## aml

**From:** [redacted]@fsc.org.nz>
**Sent:** Friday, 3 December 2021 3:08 pm
**To:** aml
**Cc:** [redacted]
**Subject:** FSC Submission - Review of the AML/CFT Act
**Attachments:** FSC Submission AML CFT Act Review 031221.pdf

**Importance:** High

Kia ora,

Please see the submission from the Financial services council regarding AML/CFT act review.

Thanks for the opportunity to be involved.

Look forward to discussing further .

Regards [redacted]

[redacted]
Chief Executive Officer

[redacted]

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Friday 3 December 2021

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**Review of the AML/CFT Act**

This submission on the Ministry of Justice (MoJ) Review of the AML/CFT Act Consultation Document, October 2021 (the Review), is from the Financial Services Council of New Zealand Incorporated (FSC).

As the voice of the sector, the FSC is a non-profit member organisation with a vision to grow the financial confidence and wellbeing of New Zealanders. FSC members commit to delivering strong consumer outcomes from a professional and sustainable financial services sector. Our 99 members manage funds of more than $95bn and pay out claims of $2.8bn per year (life and health insurance). Members include the major insurers in life, health, disability and income insurance, fund managers, KiwiSaver and workplace savings schemes (including restricted schemes), professional service providers, and technology providers to the financial services sector.

Our submission has been developed through consultation with FSC members and represents the views of our members and our industry. We acknowledge the time and input of our members in contributing to this submission.

The FSC's guiding vision is to grow the financial confidence and wellbeing of New Zealanders and we strongly support initiatives that align with our strategic intent and deliver:

- strong and sustainable customer outcomes
- sustainability of the financial services sector
- increasing professionalism and trust of the industry.

The FSC supports the objectives of the Review to improve the regime in New Zealand for preventing money laundering (ML) and financing of terrorism (FT), "without compromising the ease of doing business or unduly impacting the lives of New Zealanders". However, conducting a comprehensive review on the entirety of a substantial and wide reaching regime (comprising of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (the Act), multiple regulatory instruments, guidance, and exemptions) within a relatively small consultation window, during the Covid-19 pandemic and at a time of substantial regulatory change is not an easy task nor ideal. At this stage, our members consider there are three key principles that should be taken into consideration:

- Principle 1: Structure the regime with a much more risk based approach to deterring, detecting, and preventing ML and FT.
  This would involve reducing requirements in scenarios presenting lower risk and increasing requirements for higher risk (as determined by National and Sector Risk Assessments).

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- Principle 2: Remove all New Zealand regulatory requirements that exceed the Financial Action Task Force (FATF) requirements, primarily the verification of a physical address.
  In addition, the Review makes suggestions that go beyond any recommendations made or deficiencies identified by the FATF. Our members are concerned about the additional compliance burden placed on the private sector (as well as creating greater powers for the Financial Intelligence Unit (FIU) and other regulators) in circumstances where there appears to be no justification.
- Principle 3: Improve the non-legislative aspects of the regime so that they provide value to Reporting Entities (REs) and are not overly complex or inefficient.
  For example, the exemptions regime and guidance production (such as licensed intermediaries' guidance).

Further areas that require consideration or removal from the regime include:

- Adding prevention to the regime if it comes with either excessive compliance cost or is not otherwise offset by reduction in compliance burden in areas that do little to reduce ML or FT.
- We strongly oppose the introduction of further rules following the prescriptive Australian regime which we consider to be a backward step for New Zealand. The New Zealand regime needs more risk and principles based approaches rather than increased prescription which would result in disproportionate compliance costs particularly for those REs which have low exposure and low risk of ML or FT.
- We do not support the introduction of an additional AML/CFT license, particularly for financial services licensees who are already required to hold one or more licenses and would therefore add additional and unnecessary costs to business.

As the Review document is substantial, we have chosen to focus on key questions and removing those where we do not have feedback but noting that this is only at this stage. We appreciate the external time pressures the MoJ faces to conduct the Review, and we support working further with industry beyond the consultation timeline where possible.

