Submission

From the Securities Industry Association

Ministry of Justice consultation paper on Phase Two of the AML/CFT Act

16 September 2016

The Securities Industry Association is an unincorporated body established to represent the New Zealand Sharebroking Industry and provides a forum for discussing important industry issues and developments, managing industry change, and to represent the broking industry in respect of legislative management, operational and regulatory issues that impact the industry as a whole.

The Securities Industry Association members employ circa 400 Authorised Financial Advisers and deal with a combined 300,000 New Zealand retail investors with total investment assets exceeding $60 billion. They also deal with virtually all global institutions with the ability to invest in New Zealand.

SUBMISSION

Introduction

Thank you for the opportunity provided to complete a submission on the Ministry of Justice consultation paper on Phase Two of the AML/CFT Act.

SIA Submission Points

Consultation document Parts 3-5 – Sector Specific Issues & Questions, Supervision and Implementation

The SIA expresses its support for the extension of the AML/CFT regime via this Phase Two proposal to capture a greater range of industries and entities without commenting in detail on the questions posed relating to the specific sector issues and implementation.

In respect of supervision, the SIA originally supported the multi-supervisor model at the time of implementation of the original regime. While we consider that the multi-supervisor model delivered efficiencies at that time, SIA preference is now moving towards the development and implementation of a single supervisor model, as noted in submissions under the "information sharing" proposal below.

Consultation document Part 6 – Enhancing the AML/CFT Act

The SIA submits on the various sections under Part 6 as follows:

Proposal: expanded reporting to the Police financial intelligence unit – Transactions vs activities

Question 1: Should the current requirement to report suspicious transactions be expanded to reporting suspicious activities? Please tell us why or why not.

SIA response: The SIA is supportive of expansion of reporting to include activities as well as transactions to assist in detecting potentially criminal activities. However, it should be noted that AML/CFT systems and monitoring and compliance programmes will need to undergo significant changes to meet such a requirement.

To avoid potential problems with the practical application of the extension of the reporting regime to include activities, it should be accompanied with clear guidance including, for example, providing a good definition of "Suspicious Activity". Consideration should also be given to making Go AML more user friendly for (both) activities and transactions. The SIA suggests that it would also be useful for the FIU to extend an invitation to organisations to further discuss the submission of STRs/SARs.

Proposal: information sharing

Question 1: Should industry regulators be able to share AML/CFT-related information with government agencies?

SIA response: At a general level, the SIA supports industry regulators being able to share AML/CFT-related information with government agencies with appropriate safeguards, while recording

the SIA developing preference for a single supervisory regime, potentially relevant to the questions raised in Part 4 of the consultation. While noting the issues that a single supervisor option may pose in the short term, there are significant long term benefits that stand to be gained, including:

1. *Market wide oversight*
2. *Uniform standards*
3. *Market wide perspective where guidance is required*

Where a single supervisory model is not pursued, equal powers and obligations should apply across all supervisors and industry regulators.

Question 2: Should AML/CFT supervisors be able to share customers' AML/CFT-related personal information with government agencies?

SIA response: Generally, we agree that the AML/CFT Supervisors should be able to share prescribed customer AML/CFT related personal information with specified government agencies for the purposes of detecting or preventing crime. Further work and information is required as to which agencies the information may be shared with, the reasons and the extent of the information sharing, and safeguards to ensure the information is only used for the purposes for which it is shared.

Question 3: What are the appropriate circumstances under which the FIU can share financial intelligence with government agencies (such as the sector supervisors, industry regulators, intelligence agencies, IRD and Customs) and reporting entities? What protections should apply?

SIA response: The FIU should be able to share information with certain prescribed government agencies for the purposes of crime prevention and detection. The parameters of the information sharing and the purpose for which it is shared and appropriate safeguards should be clearly prescribed.

With respect to the FIU sharing information with Reporting Entities, the SIA would support such an initiative. Information sharing of this nature on a more contemporaneous basis would better inform Reporting Entities of current risks and trends.

Questions 4: What restrictions should be placed on information sharing?

SIA response: As above, the agencies with which information is shared and the extent of that information sharing needs to be more fully developed to understand the extent of the envisaged information sharing and any restrictions that should reasonably apply.

Proposal: reliance on third parties

Question 1: Are the existing provisions that allow reporting entities to rely on third parties to meet their AML/CFT obligations sufficient and appropriate? If not, what changes should be made?

SIA response: We believe the existing provisions are sufficient to enable reporting entities to rely on other parties where they are working in concert with the reporting entity to provide the investing public with financial products such as an issuer or intermediary. This applies where the other party is either within their own organisational group/structure or a relevant commercial third party.

The concern we have is when reliance on an independent third party is employed. Due diligence previously undertaken on an underlying client may have satisfied legislative requirements in place at the time, however due diligence on file for the underlying client may not satisfy today's requirements where there has been no cause or reason for the entity to have reviewed the client file.

Offers of securities where client applications must be made through NZX participant firms are a significant feature of the New Zealand capital market. Recent offers of securities by issuers who are reporting entities have highlighted the need for a workable pathway for those entities to be able to rely on the CDD procedures of the NZX firms whose clients are the subscribers. In particular there should be a pathway that works for pre-2013 clients whose accounts have not yet been re-papered to the standard required by the Act, and that doesn't require all of the relevant verification information to be provided to the issuer (provided that it can be made available on request). We understand that the supervisors have demonstrated some flexibility in this regard but we believe express recognition in the Act (or by way of exemption) is appropriate.

