

Parliamentary Joint Committee on  
Corporations and Financial Services

**Inquiry into the Collapse of Trio  
Capital Limited and related  
matters**

**Submission of Australia and New Zealand Banking  
Group Limited**

14 October 2011



## Introduction

Australia and New Zealand Banking Group Limited (ANZ) is pleased to assist the Parliamentary Joint Committee in its Inquiry into the Collapse of Trio Capital Limited (Trio Capital) (formerly Astarra Capital Limited) and related matters as set out in the terms of reference. The Committee has further identified a range of issues that we could helpfully address in this submission, specifically relevant to the role of Custodians. ANZ was the custodian for assets held on behalf of Trio Capital during the period February 2005 to January 2009.

ANZ is deeply concerned that investors have been defrauded and notes that Shawn Richard pleaded guilty to dishonesty charges that resulted in a prison sentence. We understand the distress an event such as this causes investors, many of whom were seeking to fund their retirement. This also impacts the financial services and related industries more broadly in terms of reputational damage and undermining investor confidence.

Financially, all superannuation funds regulated by the Australian Prudential Regulation Authority (APRA) must contribute to the Government's announced \$55 million financial assistance and compensation scheme, which will provide compensation to investors of APRA regulated superannuation funds (although not those in self-managed superannuation funds). We understand the view that those who were operating self-managed funds may wish to be included under the compensation scheme and have a regulatory system which offers them further support.

A number of reforms underway, including the Future of Financial Advice, will address some of the matters raised in submissions and testimony received by the Committee and follows from previous inquiry work of this Committee.

ANZ is not aware of any evidence that the collapse of Trio Capital stemmed from a deficiency in the regulatory framework.

While we no longer operate a custodian services business, we are pleased to be able to assist the Committee in this submission by presenting our previous experience and identifying any areas where further improvements can be made. We have also included an Appendix addressing the specific questions provided as a guide by the Committee.

We have also been working cooperatively with ASIC to provide assistance and information for its review of the collapse of Trio Capital.

The Australian Securities and Investments Commission (ASIC) and APRA submissions cover, in some detail, the legal role of Custodians, and we will not seek to replicate that work, but instead share with the Committee our experience of offering custodial services generally, and Trio Capital more specifically.

# 1. The custody business

## (i) Role of custodians

Following the introduction of the Managed Investments Act in 1998 (chapter 5C of the Corporations Act), the concept of a single point of accountability, called the 'Responsible Entity' (RE), was introduced replacing the Prescribed Interests regime (part 7.12 of the Corporations Law) of both a Manager and Trustee. The RE was obliged to hold legal title to scheme property on trust for the scheme members, or to appoint a custodian to act as the agent of the RE to hold legal title to the scheme property separately from the property of the RE or the property of any other scheme.

As a result of these reforms, the demand for custodial services in Australia grew significantly. REs which did not meet the financial requirements set out in their licences were obliged to appoint a custodian to hold assets on their behalf. The purpose of such an appointment was to segregate the trust assets from the RE's proprietary assets.

The primary purpose of the 1998 reforms was to ensure that one entity alone, namely the RE, was responsible to investors for the management of assets held under managed investment schemes. Under the Corporations Act (section 601FB) the RE is liable for the operation of the scheme, in accordance with the scheme's constitution and the Corporations Act. Under section 601FC of the Corporations Act, the RE's duties include the obligation to act honestly; to act in the best interest of members; to ensure all payments out of scheme property are made in accordance with the scheme's constitution; and to ensure the scheme property is valued at regular intervals appropriate to the nature of the property.

The Corporations Act defines custodial services (section 766E) as "an arrangement...[where] a financial product, or a beneficial interest in a financial product, is held by the provider on trust for, or on behalf of, the client..." The role a custodian is to hold the assets managed by the RE (the client/customer) as bare trustee and to act on proper instructions from the RE in respect of those assets. In this respect, ANZ agrees with the Australian Securities and Investments Commission's (ASIC) submission to the Inquiry, where ASIC explained that custodians act as bare trustees, holding the legal title of their clients' assets without discretion as to how the assets are managed or invested.

It has been suggested in submissions made to the Committee that a custodian is required to confirm the existence of a fund's underlying assets. This is incorrect. The custodian's role and function, as bare trustee, is to hold assets on behalf and upon instruction of the RE. Its duty, which is owed exclusively to the RE, is to act on proper instructions from the RE in relation to those assets. The role of the RE is to manage the assets of the scheme, including activities

such as investment strategies and valuations. A custodian does not have discretion to choose whether or not to act on a proper instruction which is lawfully given by the RE. The custodian has no discretion regarding the investment or management of the custodial assets.

## **(ii) Process to set up as a custodian**

A financial services institution that proposes to set up a custody business is first required to obtain the appropriate Australian Financial Services Licence (AFSL) from ASIC, authorising it to, amongst other things, provide custodial and depository services.

