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SDIA Submission to the Senate Legal & Constitutional Committee

Inquiry into the Exposure Draft of the Anti-Money Laundering and Counter-Terrorism Financing Bill 2005

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The Securities & Derivatives Association (SDIA)

The Securities & Derivatives Industry Association (SDIA) is the industry body that represents over 66 stockbroking firms, who inturn represent over 98% of the market by value on the ASX.

The SDIA actively liaises with our members, regulators and other market participants to further strengthen our profession in Australia.

The SDIA includes organisations of all sizes across the entire breadth of the industry, both institutional and retail, which enables the SDIA to have a comprehensive understanding of the challenges and opportunities facing our industry.

The SDIA has representation on the Minister for Justice & Customs AML/CTF Advisory Group.

For information about the SDIA go to www.sdia.org.au.

Introduction

Firstly the SDIA would like to thank the Senate Legal & Constitutional Committee for inviting the SDIA to make a submission on the AML/CTF Exposure Draft Bill, Draft Rules and Guidelines and Supporting Information issued by the Federal Attorney-General's Department and AUSTRAC on 16 December 2005.

The SDIA recently convened an AML/CTF Working Group (of its members) to discuss and raise issues that may have an impact on our industry members. The final daft Rules are yet to be released but we do highlight some of the issues facing our industry in this submission.

ISSUES

1. Customer Identification

1.1 Individuals or natural persons

The minimum "know your customer" information requires that you receive both the customer's full residential address (which would include the country of residence) and the country of residence? This seems to be an unnecessary duplication. Or the country of residence should be reworded to become the "principal country of residence.

1.2 Secondary Identification

Australian Electoral Cards do not have any security features, and could easily be forged therefore it is considered this method unworthy of use.

Not all utilities are public utilities, some are now owned by the private sector.

A young person living at their parents' home could have difficulties being identified if they do not drive or hold a passport.

Some secondary identification documents appear limited but the list could also be expanded upon. The list of documents should be reviewed.

2. Non Face-to-Face Customer Identification

Most contact with stockbrokers is not face-to-face and it would be very difficult, if not impossible to change this. Accordingly the bulk of identification will be on the basis of documents.

3. Remote (Overseas) Customer Identification

Most stockbrokers would have overseas clients. Although brokers with overseas affiliations may find it relatively easy to appoint agents to handle the customer verification process, this will not be easy for other brokers.

4. Third Party Due Diligence

Where an AFSL licence holder is a reporting entity and proposes an arrangement with another AFS licensee such an arrangement should be exempt from the due diligence requirements. These entities have already been through an in depth

screening process in their licence applications and, if there is no adverse finding against them by the Australian Securities & Investments Commission (ASIC) after the receipt of the licence, the reporting entity must be able to do business with them in the normal course. The expectation should be that they also comply with AML/CTF legislation and that they have completed the customer identification process for their clients. Both licensees should not be required to obtain customer identification – only the primary contact. Similarly, it should not be a requirement that reliance on another licensee requires that a stockbroker review and approve the process for customer identification employed by that other licensee. Examples of these types of arrangements are stockbrokers having arrangements with financial planners and other intermediaries, margin lenders and managed fund providers.

It is also considered that this could include related bodies corporate of AFS licensees.

5. Employee Due Diligence

5.1 Screening prospective employees

The issue of screening prospective employees is not clear. Who is a prospective employee? Is it someone who is interviewed for the role, those that have made a shortlist or is it the individual that an offer is made to? Then, if the screening process highlights a matter that causes employment not to be offered what happens:

- If it is an AML/CTF unrelated matter; or
- If it is a related AML/CTF matter.

Is there an obligation to report the information or is privacy an issue?

If police checks are required, the delays that are often experienced in obtaining these reports in some states might obstruct the normal employment process. It is not clear whether employment can commence prior to the checks being completed or if they must be finalised prior to an offer of employment being made. If we are required to wait then this would be detrimental to both the employer and the prospective employee.