I can be contacted on [redacted] or [redacted]@fsc.org.nz or [redacted], Head of Regulatory Affairs, at [redacted]@fsc.org.nz, to discuss any aspect of our submission.

Yours sincerely

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**PART 1: Institutional arrangements and stewardship**

Purpose of the AML/CFT Act

1.1 Are the purposes of the Act still appropriate for New Zealand's AML/CFT regime or should they be changed? Are there any other purposes that should be included other than what is mentioned?

We consider that the current purposes of the Act are appropriate for New Zealand's AML/CFT regime.

Insurance fraud is mentioned in the Review (which is currently outside the scope of the Act), and we consider this to be a completely different concept to ML. Insurance fraud is unrelated to ML and the proceeds of crime and people who commit insurance fraud are not necessarily trying to disguise illicit money. If the purpose of the Review is to consider extending the scope to include fraud, then all entities would need to become REs, due to the reach of fraud, which is not practical when the focus of the Act is deterring, detecting, and preventing ML and TF. However, we encourage consideration of including reference to the high occurrence of fraud in New Zealand and ways to address the gap in reporting requirements which do not inadvertently pull more entities into the regime for only this purpose.

Actively preventing money laundering and terrorism financing

1.2 Should a purpose of the Act be that it seeks to actively prevent money laundering and terrorism financing, rather than simply deterring or detecting it?

In principle, an AML/CFT regime should aim to prevent ML and FT. If it achieves deterrence but allows ML and FT, it has failed. However, purely focusing "prevention" could result in compliance costs if not thought through carefully and, especially if the requirements were not risk based. We disagree that the scope of the purpose of the Act should be broadened to include requiring REs to "actively" prevent ML/FT. This is not a gap in preventative measures identified by FATF requiring amendment.

Prevention "additions" should be offset with "subtractions" of effort where there is little risk of ML and FT. For example, as noted at Question 4.9, we submit that low or medium to low risk entities to defer CDD until a customer requests a first withdrawal should be enabled under the Act.

The burden of enforcement of the Act should not be passed onto the private sector. This suggestion appears to arise out of an appreciation of the lack of resources available within enforcement agencies to investigate suspicious activity and transactions that are reported. In addition, such an approach raises issues for REs such as the protections that are available to them when they take such preventative measures, and they may be dissuaded from reporting suspicious activity identified after a transaction has occurred. From a customer perspective, it is unknown what recourse would be available to them if their transactions were wrongly interfered with and the rights of innocent parties who are deemed 'high risk' may be impinged, both of which would have the likely consequence of damaging REs relationships with their customers as well as reputational risk.

There is a real risk that adding "prevention" will place undue burden and cost to REs that are already facing significant increases in compliance costs in a period of constant regulatory change. There is also considerable risk of unintended consequences that could severely impact the efficiency of New

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Zealand's economy and financial system. Any reforms to achieve this would need to be consulted on further with industry.

1.3. If so, do you have any suggestions how this purpose should be reflected in the Act, including whether there need to be any additional or updated obligations for businesses?

As noted in response to Question 1.2 above, any reforms in this area should be consulted on further with industry, particularly regarding proposed obligations to be placed on businesses.

Understanding our risks

1.7. What could be improved about New Zealand's framework for sharing information to manage risks?

We consider better typology and sharing of information would improve New Zealand's framework and enhance understandings such as for sector supervisors.

The FIU's Quarterly Typology Reports ceased in 2017. These were helpful for REs to have a good understanding of the types of risks faced and red flags commonly seen in their sector. Such reports also provided the opportunity for the FIU to provide a feedback loop to REs who do not often receive any feedback from the FIU once they have submitted a suspicious activity report (SAR) or suspicious transaction report (STR).

We also note that we are still awaiting the RBNZ's guidance on enforceable undertakings.

1.8. Are the requirements in section 58 still appropriate? How could the government provide risk information to businesses so that it is more relevant and easily understood?

Joint guidance provided by all three regulators does not take into account the differing risks, financial services and products and access to information within each sector (such as banks compared to other financial service providers). We consider more sector specific, practical guidance would be beneficial, such as red flags seen in specific sectors and examples of good practice. At present, a one size fits all approach is taken.