A prospective licensee is required to complete the appropriate ASIC application form and attach the relevant supporting evidence in order to satisfy ASIC requirements. A prospective licensee is required to meet the minimum financial standards including holding \$5 million of Net Tangible Assets (NTA) and fulfilling the minimum cash flow requirements.

Upon being issued a licence, a licensee must comply with the general obligations set out in the Corporations Act and meet the conditions of the licence. In addition, a licensee may need to meet other regulatory requirements including:

- ASX Settlement Operating Rules regulated by the ASX Settlement Corporation;
- The Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (AMLCTF Act) regulated by the Australian Transaction Reports and Analysis Centre (AUSTRAC); and
- Various prudential standards as determined by APRA where the licensee is also an Authorised Deposit-taking Institution (ADI).

ANZ offered custodial services in Australia and New Zealand through its business unit, ANZ Custodian Services, for approximately 50 years until November 2009. ANZ was authorised to offer custodian services and was regulated by the following regimes:

- The Financial Services Reform Act 2001 granted ANZ authority to provide custodial and depository services, by virtue of ANZ operating an existing financial services business.
- From 1 October 2003, ANZ's custodian services business operated under ANZ's AFSL. The licence authorised ANZ's provision of custodial and depository services. ANZ acted as custodian and ANZ Nominees Limited (ANZ Nominees), a wholly owned subsidiary of ANZ, acted as sub-custodian. ANZ Nominees was appointed as a corporate authorised representative of ANZ under its AFSL in order to provide the service.

### **(iii) Regulatory oversight**

A number of regulators oversee the operations of custodians. ANZ operates under an AFSL issued by ASIC that authorises ANZ to, amongst other things, provide custodial and depository services. ASIC is responsible for the supervision and regulation of licensees. As an ADI, ANZ is also regulated by APRA and subject to APRA's supervisory regime.

It is the responsibility of the custodian to be aware of its obligations to the relevant regulators and comply with them accordingly. It is not uncommon for organisations and entities in the financial services sector to have their activities regulated by a number of regulators both within and outside of Australia. For example in Australia, ANZ's operations are regulated by APRA, ASIC and the Reserve Bank of Australia (RBA), while overseas we must comply with multiple regulators in each of the 32 countries in which we have operations.

The ASIC Act and APRA Act set out the relevant roles and responsibilities for the operation of ASIC and APRA respectively. ANZ has separate teams responsible for ensuring compliance with each Act and their regulations.

### **(iv) Proper instructions**

An authorised instruction or 'proper instruction' forms the basis for all of a custodian's dealings with custodial assets. A proper instruction is an instruction in authorised form given by a person or persons duly authorised by the RE to provide such instructions. A custodian does not have discretion to choose whether or not to act on a proper instruction which is lawfully given by the RE. For example, a custodian cannot exercise discretion in relation to acting on a proper instruction based on its view of an investment.

### **(v) Trio Capital as an ANZ customer**

In 2005, ANZ acquired the custody book of Trust Company Limited (Trust Company). As a result of this acquisition, ANZ replaced Trust Company as the custodian for custody clients of Trust Company that transferred to ANZ. Assets held by Trust Company as custodian for those clients were transferred to ANZ as custodian and were held by ANZ Nominees as sub-custodian. Trio Capital was one of Trust Company's customers that transferred to ANZ.

The role of ANZ as custodian was to hold the assets managed by the RE as bare trustee and to act on proper instructions from the RE in respect of those assets. Its duty, which is owed exclusively to the RE, is to act on proper instructions from the RE in relation to those assets.

Once proper instructions were received from a duly authorised person(s) at the RE, ANZ operations staff were required to process the transactions in accordance with those instructions. ANZ's procedures involved checking that the instructions were in proper form and signed by a duly authorised representative of the RE, executing those instructions and



recording the relevant transactions. These procedures applied equally to domestic and international transactions, including transfers of money.

The RE is responsible for managing the assets of the Scheme and is accountable for valuations and confirmation of the existence of the assets in accordance with its duties set out in Chapter 5C of the Corporations Act.

#### **(vi) Transfer of Trio Capital from ANZ to National Australia Trustees**

During 2008, as part of a strategic review of the custodian services business customers, ANZ made a commercial decision to exit arrangements with a number of smaller customers, including Trio Capital. The review included an analysis of the profitability of individual customers based on fees generated and operational costs to service those customers. The custodial arrangement with Trio Capital was terminated and Trio Capital appointed National Australia Trustees Limited (NAT) as its successor custodian in February 2009. In accordance with Trio Capital's instructions, ANZ commenced the transfer of assets held by ANZ on behalf of Trio Capital to NAT in February 2009. ANZ had transferred substantially all of the custodial assets held by it under the custody arrangements to NAT by September 2009. ANZ is continuing to work with the liquidators of Trio Capital to transfer a small number of residual assets to a successor custodian.

