to provide comments on the Australian Transaction Reports and Analysis Centre (**AUSTRAC**)'s proposed draft changes to Chapters 3, 6, 7 and 10 of the Anti-Money Laundering and Counter-Terrorism Financing Rules (**Rules**) and the draft guidance on Correspondent Banking and Reliance (**Guidance**).

The ABA strongly supports the objectives of the AML/CTF regime. It also strongly supports that the obligations be simplified, streamlined and clarified, and the regulatory burden reduced where possible.

While we are supportive of these amendments overall, the ABA seeks clarification on aspects of the draft Rules and Guidance.

Chapter 3 – Correspondent Banking

Policy principles period

The ABA understands that the policy principles period is for reporting entities to implement the changes required in their systems and processes to comply with the new requirements. In regard to the requirement of the two year review frequency of ongoing due diligence assessment of correspondent banking relationships (**CBR**), we seek clarification from AUSTRAC on when the reporting entity should re-set the review cycle.

The periodic review cycle is set based on the time when the customer was initially on boarded and/or when the last periodic review was conducted. For the implementation of the change in review frequency, the ABA seeks clarity on whether the expectation is:

- for the reporting entity to commence the re-setting of the periodic review cycle during the policy principles period; or
- whether the re-setting may commence after the policy principles period.

For example, for existing CBRs prior to 16 June 2022 that have the next review due date beyond two years (i.e. due May 2025), is there an obligation to change the review date to align with two years or will the two-year cycle start from the next review date (i.e. change the review cycle from May 2025, with next review date to be in May 2027)?

Chapter 3 Draft Rules

Part 3.1 – Entry into a correspondent banking relationship

The ABA notes that rule 3.1.3 (3) (b) refers to both a 'parent company' and 'ultimate parent company'. For consistency, we would suggest any reference be to the 'ultimate parent company'.

In addition, rule 3.1.3 (6) continues to reference 'related bodies corporate'. As previously raised, this is a broad concept. Global banks have complex structures and may have related bodies corporate in those structures that are not involved in activities related to the vostro account. This would impact on which related bodies corporate would be included in the assessment for this factor. We would suggest this rule be limited to the 'respondent'.

Part 3.2 - Ongoing assessments of a correspondent banking relationship

The ABA notes that the existing section 3.2.2 in the current Rules has been removed in the proposed draft Rules and banking services are no longer defined. It is unclear to the ABA why this is the case, and we seek clarity from AUSTRAC as to its reasoning for this removal.

In the absence of the existing section 3.2.2, a CBR is no longer limited to vostro accounts and now includes any products / services offered to a Financial Institution (**FI**) as part of a CBR (which may include nostro or other types of accounts / services). This will also have an impact on shell bank prohibitions that will now be applied to all such CBRs. In this regard, the ABA seeks clarity as to the scope of the CBR. If it is AUSTRAC's intention to expand the scope beyond vostro accounts, then clarity is needed as to regulatory obligations that apply to vostro, nostro and other designated services provided under a CBR.

In addition, we note the requirement for a reporting entity to conduct due diligence assessments of a CBR with another FI every two years. The ABA is of the view that this is overly prescriptive, and it should be left to the FI to determine the appropriate review cycle for due diligence assessments that is commensurate of the risks of that CBR.

Chapter 3 Guidance

Correspondent banking relationships

What is a correspondent banking relationship?

The Guidance states that "A correspondent banking relationship involves a financial institution providing banking services to another financial institution in another country". This section could create a wider definition for CBRs including where services are provided on a principal-to-principal basis. This may occur in the instance where the first bank sells a bond to the second bank, and not necessarily for the benefit of the customers of the respondent. We seek clarity on whether this is AUSTRAC's intent.

The ABA proposes an alternate definition of CBR for consideration by AUSTRAC.

> "Correspondent Banking Relationship - The relationship that involves the provision of banking related services by one Financial Institution (the Correspondent) to an overseas Financial Institution (the Respondent) to enable the Respondent to provide its own customers with cross-border products and services that it cannot provide them with itself."[1]

In addition, the Guidance seems to expand the scope of the regulatory obligations for due diligence included in the Act and the Rules. In particular, we draw AUSTRAC's attention to the following sections in the Guidance:

- Requirements for correspondent banking relationships – indicates that the specific requirements for FIs currently in, or entering into a CBR with another FI are detailed in Part 8 (Correspondent banking) of the AML/CTF Act and Chapter 3 of the AML/CTF Rules. This should be limited to vostro accounts as per the Act.
- Factors to consider when conducting initial and ongoing due diligence assessments – provides factors as per the draft Rules to be considered as part of a CBR (which is defined broader than vostro accounts). This is in addition to the Amendment Act which requires due diligence to be conducted only on vostro accounts.