Proposal: Trust and company service providers

Question 1: Should the scope of the provision requiring persons providing trust and company services to comply with the AML/CFT Act be extended to activities carried out in the ordinary course of business, rather than just when they're the only or principal part of a business?

SIA response: The SIA view is that any person providing trust and company services should be captured under the regime, irrespective of whether the provision of these services is in the ordinary course of the business or a principal part of the business.

Proposal: simplified customer due diligence

Question 1: Should the simplified customer due diligence provisions be extended to the types of low-risk institutions we've proposed above? If not, why?

Question 2: Should we consider extending the provisions to any other institutions?

SIA response to both questions: We agree that, as proposed, the simplified customer due diligence provisions should be extended to SOEs and majority-owned subsidiaries of publicly traded entities in New Zealand and low risk overseas countries.

However, we think these provisions should be further extended as follows:

Majority-owned subsidiaries of entities that themselves are subject to simplified customer due diligence

The rationale for extending the simplified customer due diligence provisions to majority-owned subsidiaries of publicly traded entities is, in essence, that the subsidiaries have the same ownership structure as the parent, and through their ownership are subject to the same disclosure and oversight requirements.

In our view this rationale applies equally to majority-owned subsidiaries of any entity that itself is subject to simplified customer due diligence.

This would include, for example, subsidiaries of registered banks and licensed insurers. It is very difficult to explain to such subsidiaries why, under the current rules, standard customer due diligence is required to be applied, when it is not to their owner.

AFSL licensees and ADIs

*Under the Australian AML/CFT Rules, Australian Financial Service Licence (**AFSL**) holders are subject to a form of simplified CDD – verification of company details can be achieved through a search of the relevant ASIC register (Anti-Money Laundering and Counter-Terrorism Financing Rules Instrument 2007 (No. 1), Rule 4.3.8) and details of beneficial owners need not be collected or verified at all (Rule 4.12.2(2)(a)).*

This makes sense in the Australian context given the information that is supplied to and reviewed by ASIC as part of the AFSL licensing process. This includes (see RG2: AFS Licensing Kit: Part 2—Preparing your AFS licence or variation application):

- *a business proof giving an overview of the business, including an organisational chart identifying (among other things) the positions held by the responsible managers, and the relationship between the applicant and any ultimate holding company or other group company*
- *"people proofs" for each responsible manager, including criminal history and bankruptcy checks, copies of qualifications and business references.*

Licensees are also required to notify ASIC of changes to various details, including changes to responsible managers and changes in persons controlling the licensee (see http://www.asic.gov.au/afs-change-control).

*Similarly, authorised deposit-taking institutions (**ADIs**) are subject to intensive oversight by APRA and, in Australia, are also subject to a form of simplified CDD under the Australian AML rules.*

We appreciate that AFSL holders and ADIs are not regulated in New Zealand. However, they are extensively regulated in Australia. New Zealand has recognised the benefit of mutual recognition regimes in many other areas, such as in in the provision into New Zealand of advice by AFSL holders[1] as well as relation to the offering of financial products generally.

[1] Financial Advisers (Australian Licensees) Exemption Notice 2011.

Analogously to the reasons given for the licensed managing intermediaries class exemption,[2] we think that AFSL holders and ADIs should be subject to simplified customer due diligence in New Zealand, given that:

1. *there is a low risk of money laundering and terrorism financing in respect of transactions between reporting entities and AFSL holders / ADIs because the latter operate within a heavily regulated environment; and*
2. *the requirement for a reporting entity to conduct customer due diligence on AFSL holders / ADIs:*
    a. *has associated costs, may give rise to privacy concerns, and may deter international investment; and*
    b. *is out of proportion to the risk of money laundering and terrorism financing posed by those entities.*

We also refer you to the SIA comments on the due diligence standard applicable to overseas government owned entities, as raised in our letter (dated 2 March 2016) to the Ministry of Justice and subsequent discussion (22 July 2016) with the Ministry of Justice, where we suggest that there is scope to further extend simplified customer due diligence provisions.

Other matters

The SIA would also like to use this opportunity to raise some other matters.

We understand the priority that the government wishes to accord to the implementation of Phase Two of the AML/CFT regime.

However, we submit that this consultation should not delay the development of the prescribed transaction reporting regulations development, due for implementation by 1 July 2017, and currently awaited by industry.

We submit that this consultation also provides an opportunity to consider some additional matters raised by the SIA in its letter addressed to the Ministry of Justice and dated 2 March 2016, the contents of which were also discussed between SIA representatives and Ministry officials on 22 July 2016.

Where not already captured in the submission comments above, matters raised in that letter and discussed in the subsequent meeting that we consider are worthy of further consideration are listed as follows:

- AML suspicious transaction reports and Regulation 5A
- Obligations applicable to NZX Firms to investigate and report under AML/CFT Act Section 40 and NZX Participant Rule 15.6 (Insider Trading)
- SIA submissions on the Financial Adviser Act review
    - Reducing duplication in reporting between the FAA and AML regimes
    - Extending the time period between AML audits

Rather than including expanded comment on these matters in this submission, we refer the Ministry to the SIA letter dated 2 March 2016 and the meeting agenda and discussion notes circulated following the meeting held on 22 July 2016, noting that the SIA has included copies of these documents with this submission to facilitate access to them.

[2] Anti-Money Laundering and Countering Financing of Terrorism (Class Exemptions) Notice 2014, Schedule Part 4, clause 4

In the event that the stated government priority to focus on Phase Two development and implementation precludes consideration of these additional matters at this time, we request that the Ministry consider preparing and releasing a timetable outlining when these matters (and any additional matters that may have been raised by other entities) will be considered.