#### **(vii) Sale of ANZ custody business**

ANZ sold its custodian services business to JPMorgan Chase Bank, National Association in November 2009. The decision to sell the business was made in order for ANZ to focus on higher priority core banking services and because, as a regional bank, ANZ formed the view that it could not achieve sufficient scale in its custodian services business or provide the global reach now typically required by custody customers. Most of the staff in ANZ's custody business were offered positions at JP Morgan and the vast majority of staff offered roles took up those positions.

## 2. Operational aspects of a custody business

The Committee has asked for further information on two particular aspects of running a custody business: (i) the checks and balances involved as part of the transfer of monies, including the transfer to hedge funds; and (ii) fraud and suspicious matter reporting.

### (i) Transfer of monies

At ANZ, the process to transfer monies to overseas hedge funds is no different from the process adopted for all monetary transfers and is dependent on receipt of a 'proper instruction'.

As a financial institution, ANZ:

- Accepts international payment instructions from customers electronically or manually. ANZ only accepts payment instructions from customers who hold a transaction account with ANZ and have successfully satisfied ANZ's Know Your Customer (KYC) due diligence process in accordance with the relevant legislation. The KYC due diligence includes the collection and verification of specified information about customers as set out below.
- Upon receipt of the instruction, validates the customer instruction and checks against authorisations held and the account balance/limit prior to drawing the amount.
- Enables payments to be made across a variety of channels, for example an automated message sent via SWIFT (Society for Worldwide Interbank Financial Telecommunications) by a SWIFT enabled customer. SWIFT is a not for profit organisation that provides, amongst other things, secure messaging systems for member organisations. Over 9,000 financial institutions globally are SWIFT enabled including ANZ. Where a payment is made via SWIFT, the formatted SWIFT message passes through ANZ's PRIME filter (a control mechanism to compare customer and recipient details against prescribed sanctions lists) in order to comply with AML CTF Act requirements. Where there is a match, a "flag" is raised, and these are managed by a centralised team on a case by case basis.
- Transmits the SWIFT message to the relevant currency/country correspondent bank. ANZ undertakes KYC validation against the correspondent bank in line with relevant Australian legislation.



The correspondent bank will have met the minimum requirements for inclusion in the SWIFT system, including being adequately supervised, and it will also have been required to comply with its obligations under relevant legislation for that jurisdiction.

When ANZ acted as a custodian, once proper instructions were received from a duly authorised person(s) at the RE, operations staff were required to process the transactions in accordance with those instructions. Typically, a custodian services business receives instructions for transfers via SWIFT, or, where the customer is not SWIFT enabled, via fax. Operational procedures for written instructions involve checking that the instructions are in proper form and signed by a duly authorised representative of the RE and executing those instructions via a control process involving dual authorisation ('maker'/ 'checker'), i.e. one staff member is responsible for the preparation of the payment or other activity with another staff member to validate.

Transfers at ANZ are managed by appropriately appointed operations staff. As with all ANZ staff, these staff are subject to background checks, including police checks, prior to appointment. These staff are provided with the relevant discretion to process and/or authorise the payment. The value of the payment instruction is the determining factor as to the level of seniority of the staff member authorising the payment release.

#### 'Missing' funds

A question has been raised about the role of custodian in retrieving assets which have gone 'missing'. Where funds held by a custodian have gone 'missing', the custodian will have a role in assisting the liquidators and/or regulators in any attempts to retrieve those funds. Following the collapse of Trio Capital, ANZ has fully cooperated, and continues to cooperate, with ASIC and with the liquidators of Trio Capital.

## **(ii) Suspicious matter reporting and fraud**

### Suspicious matter reporting and customer identification

While ANZ no longer operates a custodian business, the following sets out our approach to suspicious matter reporting and fraud detection for our wider business.

The AML CTF Act and the Anti-Money Laundering and Counter-Terrorism Financing Rules 2007 (No. 1) require participants in the financial services industry to make due diligence inquiries when taking on prospective clients, as well as carrying out suspicious matter reporting.

The AML CTF Act was part of a legislative package to reform Australia's AML-CTF regulatory regime. As well as amending obligations in respect of suspicious matter reporting, the legislative package introduced a range of new obligations on reporting entities in relation to



customer identification and verification. Different aspects of the legislative regime commenced over stages between 2006 and 2009 (with further changes ongoing).

ANZ, as with other participants in the financial services industry, is required to report suspicious matters to AUSTRAC and adopt policies to manage these responsibilities.

The AML CTF Act requires ANZ to have an AML CTF program in place that is subject to oversight by its Board. At ANZ, this requirement is managed by the Group AML CTF policy, which contains the key obligations that apply directly to all staff. ANZ has policies, processes and training programs in place to ensure compliance with the requirements of the AML CTF Act.