[1] This does not include accounts maintained domestically by foreign FIs, including for domestic agency clearing services.

We note the Guidance refers to 'agents' or 'intermediary'. The term 'agent' has different connotations, and we suggest the guidance remove this reference and only use the term 'intermediary'.

Requirements for correspondent banking relationships

We note the introduction of the term 'anti-proliferation financing programs' in the Guidance and would suggest its removal as it is not a reference that is defined in the Act or draft Rules.

When a financial institution enters into a correspondent banking relationship

The ABA would be supportive of AUSTRAC including commentary in this section that an FI is to determine when an agreement establishing the relationship comes into effect, depending on particular circumstances.

What is a vostro account?

The definition of a vostro account in the Guidance uses the term 'any account'. We are of the view that this is too broad and creates confusion as to the scope of a vostro account. Further clarification is needed as to how this is correlated to the services outlined in page 2 of the Guidance.

In addition, we note the use of the term 'respondent' omits the reference to the respondent being overseas.

The ABA proposes an alternate definition of vostro account for consideration.

> "Vostro account - A local currency account conducted or held by an overseas Financial Institution (Respondent) with a Correspondent Bank to settle cross-border payments initiated by either party to the account."[2]

What is a nostro account?

The ABA has concerns with the inclusion of nostro accounts in the Guidance. We note that these types of accounts have been removed from the legislation and including them in the Guidance creates confusion as to the regulatory obligations that are to apply to them. If AUSTRAC is intending to reintroduce them, then greater guidance is needed as to the regulatory obligations that apply.

We note the reference to 'foreign currency' in the definition is unclear as to whether it is referring to the local currency of the correspondent or the respondent and suggest this be clarified.

Definition of Financial Institution

The ABA notes that the Guidance does not provide clarity on the definition of an FI in the Act. The current definition of an FI is too narrow and is inconsistent with other international standards. The ABA requests AUSTRAC consider widening the definition of a FI to a limited subsection of FI's i.e. the inclusion of money market corporations (broker dealers)[3], to better clarify the expectations of FIs that could be offered various products such as vostro accounts.

In addition, greater clarity is required in relation to implications of an expanded CBR scope, in regard to the ability to provide other types of accounts/designated services (i.e. other than vostro account) to a broader range of FIs not captured by the definition.

When you must terminate a correspondent banking relationship

The ABA notes this section should outline that where a respondent has a CBR with a shell bank, the obligation is to request the respondent to terminate its relationship with the shell bank within 20 days after the FI becomes aware, and not to terminate the relationship entirely as stated in the draft

[2] This does not include other types of accounts maintained for overseas financial institutions or accounts maintained domestically by foreign FIs for domestic agency clearing services.
[3] See Reserve Bank of Australia definition of Non-ADI Financial Institutions at https://www.rba.gov.au/fin-stability/fin-inst/main-types-of-financial-institutions.html.

Guidance. We also suggest AUSTRAC clarify whether the reference to 20 days is referring to calendar or business days.

Due diligence of correspondent banking relationships

Why additional due diligence is required for correspondent banking relationships?

This section notes that the highest risk CBRs are those that involve the provision of a vostro account to respondents that "deal or trade on behalf of undisclosed underlying customers". It is unclear to the ABA if this relates to instances where customer transactions are instructed over the vostro account in the respondent's own name, when the underlying transaction is really on behalf of/for the benefit of another party.

We would suggest that rather than the use of the terms 'weak regulatory frameworks or AML/CTF controls', the terms 'weak AML/CTF regulatory framework' are used.

Factors to consider when conducting initial and ongoing due diligence assessments

Ownership, control and management structures

Greater clarity is required around AUSTRAC's expectations for identification where the guidance refers to "the identity of any beneficial owners and controllers". In particular, how this correlates with Chapter 35 and Chapter 4.

Furthermore, imposing the consideration of "experience of the board of directors and executive management" in the due diligence assessment is onerous and is very difficult to assess. We would suggest this factor be removed from the Guidance.

In addition, it is unclear to the ABA what is required as part of the due diligence of the factor relating to "the information from the respondent's website and latest annual return", and we would suggest this be clarified in the Guidance.