We also consider that consideration should be given to the Australian model as an option for the FIU.

Balancing prescription with risk-based obligations

1.9. What is the right balance between prescriptive regulation compared with the risk-based approach? Does the Act currently achieve that balance, or is more (or less) prescription required?

We strongly support a shift towards a more risk based approach. At present, by and large, we do not have a risk based regime and in many cases, it is "one size fits all". We consider there to be a lot of scope for the regime to rebalance to prevention in higher risk scenarios and reduce financial exclusion to New Zealanders, compliance costs and inconvenience to customers in lower risk scenarios.

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Whilst we recognise that the FATF requires a certain level of prescription in order for SAR to meet international standards and best practice, the current regime places disproportionate and inefficient obligations on businesses which have low exposure and low risk. Similarly, for those businesses which have high exposure and present high risk, further obligations and more prescriptive controls should be imposed to reflect the increased risk and likelihood of ML and FT through their financial systems.

In general, less prescription is needed. One reason for this is that the more rigid the requirements the more literally independent auditors rate issues. Our members have many examples of audit findings that require a lot of effort to resolve yet add nothing to reducing ML or FT, which we are happy to discuss further with MoJ if required.

1.10. Do some obligations require the government to set minimum standards? How could this be done? What role should guidance play in providing further clarity?

We support the provision of guidance where it adds value and clarity. However, as there are multiple supervisors overseeing compliance with the AML/CFT regime and issuing their own guidance, we recommend there is greater collaboration between supervisors to ensure it is clear to whom published guidance notes apply. In many instances, guidance issued by one supervisor will be relevant to another supervisor’s sector, so it is unclear to what extent that guidance can be relied upon by entities from another sector (and therefore not overseen by that particular supervisor). We therefore further recommend that guidance is sector focused as appropriate.

1.11. Could more be done to ensure that businesses’ obligations are in proportion to the risks they are exposed to?

In this submission we identify areas where less prescription for low or medium to low risk entities would produce better outcomes. Greater attention to high risk customers, products, methods, and jurisdictions (such as higher risk entities as identified in the National Risk Assessment) and less demands on lower and medium to low risk entities is necessary to obtain improved proportionality in the regime and, consequently, better AML/CFT outcomes.

<u>Capacity of smaller and larger reporting entities</u>

1.12. Does the Act appropriately reflect the size and capacity of the businesses within the AML/CFT regime? Why or why not?

We consider that the Act does not recognise that there are some large and complex entities offering a broad range of services to a broad customer base that still have low exposure and low risk of ML and FT. Life insurers, as an example, are within scope of the Act but the risk is relatively low compared to money remitters. The Act and its obligations are not risk based and largely disproportionate to risk in this situation. Therefore, in many circumstances it does not follow that a larger reporting entity will need to have more complex AML/CFT measures than smaller entities.

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Applying for exemptions from the Act

1.14. Are exemptions still required for the regime to operate effectively? If not, how can we ensure AML/CFT obligations are appropriate for low risk businesses or activities?

Whilst we support a more efficient exemption or exclusion process, we consider this question should apply equally to regulations as to exemptions. A more risk based regime would reduce the need for exemptions substantially, saving REs and the and MoJ time seeking relief.

Partnering in the fight against financial crime

1.24. Can the Act do more to enable private sector collaboration and coordination, and if so, what?

Allowing sharing of CDD or politically exposed person (PEP) screening information and results among REs (without any "intermediaries" exemptions or Privacy Act impediments) would facilitate AML/CFT activities immensely.

1.25. What do you see as the ideal future for public and private sector cooperation? Are there any barriers that prevent that future from being realised and if so, what are they?

We consider there to be an absence of communication between the FIU and the private sector at present. REs often do not hear from the FIU after they have filed a STR or SAR and it would be helpful if timely feedback or further information could be provided.

We consider sector specific and more applicable guidance, built by the applicable supervisor in partnership with a sector's entities, would produce better outcomes. The change to no default acceptance of expired passports is an example of a decision not in the best interests of REs or customers, adding unnecessary compliance costs and inconvenience and even potentially exclusion to some customers, particularly the elderly.