The KYC process is the due diligence performed prior to taking on a new customer. The aim is to ensure that only legitimate customers are accepted into the bank and that customers are identified using reliable and independent documentation. ANZ's procedures set out the required identification and verification requirements for each entity classification.

If the entity classification is an Australian company, the information to be collected is:

- the full name of the company;
- the company's registered office address;
- the company's principal place of business address;
- the Australian Company Number (ACN);
- the full name of each director;
- the industry or nature of business; and
- whether the company is public or non-public.

The full name of the company, the ACN and the type of company are then verified through independent and external sources such as ASIC Company Searches. In addition, any directors or people associated with the company that will have authority to transfer or withdraw funds from an account must be identified and verified as an individual signatory. Information collected to identify an individual includes their full name, date of birth, residential address and occupation. Various forms of identification can be used to verify a person's identity. ANZ has a process to manage ongoing customer due diligence through regular screening of customer information.

The identification of suspicious matters is aided through transaction monitoring tools designed to detect abnormal or unusual behaviours based on certain typologies. ANZ provides guidance and training to staff to assist with the identification, and escalation, of suspicious matters.



Suspicious matters raised by ANZ staff are referred to a centralised ANZ team, ANZ Financial Intelligence Office (FIO), for further investigation. FIO acts as the escalation point to ensure that any suspicious matters sent to AUSTRAC contain complete and relevant information to assist in the broader management of financial crime. ANZ officers within FIO investigate each 'suspicious and unusual activity matter report' in order to determine whether a suspicious matter report should be provided to AUSTRAC as required under the AML CTF Act. For example, ANZ in the year to 30 September 2011 reported 1092 suspicious matters to AUSTRAC.

The AML CTF Act imposes reporting obligations on anyone who has an actual suspicion on reasonable grounds that activities referred to in the AML CTF Act are occurring, for example, tax evasion, financing of terrorism and money laundering. Prior to enactment of this legislation, reporting of suspicious transactions was regulated by the Financial Transactions Reports Act 1988. These obligations, by definition, operate where a participant has an actual suspicion on reasonable grounds of such matters. ANZ complies with any such reporting obligations.

All cross border transactions to and from ANZ are screened against a set of sanctions lists to ensure no sanctioned party or country is involved in the transaction. In addition all payment messages are also screened for transfers to and from high risk jurisdictions.

### Fraud

In relation to fraud prevention and detection, ANZ has a range of controls to mitigate the risk of fraud across its banking services. These controls include:

- screening and background checks of prospective employees and suppliers. All individuals who join ANZ (including temporary and contracting staff) are required to be screened via background checks which include both police and sanctions checks;
- training and awareness programs tailored to employees' roles and responsibilities. Employees must comply with ANZ policies such as the ANZ Code of Conduct, including a requirement to provide an annual declaration of compliance with the Code, and ANZ's AML training requirements on an annual basis;
- organisation structures which provide for segregation of duties to ensure that there is appropriate segregation between customer facing staff and those staff performing operational duties;
- validation and dual authorisation of instructions (maker/checker);

- appointment of risk and compliance teams with specific roles and responsibilities including identification and management of fraud;
- internal audit reviews and quality assurance programs; and
- centralised management of fraud matters including reporting of suspicious transactions.

Custodian services businesses undertake periodic audit and other control reviews and may also provide reports to customers under GS007 (formally AGS 1026) prepared by its external company auditor. Customer appointed auditors also have the ability to seek access to records of a custodian.

### 3. The regulatory framework – looking ahead

The Committee has sought a view on ASIC’s submission that there may be an expectation gap as to what is legally required of custodians and what investors expect from a custodian. The Committee has also sought views on the reasons for the Trio Capital collapse and whether the existing regulatory framework is adequate.

#### **(i) “Expectation gap”**

The statement by ASIC that there may be an expectation gap may stem from both the complexity of the managed investment schemes and the manner in which they operate under the regulatory environment (Chapter 5C of the Corporations Act) and from a lack of understanding of the respective role and responsibilities of the RE and the custodian.

As discussed above, the role of ANZ as custodian was to hold the assets managed by the RE as bare trustee and to act on proper instructions from the RE in respect of those assets. Its duty, which is owed exclusively to the RE, is to act on those instructions in relation to those assets. It is not part of the role or function of a custodian to value the custodial assets. The custodian has no discretion as to how to manage or invest the custodial assets. It is the RE’s responsibility to make all investment decisions in relation to scheme assets, to obtain appropriate advice about such decisions and to obtain the necessary valuations.

In this respect, ANZ agrees with the ASIC submission to the Inquiry, where ASIC explained that custodians act as bare trustees, holding the legal title of the assets of their customers without discretion as to how the assets are managed or invested.

#### **(ii) Regulatory framework**

The collapse of Trio Capital has resulted in a significant financial and emotional impact to many investors. It is evident from the results of ASIC’s investigation that the Trio Capital collapse occurred as a result of fraud rather than a direct failing of the regulatory regime.