The fit and proper test for employees is too high. Currently this is similar to the Responsible Officer test required by ASIC and it is considered that a more relevant term need to be defined. Employers should have sufficient scope to determine what level of investigation into the background of an individual is necessary given the position and functions for which they are being employed.

5.2 Re screening of employees

This needs to be reviewed. If you re assess or screen a current employee and the re screening highlights an issue of concern that is not AML/CTF related then normal employment and privacy legislation may be breached. It would appear that this requirement would not be satisfied if an employer merely obtained written confirmation from employees that they were not bankrupt, they did not have a criminal record etc.

6. Board Ongoing Oversight of all Components of an Entity's AML/CTF Program

The requirement of a board to have "ongoing oversight" of an entities AML/CTF program is unwarranted.

In reality, a board would approve the program that would be implemented and monitored by those employees charged with such a function (eg. Risk or compliance employees) with the understanding, that any material issues would be advised to the board through the normal reporting channels.

The wording should rightly take into account the board but should also recognise normal business practices and understand that this function is part of board delegation. The Board should have overall responsibility for this in the same manner that they have overall responsibility for the rest of the business. It is unreasonable to expect board members to be caught up in the detail.

7. Customer Risk Rating and Ongoing Monitoring

Draft AML/CTF Rule 17 states *"that a reporting entity must assign each existing customer with a risk classification as soon as practicable after the commencement of Part 7 of the AML/CTF Bill but by no later than [X] months after its commencement."*

To risk rate existing clients (whilst not re identifying them) may prove haphazard if sufficient time is not allowed for proper systems to be built. The risk systems will be new, only new clients will be identified in accordance with this Bill. The majority of the client base at that point in time does not require identification (they are existing clients) therefore, it is important that risk rating existing clients is done with as much surety as possible. On this basis a period of time of not less than twenty four (24) months should be allowed to risk rate existing customers. New clients of course should be rated immediately.

If existing clients are not rated properly the ongoing monitoring of customer transactions could be compromised.

8. Reporting of Suspicious Matters

8.1 Suspicious matters
Timing of reporting transactions

Section 39 (2)

In essence the above section requires that if you need to a report a matter relating to section 39 (1)(d) referring to money laundering then you have three (3) days to report the matter to AUSTRAC. If you have a need to report a matter relating to section 39 (1) (e) or (f) then you only have twenty four (24) hours.

We submit that both should be reported within the same time period, which would be three (3) days under the proposals. However we believe a more reasonable time period would be 5 business days. It is considered that twenty four (24) hours is insufficient time for someone to logically suspect that the provision or prospective provision of a service or information provided to a customer, would be relevant to an investigation of a terrorism offence or a financing of such.

9. Politically Exposed Persons

There is little or no available source for financial service providers to ascertain if a person is politically exposed and obviously a subjective decision is not one that can be made. This is not the type of information that a client would provide in the normal business of opening an account – rather they would go to great lengths to avoid disclosure of the fact.

The SDIA suggests that the Government or a Government chosen commercial enterprise should retain a reliable data base with access provided to those that provide designated services.

10. Shell Banks

It is suggested that the Government or a Government chosen commercial enterprise should retain a reliable data base with access provided to those that provide designated services.

11. Non Individual (Companies, Trusts, Charities etc) Customer identification

Identification of the above entities should not be "one size fits all". Companies listed on Australian and indeed on overseas complying countries' exchanges (eg United Kingdom and United States) should require only the normally accepted identification. A listing of recognised stock exchanges could assist this purpose.

There are certain entities that do require higher identification (trusts, charities, private companies) therefore it is suggested that it is clearly stated in the Bill that the treatment of identifying listed companies from recognised exchanges is a separate requirement.

If an ASX participant intends to deal with a company or a superannuation fund will we be expected to get information on all of the directors and beneficial holders? This also requires clarity as the task will become unwieldy.