1.26. Should there be greater sharing of information from agencies to the private sector? Would this enhance the operation of the regime?

We support greater sharing of information between the public and private sector, particularly in relation to the verification of identities. An example of this would be the ability for REs to send a potential customer's name and date of birth directly and have confirmation returned from official Government sources without charge. Privacy concerns should not be an issue because the potential customers being checked have provided their information to the RE so there is nothing being disclosed in simply verifying that customers' data is valid.

Supervising implementation of targeted financial sanctions

1.34. Should supervision of implementation of TFS fall within the scope of the AML/CFT regime? Why or why not?

TFS should not be hastily implemented because there is a high likelihood of considerable compliance cost arising from such a regime. Many lower risk entities have a low likelihood of having any transactions subject to it. Exemptions for some industries should be considered, particularly those

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where all transactions are through New Zealand banks because the banks themselves sufficiently identify any TFS issues.

1.35. Which agency or agencies should be empowered to supervise, monitor, and enforce compliance with obligations to implement TFS? Why?

Whether a centralised agency for this area should be tasked with managing TFS or whether it is added to the three supervisors' remits is important. We consider the supervisors may not be the best placed in this space due to resourcing and recruitment of staff with the specialist knowledge required.

Across the entire AML/CFT regime, including TFS, we strongly support simplification, risk based and more streamlined requirements and greater collaboration and consistency between the agencies or supervisors.

Direct data access to FIU information for other agencies

1.47. Would you support regulations being issued for a tightly constrained direct data access arrangement which enables specific government agencies to query intelligence the FIU holds? Why or why not?

This is not an issue identified by the FATF in its report. Such a change is unnecessary as the Privacy Act 2020 already allows the lawful sharing of information between government agencies in appropriate circumstances. We would be concerned about government agencies having greater powers to share our customer's private information beyond current restrictions.

AML/CFT licensing for some reporting entities

1.55. Should there also be an AML/CFT licensing regime in addition to a registration regime? Why or why not?

Our members oppose the introduction of an additional AML/CFT license as it is considered a heavy regulatory tool. FSC members are already required to hold one or more licenses (with further conduct licensing to be introduced next year under the Financial Services (Conduct of Financial Institutions) Amendment Bill (CoFI Bill) and this would therefore add additional and unnecessary cost to businesses that are already closely monitored and supervised. To address particular gaps (for example, the DIA) targeted registration could be introduced. Any reforms in this area should be targeted and risk based to avoid undue burden and cost for those REs already highly regulated.

We consider that there are currently adequate protections in place under the existing licence regimes which already include fit and proper requirements for controlling owners, directors, and senior managers of registered financial institutions. In addition, regulators conduct regular ongoing monitoring visits of those financial institutions that they supervise. This is supported by the FATF who concluded in their report, "There are minor shortcomings with respect to New Zealand's ability

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to withdraw, restrict or suspend the license or registration of FIs for failure to comply with AML/CFT requirements and the range of sanctions that can be applied."[1]

1.57. Should a regime only apply to sectors which have been identified as being highly vulnerable to money laundering and terrorism financing, but are not already required to be licensed?

We recommend a more targeted approach to those entities that are not already subject to other licensing regimes, are AML/CFT REs, and are at the higher risk end such as remitters. However, we would support measures that impact an existing license if a significant AML/CFT breach or breaches occurred.

The objective here appears to be to enable supervisors to identify those businesses within their scope of supervision. We consider this to be an unnecessary compliance cost not justified in the circumstances as such information could easily be obtained elsewhere. In addition, if the concern is ensuring compliance with the Act, then licencing conditions can be amended for those REs who are already registered or licenced under an alternate regime.

We consider any fees or levies to REs for obtaining an AML/CFT licence is contrary to current licences in the financial sector which a distinct benefit to the RE arises from the activities the licence enables. Conversely, there is no direct benefit to REs from fulfilling AML/CFT obligations.

Registration or licensing fee

1.60. Would you support a levy being introduced for the AML/CFT regime to pay for the operating costs of an AML/CFT registration and/or licensing regime? Why or why not?