It is an unpleasant reality that regardless of the robustness, depth and breadth of the regulatory and internal control environment, the possibility of fraud remains. Notwithstanding this, since 2008 several substantial reforms have been, or are in the process of being, introduced, including the Future of Financial Advice reforms. These reforms will work to further enhance investor protections and awareness.

ANZ is of the view that improving the general awareness of the various roles industry participants play is integral to preventing repeats of the Trio Capital collapse. We note that ASIC’s and APRA’s banning orders against former directors of Trio Capital were a result of the directors’ failing in their duties, as required by law.

The Committee may wish to consider the following suggestions in relation to further action that might be taken to address the issues raised during this Inquiry including:

- increased supervision and guidance for auditors relating to scheme audits, in particular valuation practices;
- improved standards for the education of directors and Responsible Managers on their roles and responsibilities as officers of AFSL holders;
- a requirement to review periodically the RE's reporting requirements to investors to ensure that an 'expectation gap' does not emerge over time as to what the RE is responsible for and what role investors think they are performing;
- restrictions on or increased disclosure requirements for 'high risk' or complex investments made by REs on behalf of schemes; and
- improved standards for education and training requirements for industry participants that is commensurate with their respective roles.

ANZ also notes that the Corporations and Markets Advisory Committee (in its June 2011 discussion paper on Managed Investment Schemes) raises the issue, in a different context, as to whether REs should be required to keep a separate register of scheme property.

We would be pleased to provide any further information about this submission, as required, and can be contacted as follows:

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## Appendix 1: Responses to specific questions from the Committee

### 1. What is the process for setting up as a custodian?

A financial services institution that proposes to set up a custody business would first be required to obtain the appropriate AFSL from ASIC, authorising it to, amongst other things, provide custodial and depository services.

A prospective licensee is required to complete the appropriate ASIC application form and attach the relevant supporting evidence in order to satisfy ASIC requirements. A prospective licensee is also required to meet the minimum financial standards including holding \$5 million of NTA and fulfilling the minimum cash flow requirements.

Upon being issued a licence, a licensee will be required to meet the conditions of the licence, comply with the general obligations set out in the Corporations Act and may also need to meet other regulatory requirements including:

- ASX Settlement Operating Rules regulated by the ASX Settlement Corporation;
- The AML/CTF Act regulated by AUSTRAC; and
- Various prudential standards as determined by APRA where the licensee is also an ADI.

ANZ offered custodial services in Australia and New Zealand through its business unit, ANZ Custodian Services, for approximately 50 years until November 2009. ANZ was authorised to offer custodian services pursuant to the following regimes:

- The Financial Services Reform Act 2001 granted ANZ authority to provide custodial and depository services, by virtue of ANZ operating an existing financial services business.
- From 1 October 2003, ANZ's custodian services business operated under ANZ's AFSL. The licence authorised ANZ's provision of custodial and depository services. ANZ acted as custodian and ANZ Nominees, a wholly owned subsidiary of ANZ, acted as sub-custodian. ANZ Nominees was appointed as a corporate authorised representative of ANZ under its AFSL in order to provide the service.

ANZ sold its custodian services business to JPMorgan Chase Bank, National Association in November 2009. The decision to sell the business was made in order for ANZ to focus on higher priority core banking services and because, as a regional bank, ANZ

formed the view that it could not achieve sufficient scale in its custodian services business or provide the global reach now typically required by custody customers.

**2. Can you explain the process for transferring monies to overseas hedge funds? What checks and balances are in place as part of that process?**

At ANZ the process to transfer monies to overseas hedge funds is no different from the process adopted for all monetary transfers and is dependent on receipt of a 'proper instruction'.

As a financial institution, ANZ:

- Accepts international payment instructions from customers electronically or manually. ANZ only accepts payment instructions from customers who hold a transaction account with ANZ and have successfully satisfied ANZ's KYC due diligence process in accordance with the relevant legislation. The KYC due diligence includes the collection and verification of specified information about customers as outlined in our response to Question 8.
- Upon receipt of the instruction, ANZ validates the customer instruction and checks against authorisations held and the account balance / credit limit prior to drawing the amount.
- Enables payments to be made across a variety of channels, for example an automated message sent via SWIFT by a SWIFT enabled customer. SWIFT is a not for profit organisation that provides, amongst other things, secure messaging systems for member organisations. Over 9,000 financial institutions globally are SWIFT enabled including ANZ. Where a payment is made via SWIFT, the formatted SWIFT message passes through ANZ's PRIME filter (a control mechanism to compare customer and recipient details against prescribed sanctions lists) in order to comply with AML CTF Act requirements. Where there is a match, a flag is raised and these are managed by a centralised team on a case by case basis.
- Transmits the SWIFT message to the relevant currency/country correspondent bank. ANZ undertakes KYC validation against this correspondent bank in line with relevant Australian legislation.
- The correspondent bank will have met the minimum requirements for inclusion in the SWIFT system, including being adequately supervised, and it will also have been required to comply with its obligations under the relevant legislation for that jurisdiction.