12. Materially Mitigate

Paragraph 5 of the Draft AML/CTF Rules requires "as part of its AML/CTF Program, a reporting entity must put appropriate risk based systems and controls in place to materially mitigate any high AML/CTF risks that it may reasonably face in relation to the matters in paragraph 2.

Paragraph 2 refers to effectively identifying:

- High risk customers;
- High risk services;
- High risk service delivery methods;
- High jurisdictional risks.

Although paragraph 5 discusses only those risks that "it may reasonably face" in relation to paragraph 2, there needs to be clearer guidance on what materially mitigate means as well as a definition of the term. We also need examples of what a "high risk customer is" etc.

13. Compliance Costs

Compliance costs will obviously increase during the implementation and transition period. They will also remain high into the future.

If the transition period is short, the costs will increase significantly during this period. This should be taken into account by the Government when considering the transitional period and this period should not be less than two years. The government should also consider special grants or tax relief in relation to the costs of implementing compliance arrangements.

14. Record Keeping

It is considered that the requirement for the retention of records should be the same as the general requirement under the Corporations Act – seven years.

15. Transaction Monitoring

Due to the mix of clients that our industry members may have, being a mixture of small retail clients through to large retail clients, and on to institutional clients, transaction monitoring will require significant cost and system improvements to properly monitor transactions. Obviously the stockbroking industry monitors transactions for many reasons (eg. No change of beneficial ownership and other conduct requirements). Many of the current issues relating to transaction monitoring are successfully manually driven but, to properly monitor transaction in relation to this proposed Bill will require significant new systems.. This must be taken into account in the Government deciding on the length of time for transition.

16. Risk Systems and Risk Triggers

Industry monitoring of transactions for AML/CTF purposes as we all are aware is not new to the Australian Government and private enterprise as Austrac has been around for sometime however, this legislation takes us to new frontiers. The risk systems and risk triggers required will be individual to not only each business (and industry) but also to each client. Industry will definitely grapple with the requirements and on this basis the Government should ensure that it details in the Guidelines its realistic expectations on what is acceptable.

17 Definition – Remittance Provider

There is no definition of a remittance provider although, section 9 (1) states that:

"A reference in this Act to a designated remittance arrangement is a reference to a remittance arrangement, where:

(a) the person who accepts money or property from a transferor entity to be transferred under the remittance arrangement is not an ADI, a bank or a building society; and
(b) the person who makes money or property available to an ultimate transferee entity as a result of a transfer under the remittance arrangement is not an ADI, a bank or a building society.

The above section could wrongly be interpreted as any entity that is not an ADI, a bank or a building society. Remittance Providers must be defined more succinctly.

18. Patriot Act s314b - Cooperation Among Financial Institutions states:

"Upon notice provided to the Secretary, 2 or more financial institutions and any association of financial institutions may share information with one another regarding individuals, entities, organizations, and countries suspected of possible terrorist or money laundering activities. A financial institution or association that transmits, receives, or shares such information for the purposes of identifying and reporting activities that may involve terrorist acts or money laundering activities shall not be liable to any person under any law or regulation of the United States, any constitution, law, or regulation of any State or political subdivision thereof, or under any contract or other legally enforceable agreement (including any arbitration agreement), for such disclosure or for any failure to provide notice of such disclosure to the person who is the subject of such disclosure, or any other person identified in the disclosure, except where such transmission, receipt, or sharing violates this section or regulations promulgated pursuant to this section."

The SDIA considers that it is important for it's members to be able to share information (under notice to AUSTRAC for AML/CTF purposes) regarding certain activities of certain people. This would help prohibit more than one of our members becoming involved with an individual or entity, if the member who first suspected an instance where money laundering or terrorist financing was the reason behind a transaction, could inform other members. To be successful there must be immunity from prosecution for sharing such information. We recognise that tipping could be a problem arising from such sharing of information as it would be difficult to identify the source however not sharing the information could have a significant impact on the industry.

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