We note that this section of the Guidance does not refer to politically exposed persons (PEP) while the section on "Ongoing due diligence assessments of correspondent banking relationships" does. We would suggest greater clarity is provided on the expectations for PEP requirements with consideration given to the correlation with Chapter 35 and Chapter 4.

Nature of the business

The ABA suggest the use of the term 'delivery types' be replaced with the term 'delivery channels'.

Foreign countries

For consistency purposes, the ABA suggests the reference to 'parent company' by one that refers to 'ultimate parent company'.

In addition, the guidance would benefit from further expansion as to how the following examples would be assessed by the FI:

- "the existence and quality of any AML/CTF laws, regulations and supervision";
- "the quality of that supervision"; and
- "the perceived quality of the parent having robust group-wide controls, and whether the parent is regulated for AML/CTF to FATF or equivalent standards".

AML/CTF regulations and supervision

With regards to the assessment of "the adequacy and effectiveness of the respondent's AML/CTF controls", the ABA suggests AUSTRAC outline its expectations as to how an FI will assess this. Greater guidance will provide consistency across the sector when engaging respondent institutions. Examples of effective versus non-effective would assist FIs.

Furthermore, we would suggest that the section "you may also wish to speak with representatives of the respondent to reassure yourself that senior management recognise the importance of AML/CTF

controls" be replaced with "you may also wish to speak with representatives of the respondent to finalise any outstanding due diligence responses, if clarifications are required", as this is clearer and less onerous.

Company reputation

As previously raised, the ABA has concerns with the use of the term 'related bodies corporate' and would suggest its deletion.

Vostro account information

To ensure clarity, the ABA suggests AUSTRAC include an example in this section that the following scenario does not constitute a 'payable-through account' facility:

- Permission for branches and subsidiaries of a Group to have 'debit authority' over a parent/head office vostro account maintained with the correspondent bank (this debit authority is facilitated by permitting the entity to operate over the account using their own SWIFT BIC).

We note the reference to subsection 99(2) of the AML/CTF Act in the callout box and believe it should be a reference to subsection 96(2) of the Act.

Ongoing due diligence assessments of correspondent banking relationships

We note the reference to the need for an FI to consider and address "any material changes to those risks". The ABA suggests AUSTRAC provided examples of it would consider material changes to provide the necessary clarity for FIs.

Callout box

We note the reference below is unclear and seek clarification as to AUSTRAC's expectations for Chapter 3 due diligence requirements to parties that maintain SWIFT RMA relationships with correspondent banks, when they do not maintain a vostro account.

- Guidance page 11 -"when conducting initial and ongoing due diligence assessments, consider both the direct use accounts and other exchange relationships such as the SWIFT (Society for Worldwide Interbank Financial Telecommunication) system, or other types of accounts that can be transacted through".

The examples provided in the callout box seem to be a combination of type of accounts (some held by the respondent for their customers, some by correspondent bank for the respondent) and expected activity. It is unclear from the examples if AUSTRAC's intention is to note that in performing the ongoing due diligence the correspondent should pay special attention to transactions received from respondents banking the following accounts/customers. We would suggest this be clarified in the Guidance.

In addition, we would encourage AUSTRAC to outline in the Guidance that the day of completing the assessment is considered the day when all information required has been received and clarified with the respondent.

Frequency of assessments of correspondent banking relationships

The ABA suggests that the reference to "…you should immediately initiate a due diligence assessment." be replaced with the following " … you should immediately assess whether the investigation is material to trigger a due diligence assessment.", as the current wording is very broad.

Recording your assessment of the correspondent banking relationship

The ABA notes the reference in the Guidance to the need to prepare a written record of each ongoing due diligence assessment. Any reference to providing a record should allow for technology neutral solutions for capturing assessment outcomes. We would suggest the reference to 'written' records be removed and this be applied across the draft Rules and Guidance.

In addition, the Guidance notes the need to provide the record of each ongoing due diligence assessment within 10 business days of its completion and we seek confirmation that the term 'completion' is defined as when the assessment is complete and ready for senior officer approval.

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Due diligence assessments and the provision of a vostro account

The Guidance references the requitement to conduct due diligence assessments under Part 8 of the AML/CTF Act is triggered by the provision of a vostro account. We note that Part 8 should only be applied to vostro accounts and should not be triggered by the provision of a vostro account. Greater clarity is needed on AUSTRAC's expectations if no vostro account is provided but other designated services are provided to FIs.

