

Chapter 6

ACCOUNT OPENING PROCEDURES

Introduction

6.1 The account opening provisions of the FTR Act (Part III) commenced operation on 1 February 1991. The procedures oblige cash dealers to verify the identity of a person becoming a signatory to an account in accordance with the Act and the regulations. Until the person's identity is so verified the account is blocked to withdrawals by the person.

6.2 The account opening provisions were the subject of much comment in the evidence to the Committee, particularly as to the cost imposed upon cash dealers from compliance with them and as to the inflexibility of the procedures themselves.

Initial Requirements for the Opening of Accounts

6.3 The FTR Act contained verification requirements which were amended before commencement, and on a number of occasions thereafter. (The most recent changes commenced on 1 February 1993, during the course of the Committee's inquiry.) The Act originally required that the identity of signatories to accounts opened with cash dealers which either reached a credit balance exceeding \$1 000 or an aggregate of credits exceeding \$2 000 over any 30 day period, were required to be verified. Similar identification requirements applied to a safety deposit facility.

6.4 Initially the only verification procedure available required the signatory to provide to the cash dealer an 'identification reference'. This is a statement signed by a person within one of the classes of approved referees who has known the signatory for a period of at least 12 months, certifying that the signatory has been commonly known by the stated name during that period and that the referee has sighted various combinations of identification documents.

6.5 In 1990, before the commencement of the account opening procedures, the FTR Act was amended to enable an alternative method of

identification to be used. This method prescribed a lengthy list of checks of identity in the FTR Regulations, each of which is allotted a point weighting according to the reliability of the check. The signatory's identity is taken to be verified once he or she has collected 100 points under the system. The method is known as the 100 point method, and is not available to all cash dealers. The method may be used only by those cash dealers declared to be 'identifying cash dealers' by the Director of AUSTRAC.

Amendment of the Account Opening Procedures After Commencement

6.6 The account opening procedures have been revised substantially since they commenced operation on 1 February 1993:

- Statutory Rules 1990 No. 340 and 341 established the detail of the 100 point identification system;
- Statutory Rules 1991 No. 7 modified the procedure in relation to the signatories to accounts held in trust;
- Statutory Rules 1991 No. 89 varied the procedure in relation to the reporting by cash dealers of accounts blocked to withdrawals by unverified signatories;
- Statutory Rules 1991 No. 166 streamlined the 100 point system in a number of ways;
- Statutory Rules 1992 No. 90 made further changes to the 100 point procedure, eg in relation to long term clients;
- Statutory Rules 1992 No. 423 further amended the regulations to make further extensive provision for the verification of identity.¹

6.7 In addition to the changes to the regulations, a number of amendments were made to Part III of the FTR Act dealing with the opening of accounts. The most extensive of these changes commenced on 1 February 1993.

6.8 The number of changes made to the procedures over such a short period of operation (two years) is itself an indication that the account

¹ Submission No. 35, (Attorney-General's Department) pp. 55-56.

opening procedures are unsatisfactory. Attorney-General's Department conceded that:

the 'account opening' procedures as originally drafted were unnecessarily inflexible. Following extensive consultation with cash dealers, the procedures have been adjusted to a point where they should be considerably less onerous than initially without loss of effectiveness in preventing easy opening of false name accounts.²

6.9 Elsewhere the Department conceded that not all problems may yet have been addressed:

In addition, the Department has become aware of some other groups with special problems providing evidence of identity and has made special provision in the FTR Regulations for their situations. The Department will need to continue to monitor the effects of the 'account opening' procedures on disadvantaged groups and others who may have difficulty with identification requirements. Should additional problem groups come to light, comparable arrangements will be made for them.³

The Evidence Received on the Cost of the Account Opening Procedures

6.10 Much of the evidence provided to the Committee about the account opening procedures concerned the compliance cost for cash dealers. That evidence is summarised below.

6.11 The AFC advised that the costs associated with account opening were:

• Staff costs	\$ 445,184
• Other branch costs	\$ 20,616
• Other administrative on-going costs	\$1,088,070

² Submission No. 35, (Attorney-General's Department) p. 44.

³ *ibid* p. 38.

6.12 This resulted in an average cost per account opened of between \$8 and \$200.⁴

6.13 The wide variation in average cost is due to the diversity of financial service providers, some of which are large volume/small loan financiers and others are small volume/large loan financiers. The AFC was unable to indicate a median or most common cost for each account opened.⁵

6.14 For the banks the cost of account opening was very large. The ABA advised that the estimated 1993 annual operating cost for account opening was \$21.7m (which is 85.8 per cent of the total compliance costs of \$25.3m). This amount was broken up as follows:

• Staff costs	\$20,644,000
• Other branch costs	\$ 221,000
• Other administrative costs	\$ 841,000 ⁶

6.15 CUSCAL estimated the recurrent cost from the account opening procedures to be \$10m.⁷ In evidence CUSCAL advised that the high cost of the account opening procedures 'is largely because of the sort of global approach that has been taken in the legislation and a lack of flexibility which, since the introduction of the legislation, has slowly been brought back to more operational reality.'⁸ The cost arose from the extra time required to open each account, the rigid document retention requirements and the computer systems needed to retain certain information.⁹

6.16 The AAPBS pointed out that the compliance costs result in higher borrowing costs for individuals and lower yields for investors.¹⁰

⁴ Submission No. 38, (AFC) p. 5.