When ANZ acted as a custodian, a 'proper instruction' formed the basis for all dealings with custodial assets. A proper instruction is an instruction in authorised form given by a person or persons duly authorised by the customer, for example a RE, to provide such instructions. A custodian does not have discretion to choose whether or not to act on a proper instruction which is lawfully given by the RE.

In regard to ANZ's obligations when it acted as a custodian, once proper instructions were received from a duly authorised person(s) at the RE, operations staff were required to process the transaction(s) in accordance with those instructions. Typically, a custodian services business receives instructions for transfers via SWIFT, or, where the customer is not SWIFT enabled, via fax. Operational procedures for written instructions involve checking that the instructions are in proper form and signed by a duly authorised representative of the RE and executing those instructions via a control process involving dual authorisation ('maker'/'checker'), i.e. one staff member is responsible for the preparation of the payment or other activity with another staff member to validate.

The identification of suspicious matters is aided through transaction monitoring tools designed to detect abnormal or unusual behaviours based on certain typologies. When suspicious matters are raised by ANZ staff, these are referred to a centralised ANZ team, the ANZ Financial Intelligence Office (FIO), for further investigation. ANZ officers within the FIO investigate each 'suspicious and unusual activity matter report' in order to determine whether a suspicious matter report should be provided to AUSTRAC as required under the AML CTF Act. The FIO acts as the escalation point to ensure that any suspicious matters sent to AUSTRAC contain complete and relevant information to assist in the broader management of financial crime.

**3. At what level in the organisation does authorisation of the transfer take place?**

Transfers at ANZ are managed by appropriately appointed operations staff. As with all ANZ staff, they are subject to background checks, including police checks, prior to appointment. These staff are provided with the relevant discretion to process and/or authorise the payment. The value of the payment instruction is the determining factor as to the level of seniority of the staff member authorising the payment release. Typically, a custodian services business receives instructions for transfers via SWIFT, or, where the customer is not SWIFT enabled, via fax. Written instructions are subject to a dual authorisation process, as described above.



**4. Does ANZ, both in its role as custodian and more broadly, have a role in detecting fraud or reporting suspicious behaviour as part of that overseas transfer?**

ANZ no longer operates a custodian services business, but, as with other participants in the financial services industry, is required to report suspicious matters to AUSTRAC and adopt policies to manage these responsibilities.

The AML CTF Act imposes reporting obligations on persons who have an actual suspicion on reasonable grounds that activities referred to in the AML CTF Act are occurring, for example, tax evasion, financing of terrorism and money laundering. Prior to the enactment of this legislation, reporting of suspicious transactions was regulated by the Financial Transactions Reports Act 1988. These obligations, by definition, operate where a participant has an actual suspicion on reasonable grounds of such matters. ANZ complies with any such reporting obligations.

All cross border transactions to and from ANZ are screened against a set of sanctions lists to ensure no sanctioned party or country is involved in the transaction. In addition all payment messages are also screened for transfers to and from high risk jurisdictions.

The process for managing suspicious matters has been outlined in our response to Question 2.

**5. The submission from the Australian Custodial Services Association (submission 43 on the website) notes that "The financial services industry is particularly vulnerable to the risk of international fraud." What processes does ANZ have in place, as a custodian, to mitigate the risk?**

ANZ no longer operates a custodian services business, but in relation to the provision of other banking services, ANZ has a broad range of controls to mitigate the risk of fraud.

These controls include:

- Screening and background checks of prospective employees and suppliers. All individuals who join ANZ (including temporary and contracting staff) are required to be screened via background checks which include both police and sanctions checks;
- Training and awareness programmes tailored to employees' roles and responsibilities. Employees must comply with ANZ policies such as the ANZ Code of Conduct, including a requirement to provide an annual declaration of compliance with the Code, and ANZ's AML training requirements on an annual basis;

- Organisation structures which provide for segregation of duties to ensure that there is appropriate segregation between customer facing staff and those staff performing operational duties;
- Validation and dual authorisation of instructions (maker/checker);
- Dedicated risk and compliance teams with specific roles and responsibilities including identification and management of fraud;
- Internal audit and quality assurance programmes; and
- Centralised management of fraud matters including reporting of suspicious transactions.

Typically, custodian services businesses undertake periodic audit and other control reviews and may also provide reports to customers under GS007 (formally AGS 1026) prepared by their external company auditor. Customer appointed auditors also have ability to seek access to records of a custodian.