In addition, the combination of the Guidance's reference to correspondent banking due diligence complementing other AML/CTF obligations and the unclear definition of CBR creates complexity and increased confusion as to the regulatory obligations that are to apply to CBRs and other designated services that are offered. The ABA suggests AUSTRAC provide greater clarity as to what chapters in the AML/CTF Rules apply to vostro accounts as opposed to other designated services a reporting entity may provide to another FI as part of a CBR.

The following scenarios should be addressed in the Guidance, in terms of services provided:

- Only vostro accounts, including related transactions;
- Nostro accounts;
- Other types of accounts / designated services for overseas FIs in addition to vostro account or separately, without a vostro account; and
- Other types of accounts / designated services for foreign FIs offered domestically – i.e. corporate style accounts for deposits or other banking operations maintained by a subsidiary of a foreign FI in Australia, in addition to vostro account or separately, without a vostro account.

In providing this guidance, the implications from the following regulatory provisions should be considered and explained:

- Chapter 35 in the Rules related to "Exemption from applicable customer identification procedures for correspondent banking relationships";
- Part 4.14 in the Rules related to "Exemptions relating to the identification of beneficial owners and politically exposed persons"; and
- The conflict in terms of the extraterritorial application of obligations between Division 4 Part 2 of the Act, Chapter 4 & 15 of the Rules and Part 8 of the Act (obligations that apply in Australia only or overseas application through geographical link).

Use of the term "serious crime risk"

The ABA suggests that references to "serious crime risk" be altered to read "serious financial crime risk".

In addition, the ABA seeks clarification as to AUSTRAC's expectations in relation to the additional due diligence assessments required beyond ML/TF and the factors stipulated in the Rules, given the global nature of correspondent banking activity and various regulatory regimes for what is considered a serious crime.

Format of the Guidance

The ABA suggests the Guidance be made available as a standalone document available on the website and that paragraphs are numbered for structure and ease of read.

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Chapter 6 – Verification of identity

Chapter 6 Draft Rules

Part 6.1 – Re-verification of KYC information

For consistency with other Rules, the ABA suggests that the use of 'obtain' in Rule 6.1.3 (1) be replaced with the term 'collect'.

Chapter 7 – Reliance

Policy principles period

The proposed rule changes impact existing arrangements in place between reporting entities and licensed financial advisers which have been established under section 38 of the AML/CTF Act and Part 7.2 of the AML/CTF Rules. Industry practice in relation to licensed financial advisers has been to assess these arrangements on a class basis (not a case by case basis) with the agreements in place between reporting entities reflecting the obligations of each party.

The proposed rule changes under section 38 will require an assessment to be conducted on a case by case basis to the new standard detailed under Part 7.2. This reflects a material change to existing practices and therefore there is a need to provide the industry with a period of transition to allow updates and changes to be made to systems, procedures, and agreements between reporting entities. A period of industry engagement between licensed financial advisers and product issuers will be required to address the proposed new Rules. Given the number of agreements in place between reporting entities and the associated activity required to process amendments to these agreements, the ABA recommends AUSTRAC allow for a 12-month transitional period for reporting entities.

Chapter 7 Draft Rules

Part 7.2 – Ongoing reliance under an agreement or arrangement

We note that the under proposed rule 7.2.4, a reporting entity is required to undertake regular assessments of agreements or arrangements for reliance at least every two years. We would suggest a minimum timeframe of at least every three years may be more appropriate where the ML/TF risk is low. This may be particularly the case where, under the customer's due diligence (**CDD**) arrangement the third party provides the reporting entity all of the ACIP information and verification documentation in line with its AML/CTF program requirements, thus evidencing the completion of the ACIP.

Chapter 7 Guidance

Ongoing arrangements

The term 'objective' in "reasonable objective grounds" is not used in the Act and the ABA suggests it be removed.

Benefits of entering into a CDD arrangement

This section makes reference to the term 'objective person' and we suggest the term 'objective' be replaced with 'reasonable' to ensure consistency with the reasonableness language used in the Act.

Factors to take into account when assessing other jurisdictions

The ABA suggests that the Guidance clarify whether all the factors listed are to be considered or if they are just possible considerations for the reporting entity.

Resolving issues with CDD arrangements and liability

This section of the Guidance refers to "…under the CDD arrangement ceases to apply from the point you knew, or objectively should have known, that this was the case". The ABA suggests the term 'objectively should have known' be amended to 'ought to have known' to reflect the reasonableness language used in the Act.

Thank you for the opportunity to provide comments on these draft Rules and Guidance. Should you have any questions or would like to discuss this submission in more detail, please do not hesitate to contact me.

Yours sincerely

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