⁵ Submission No. 53, (AFC).

⁶ Submission No. 26, (ABA) pp. 14-15.

⁷ Submission No. 34, (CUSCAL) p. 3.

⁸ Evidence (Mr Dupé) p. 22.

⁹ *ibid* p. 23.

¹⁰ Submission No. 40, (AAPBS) p. 1.

6.17 Attorney-General's Department argued that the cost of the mandatory account opening procedures was only a 'small increment'¹¹ over the costs which would be borne in any event by cash dealers from applying their own voluntary system arising from the commercial and prudential need for banks to 'know their customers':

- The great bulk of the cost to cash dealers of compliance with the FTR Act lies in the 'account opening' procedures. The costs of reporting significant cash transactions and IFTIs, once systems have been established to capture the information, are quite low. Only a small percentage of transactions are ever considered as possibly suspect. By contrast, every time an account is opened or a signatory added information has to be acquired or previous holdings checked, using staff time.
- The ABA had previously advised that banks adhered to its code of conduct, which required checking of the identity of persons opening accounts. The Department believes that the 100-point scheme, as modified after extensive discussions with cash dealers, places obligations on cash dealers with respect to account opening checks not dissimilar to those imposed on banks by the ABA code of conduct. Any difference in cost between complying with the statutory scheme and the voluntary code would only amount to a small increment over the cost the banks would have faced anyway.¹²

6.18 The Department was not in a position to provide an assessment of the cost to cash dealers of compliance with the FTR Act.¹³

6.19 On the question of the compliance cost of the account opening procedures the Committee prefers the evidence of the cash dealers, who were unanimous on the point that the costs were very high. The Committee notes the remark by Attorney-General's Department that it (the Department) 'is not in a position to provide an assessment of the cost to cash dealers of compliance with the FTR Act.'¹⁴

¹¹ Submission No. 35, (Attorney-General's Department) p. 34.

¹² *ibid* pp. 33-34.

¹³ *ibid* p. 33.

¹⁴ *ibid* p. 33.

Suggestions for an Alternative System of Account Opening

6.20 Cash dealers were almost unanimous in calling for a more flexible, more deregulated approach to account opening:

CUSCAL strongly urges the Committee to recommend a self-regulatory approach to account opening with penalties for inadequate procedures. In all likelihood, credit unions and other cash dealers will not vary their procedures significantly from the Weight of Evidence 100 Points method other than to reassign more sensible ratings to particular checks and documents which better reflect their particular customer base and provide *greater* integrity to the process. These procedures could be subject to audit by AUSTRAC as part of the Identifying Cash Dealer Audit Program.¹⁵ (Emphasis added.)

6.21 This was stressed again in evidence where Mr Dupé stated that 'we believe it would be more sensible, now that the legislation has been in place for a number of years, for financial institutions to simply be required to know their customers. They could satisfy themselves as to a person's identity in a way which was more cost-efficient and effective by their choosing the method which best suits their membership or customer base ... We think that can both reduce costs *and the likelihood of false accounts being established.*'¹⁶ (Emphasis added.)

6.22 The ABA made a similar proposal:

28. The 100 point check system is costly and the identification documents associated with it are too specific and therefore unduly onerous for the ordinary bank customer, and can be avoided through false documentation. Account opening procedures make up the vast bulk of the cost to banks of operating the Act.

29. Banks accept the obligation to know their customers and believe it would be better for customers to have that rule applied on a flexible basis rather than through the prescriptive account opening arrangements in the Act.¹⁷

¹⁵ Submission No. 34, (CUSCAL) p. 4.

¹⁶ Evidence (Mr Dupé) p. 24.

¹⁷ Submission No. 26, (ABA) p. 10.

6.23 The AAPBS also submitted that the procedure should not be prescribed in legislation:

The process has standardized procedures across financial institutions especially in regard to account opening processes. Provided this continues to be flexibly administered, receptive to change in community habits, new systems and technology, then a uniform approach is not a bad thing. There is concern however, that account opening is enshrined in this legislation with the attendant risk that in the longer term rigidity and inflexibility is built into the system. We recommend therefore that the account opening processes be taken out of the Cash Transaction Reports Act and located elsewhere, possibly in a code of banking conduct, or in an account opening code of conduct overseen by an existing Commonwealth agency.¹⁸

6.24 The AFC stated that the Director of AUSTRAC was now provided with a substantial discretion to approve alternative account opening procedures for particular cash dealers (by the amendments which commenced on 1 February 1993). The AFC argued that the legislative requirement could be reduced to a bald statement of the general duty placed upon a cash dealer and the lengthy prescriptive requirements of the FTR Act and Regulations could be omitted:

I am thinking of a parallel with the Corporations Law, particularly the prospectus provisions of the Corporations Law. At one time we had very long, technical prospectus provisions. They have been largely replaced by a provision ... of a couple of lines which says that the prospectus needs to contain everything which the investor or individual reasonably requires. If we could have that sort of approach in terms of the account opening provisions under the legislation, it would go a long way towards solving many of the problems of financial institutions without in any way circumscribing the ability of the agency to pursue its objectives.¹⁹

6.25 VCCL was also critical of the account opening procedures. They argued that the procedures were inflexible and operated to exclude some people from access to the banking system because they were unable to comply with the requirements of the identification procedure:

¹⁸ Submission No. 40, (AAPBS) p. 2.