We do not support the introduction of a levy for the reasons outlined in response to Question 1.55 and 1.57. As previously noted, the financial services sector is already facing rising compliance costs due to substantial regulatory reforms. Any potential levies should be considered holistically and in the context of new and existing fees and levies imposed by the Financial Advice Provider regime (introduced under the Financial Services Legislative Amendment Act 2019), the upcoming conduct licensing regime under the COFI Bill, for insurers, Insurance Prudential Supervision Act licensing costs and other proposed levies from the FMA for the climate-related disclosures regime and Insurance Contracts Act reforms.

However, consideration may need to be given to licensing and adoption of a levy on a risk based approach for high risk sectors at the top end of the risk scale and those who are not already subject to other licensing requirements or if a significant AML/CFT breach or breaches occurred.

[1] FATF Anti-money laundering and counter-terrorist financing measures New Zealand, Mutual Evaluation Report, April 2021, page 223.

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**PART 2: Scope of the AML/CFT Act**

Definition of financial institution activities

2.12. Should the terminology in the definition of financial institution be better aligned with the meaning of financial service provided in section 5 of the Financial Service Providers (Registration and Dispute Resolution) Act 2008? If so, how could we achieve this?

We disagree that the definition of financial institution should be consistent with the definition adopted in section 5 of the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSPA). This would significantly broaden the scope of the AML/CFT Act to entities not intended to be captured by the Act. For example, the FSPA defines financial institutions to include any entity 'acting as an insurer' whereas the AML/CFT Act limits its scope to 'issuing, or undertaking liability under, life insurance policies as an insurer'.

The scope of the Act should only be broadened where justified due to need to mitigate risk.

Non-life insurance businesses

2.28. Should non-life insurance companies become reporting entities under the Act?

The FSC's health insurance members have concerns that if they were to become REs the cost of compliance, fees and to employ an AML Officer would not be insignificant and this cost may be passed on to customers through an increase in premiums.

Health insurance products involve risk transfer for a premium calculated by the insurer. The only way to launder money would be to request a refund of premium. Given that the premiums are relatively small and health insurers set it based on the risk, it is not possible for customers to launder a substantial amount of money through the sale of health insurance products. There is also a risk of invariable false positives which could create delays in people acquiring or the management of insurance by insurers which is counter to good customer outcomes.

We note that the FATF in their report concluded that, "The main area identified as lower-risk and not warranting significant focus during the course of the assessment is insurance. The insurance products most at risk of exploitation for ML are not sold in New Zealand, mitigating many of the associated ML/TF risks".[2]

As noted above, in addition to health insurance, we consider the non-life sector is unlikely to be exploited by money launderers. Accordingly, at present there is no justification for extending the scope of the Act to this low risk sector. Non-life insurance providers already monitor for and have appropriate controls in place to identify fraud and suspicious behaviour which includes the monitoring of suspicious overpayments and requests for refunds. Nevertheless, such REs are dealing with very low volumes of money.

[2] FATF Anti-money laundering and counter-terrorist financing measures New Zealand, Mutual Evaluation Report, April 2021, page 19, paragraph 56.

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Currently exempt sectors or activities

2.39. Are there any other regulatory or class exemptions that need to be revisited, e.g. because they no longer reflect situations of proven low risk or because there are issues with their operation?

We support maintaining current exemptions for existing life insurance policies that are closed to new customers and new premiums, low value life insurance policies and pure risk based (non-life) insurance policies. Such exemptions were granted due to the low potential for ML in such sectors and we are not aware of any evidence that these sectors are now being exploited for the purpose of ML to warrant a review.

Further detail on exemptions for workplace savings schemes is contained in Appendix One of this submission.

**PART 3: Supervision, regulation and enforcement**

Agency supervision model

3.1. Is the AML/CFT supervisory model fit-for-purpose or should we consider changing it?

We consider the current model to be a one size fits all and that inevitably causes requirements for lower risk entities with lower risk customers to be above what would be applied suitably in a truly risk based regime.

3.2. If it were to change, what supervisory model do you think would be more effective in a New Zealand context?

As noted in our response to Question 1.35, we strongly support simplification, risk based (as noted throughout this submission) and more streamlined requirements and greater collaboration and consistency between the agencies or supervisors. However, we consider sector specific guidance to be most efficient to be issued by a separate policy division of each supervisor.