**6. It has been suggested (ASIC submission p72) that "there may be an expectation gap between what is legally required of custodians and what investors expect the custodian to be doing to safeguard their investment." Do you believe there is an 'expectation gap'? What is the extent of a custodian's responsibilities and to whom does a custodian have fiduciary duties?**

The statement by ASIC that there may be an expectation gap may stem from both the complexity of the managed investment schemes and the manner in which they operate under the regulatory environment (Chapter 5C of the Corporations Act) and from a lack of understanding of the respective role and responsibilities of the RE and the custodian.

As discussed above, the role of ANZ as custodian was to hold the assets managed by the RE as bare trustee and to act on proper instructions from the RE in respect of those assets. Its duty, which is owed exclusively to the RE, is to act on those instructions in relation to those assets. It is not part of the role or function of a custodian to value the custodial assets. The custodian has no discretion as to how to manage or invest the custodial assets. It is the RE's responsibility to make all investment decisions in relation to scheme assets, to obtain appropriate advice about such decisions and to obtain the necessary valuations.

In this respect, ANZ agrees with the ASIC submission to the Inquiry, where ASIC explained that custodians act as bare trustees, holding the legal title of the assets of their customers without discretion as to how the assets are managed or invested.

- 7. Custodians are generally regulated by ASIC. Where a custodian is also an Authorised Deposit-taking Institution (ADI), it is regulated by APRA. To which regulator do you report? Does this regulatory split lead to any confusion? Do you think it is clear to the regulators where the boundary lies in relation to responsibility for regulation of custodians?**

ANZ is regulated by ASIC and APRA. ANZ operates under an AFSL issued by ASIC that authorises ANZ to, amongst other things, provide custodial and depository services. ASIC is responsible for the supervision and regulation of AFS licensees. ANZ is, in its capacity as an ADI, also regulated by APRA. Where a custodian is an ADI, it will be subject to APRA's supervision in its capacity as an ADI.

It is the responsibility of the licensee to be aware of its obligations to the relevant regulators and comply with them accordingly. It is not uncommon for organisations and entities in the financial services sector to have their activities regulated by a number of regulators both within and outside of Australia. For example, in Australia, ANZ's operations are regulated by APRA, ASIC and the RBA, while overseas we must comply with multiple regulators in each of the 32 countries in which we have operations.

The ASIC Act and APRA Act set out the relevant roles and responsibilities for the operation of ASIC and APRA respectively. ANZ has teams responsible for ensuring compliance with each Act and their regulations.

- 8. *The Anti-Money Laundering and Counter-Terrorism Financing Act 2006 and the Anti-Money Laundering and Counter-Terrorism Financing Rules 2007 (No. 1)* require custodians to make extensive due diligence inquiries when taking on prospective clients, as well as carrying out suspicious matter reporting thereafter. Could you provide more details about those due diligence inquiries and, broadly, the sort of things that trigger 'suspicious matter reporting?'**

The AML CTF Act requires ANZ to have an AML CTF program in place that is subject to oversight by the ANZ Board. At ANZ, this requirement is managed by the Group AML CTF policy, which contains the key obligations that apply directly to all staff. ANZ has policies, processes and training programmes in place to ensure compliance with the requirements of the AML CTF Act.

The KYC process is the due diligence performed prior to taking on a new customer. The aim is to ensure that only legitimate customers are accepted into the bank and that customers are identified using reliable and independent documentation. ANZ's procedures set out the required identification and verification requirements for each entity classification.

ANZ has a process to manage ongoing customer due diligence through regular screening of customer information. As noted in our response to Question 4, all cross border transactions to and from ANZ are screened against a set of sanctions lists to ensure no sanctioned party or country is involved in the transaction.

If the entity classification is an Australian company, the information to be collected is:

- The full name of the company;
- The company's registered office address;
- The company's principal place of business address;
- The Australian Company Number (ACN);
- The full name of each director;
- The industry or nature of business; and
- Whether the company is public or non-public.

The full name of the company, the ACN and the type of company are then verified through independent and external sources such as ASIC Company Searches. In addition, any directors or people associated with the company that will have authority to transfer or withdraw funds from an account must be identified and verified as an individual signatory. Information collected to identify an individual includes their full name, date of birth, residential address and occupation. Various forms of identification can be used to verify a person's identity.

The identification of suspicious matters is aided through transaction monitoring tools designed to detect abnormal or unusual behaviours based on certain typologies. ANZ provides guidance and training to staff to assist with the identification, and escalation, of suspicious matters. As noted in our response to Question 2, suspicious matters raised by ANZ staff are referred to the FIO for further investigation. ANZ officers within the FIO investigate each 'suspicious and unusual activity matter report' in order to determine whether a suspicious matter report should be provided to AUSTRAC as required under the AML CTF Act. The FIO acts as the escalation point to ensure that any suspicious matters sent to AUSTRAC contain complete and relevant information to assist in the broader management of financial crime. For example, ANZ in the year to 30 September 2011 reported 1092 suspicious matters to AUSTRAC.