¹⁹ Evidence (Mr Bills) p. 29.

Whilst most customers can produce sufficient identification, certain groups face difficulties. These include pensioners, Aborigines, persons living in remote locations, recent arrivals in Australia, homeless youths and non-residents.²⁰

6.26 VCCL asserted that the procedures attempt to ensure that a procedure is available for all persons seeking to open a bank account and that no one falls between the cracks. However, the procedures 'are not, and cannot be, framed well enough to ensure that no-one suffers that fate and is excluded from the banking system. Such exclusion can cause significant hardship, particularly in light of the increased use of banks to deposit social security benefits, salaries etc.²¹

6.27 VCCL proposed that the rigid procedures should be discarded. The present procedure

should be replaced by a system which requires banks (and other relevant cash dealers) to form a reasonable opinion of a person's identity. The present mandatory identification procedures should become recommended procedures to apply in the majority of cases. The bank should, however, have a discretion to depart from the statutory procedures where it is reasonable to do so, having regard to the customer's status, the likelihood of hardship to the customer and the likelihood of fraud by the customer. The onus should be on the bank to establish that the circumstances warranted a departure from the statutory criteria and that the opinion it formed of the customer's identity was reasonable.

Such provisions would leave intact the current procedures for the overwhelming majority of cases. They merely give banks the capacity to fill those cracks through which some customers can still fall.²²

6.28 AUSTRAC did not oppose the proposal to introduce more flexibility into the procedure but emphasised the need for integrity in any replacement account opening procedure:

²⁰ Submission No. 12, (VCCL) p. 10.

²¹ *ibid* p. 11.

²² *ibid* p. 13. VCCL clarified that the expression 'the customer's status' refers to whether the customer is a member of a vulnerable group having access to few forms of documentary identification. VCCL also clarified that an opinion on the likelihood of fraud by the customer might be formed by having regard to the length of the relationship between the customer and the bank, and whether the bank is aware of any adverse matters about the customer. (Telephone discussion between the Committee Secretary and Mr Pearce of VCCL 29 July 1993.)

If you were to move to bring about more flexibility, which we are not opposing, we would suggest that there is the need to balance the general requirements in order for there to be some integrity in what is done against the need for flexibility.....

..... Whilst we support generally a move to have more flexibility, it should be tempered with the sort of thing Mr Sherman²³ raised which was the need for there to be integrity.²⁴

6.29 Indeed AUSTRAC expressed support for the VCCL proposal:

I think what is being said now is that, instead of having this 100 points regime, maybe there ought to be more flexibility; perhaps you ought to have some general code which calls up a broad 'know your customer' type thing and let us not have 100 points. The Victorian Council for Civil Liberties' submission, as I recall it, perhaps has a more attractive theme - and I might leave that to the organisation - which sort of keeps this as some baseline standard but allows a bit more flexibility.²⁵

6.30 The Committee notes that it was expected when the legislation was debated in Parliament that the cost of the account opening procedures to cash dealers would be modest. For example, the then Attorney-General, the Honourable Lionel Bowen MP, informed Parliament that:

Banks have their own mechanisms of verification. A verification mechanism might be a tax file number. It is not very difficult to take down a tax file number. The only other form of verification could be the production of a passport or a birth certificate. If they cannot be obtained, a citizenship certificate or some other identification which, in the opinion of the financial institutions, would sufficiently establish the persons identity would be acceptable. Where is the cost in that? I just cannot imagine. When a person opens a bank account all they will be asked to do is prove who they are. The banks do that now under their voluntary code.²⁶

²³ Chairman, NCA.

²⁴ Evidence (Mr Coad) p. 34.

²⁵ Evidence (Mr Coad) pp. 47-48.

²⁶ *House of Representatives Hansard, 4 June 1987, p. 4036 (Mr Bowen)*

Recommendation 5: The Committee recommends that the present account opening requirements of the FTR Act should no longer be a mandatory minimal procedure. Instead the Act should impose upon cash dealers an obligation to take reasonable steps to satisfy themselves of the identity of signatories to an account. The present mandatory procedures should become standard procedures to apply in most cases. Cash dealers should have the discretion to depart from the standard procedures where the circumstances so warrant. The onus should be on the cash dealer to prove that the circumstances warranted a departure from the standard procedure and that in its opinion the customer's identity has been established.

Recommendation 6: AUSTRAC should have the function, and the necessary resources, to audit the performance of cash dealers in complying with the statutory duty to satisfy themselves of the identity of their customers.