**9. As an ADI, ANZ is one of a series of gatekeepers that offer services within the financial advice value chain. To whom is ANZ mainly responsible as custodian?**

Following the introduction of the Managed Investments Act in 1998 (chapter 5C of the Corporations Act), the concept of a single point of accountability, being the RE, was

introduced replacing the Prescribed Interests regime (part 7.12 of the Corporations Law) of both a Manager and Trustee. The role of the RE is to manage the assets of the scheme, including activities such as investment strategies and valuations. The custodian has no discretion regarding the investment or management of the custodial assets.

The role of ANZ as custodian during the period in which it operated a custodian services business was to hold the assets managed by the RE (the customer) as bare trustee and to act on proper instructions from the RE in respect of those assets. Its duty, which is owed exclusively to the RE, is to act on proper instructions from the RE in relation to those assets. A custodian does not have discretion to choose whether or not to act on a proper instruction which is lawfully given by the RE.

**10. A custodian's central obligation is to confirm the existence of a fund's underlying assets. When was the last time this was done for the Astarra Strategic Fund or the ARP Growth fund? How was the valuation conducted?**

The suggestion that a custodian's central obligation is to confirm the existence of a fund's underlying assets is incorrect. The custodian's role and function is to hold assets on behalf, and upon instruction, of the RE as bare trustee. Its duty, which is owed exclusively to the RE, is to act on proper instructions from the RE in relation to those assets. The custodian has no discretion regarding the investment or management of the assets including conducting valuations.

The role of the RE is to manage the assets of the scheme, including activities, such as investment strategies and valuations, and is accountable for valuations and confirmation of the existence of the assets in accordance with their duties set out in Chapter 5C of the Corporations Act.

Given this division of accountabilities, this question is best directed to the Liquidators of the RE and/or the scheme auditors, to comment on the RE's actions.

**11. Why, in your opinion, did the system fail in the case of the Trio Collapse?**

The collapse of Trio Capital has resulted in a significant financial and emotional impact to many investors. It is evident from the results of ASIC's investigation that the Trio capital collapse occurred as a result of fraud rather than a direct failing of the regulatory regime. We note that Trio Capital director Shawn Richard pleaded guilty to dishonesty charges and has received a prison sentence. We also note that ASIC's and APRA's banning orders against former directors of Trio Capital were a result of the directors failing in their duties, as required by law.

It is an unpleasant reality that regardless of the robustness, depth and breadth of the regulatory and internal control environment, the possibility of fraud remains.

Notwithstanding this, since 2008 several substantial reforms have been, or are in the process of being, introduced, including the Future of Financial Advice reforms. These reforms will work to further enhance investor protections and awareness.

**12. How could the system be improved to make sure this doesn't happen again?**

As noted in Question 11 above, continued reforms will work to further enhance investor protections and awareness. ANZ is of the view that improving the general awareness of the various roles industry participants play is integral to preventing repeats of the Trio Capital collapse.

The Committee may wish to consider the following suggestions in relation to further action that might be taken to address the issues raised during this Inquiry including:

- Increased supervision and guidance for auditors relating to scheme audits, in particular valuation practices;
- Improved standards for the education of directors and Responsible Managers on their roles and responsibilities as officers of AFS licensees;
- A requirement to review periodically the RE's reporting requirements to investors to ensure that an 'expectation gap' does not emerge over time as to what the RE is responsible for and what role investors think they are performing;
- Restrictions or increased disclosure requirements for 'high risk' or complex investments made by REs on behalf of schemes; and
- Improved standards for education and training requirements for industry participants that is commensurate with their respective roles.

ANZ also notes that the Corporations and Markets Advisory Committee (in its June 2011 discussion paper on Managed Investment Schemes) raises the issue, in a different context, as to whether REs should be required to keep a separate register of scheme property.

**13. What is a custodian's role in retrieving funds that have gone missing 'on their watch'?**

Where funds held by a custodian have gone 'missing', the custodian will have a role in assisting the liquidators and/or regulators in any attempts to retrieve those funds. Following the collapse of Trio Capital, ANZ has fully cooperated, and continues to cooperate, with ASIC and with the liquidators of Trio Capital.

**14. What were the reasons for the transfer of custody [of Trio Capital] from ANZ to NAT?**

During 2008, as part of a strategic review of the custodian services business customer base, ANZ made a commercial decision to exit arrangements with a number of smaller customers, including Trio Capital. The review included an analysis of the profitability of individual customers based on fees generated and operational costs to service those customers. The custodial arrangement with Trio Capital was terminated and Trio Capital appointed National Australia Trustees Limited (NAT) as its successor custodian in February 2009. In accordance with Trio Capital's instructions, ANZ commenced the transfer of assets held by ANZ on behalf of Trio Capital to NAT in February 2009. ANZ had transferred substantially all of the custodial assets held by it under the custody arrangements to NAT by September 2009. ANZ is continuing to work with the liquidators of Trio Capital to transfer a small number of residual assets to a successor custodian.