Mechanisms for ensuring consistency

3.3. Do you think the Act appropriately ensures consistency in the application of the law between the three supervisors? If not, how could inconsistencies in the application of obligations be minimised?

We consider great consistency could be achieved if policy was separated from monitoring and supervision. The current regime has the advantage that generally REs with licences issued by the FMA tend to also be supervised by the FMA. Likewise, licensed insurers under RBNZ are supervised for AML/CFT by the RBNZ. However, where this does not work so well is in formulating guidance for example.

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3.4. Does the Act achieve the appropriate balance between ensuring consistency and allowing supervisors to be responsive to sectoral needs? If not, what mechanisms could be included in legislation to achieve a more appropriate balance?

Gaining consensus among three government agencies, each with its own personalities and sector specific concerns is not efficient. Therefore, we encourage consideration of separating policy from monitoring and supervision.

Powers and functions

3.5. Are the statutory functions and powers of the supervisors appropriate or do they need amending? If so, why?

We consider that enforcement should be focused on egregious breaches, avoiding penalties that are disproportionate to the harm. Our members are committed and focused on complying with the Act and should not be penalised for unintentional and minor breaches.

Independent auditors

3.11. Should explicit standards for audits and auditors be introduced? If so, what should those standards be and how could they be used to ensure audits are of higher quality?

Rather than explicit standards, we consider the introduction of guidelines in this space (reflective of the risk and size of the RE that they are auditing) would be more helpful, clearly articulating audit requirements and the objectives for such audits. A checklist to assist REs to prepare for audits would also be helpful.

We are also concerned about the consistency and quality of audits conducted in the market. There are presently no standards applicable to independent auditors to ensure the consistency and quality of these reviews. We agree that independent auditors should be restricted to those who are appropriately qualified, however, greater guidance or regulation is required to ensure minimum standards are adopted (such as a Chartered Accountant or Association of Certified Anti-money Laundering Specialist qualification). REs are often not in a position to identify those who are not meeting requirements of the Act, audit guidelines, and expectations of regulators. We also consider regulation of auditors would prevent auditor shopping.

The FSC supports adopting an approach where the frequency of audits required is in proportion to risk, namely every two years for higher risk sectors, and five years for lower risk.

3.14. Should there be any protections for businesses which rely on audits, or liability for auditors who do not provide a satisfactory audit?

We agree that REs who in good faith rely upon an independent auditor’s report (and any advice received) should be afforded certain protections under the Act.

In addition, the ability to bar an auditor who is found to be inadequate could be considered. That, together with introducing a requirement to be re-audited if the current auditor is later barred, would incentivise auditors to improve their performance.

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Allowing for intermediary enforcement options

3.21. Does the existing penalty framework in the AML/CFT Act allow for effective, proportionate, and dissuasive sanctions to be applied in all circumstances, including for larger entities? Why or why not?

We refer to our response to Question 3.5.

3.22. Would additional enforcement interventions, such as fines for noncompliance or enabling the restriction, suspension, or removal of a licence or registration enable more proportionate, effective, and responsive enforcement?

Penalties should be focused on actions that facilitated ML or FT (or made it much more likely). Administrative failings such as reporting, or slightly overdue audits, should not trigger penalties as they do not mean ML or TF happened or was materially more likely.

Sanctions for employees, directors, and senior management

3.25. Would broadening the scope of civil sanctions to include directors and senior management support compliance outcomes? Should this include other employees?

We disagree that the Act should incorporate penalties for directors, senior management, and employees to ensure compliance with the Act. Any such penalties should be limited to conduct that is egregious and at a level where it could be said that they were facilitating ML rather than mere technical non-compliance.

We also note that there is extensive legislation and regulation in the industry that impose potential liability on directors and senior managers. Businesses may be unable to employ high quality candidates who are willing to take on such risk in the scope of the Act was broadened to include personal liability.

**PART 4: Preventative measures**

Customer due diligence

4.1. What challenges do you have with complying with your CDD obligations? How could these challenges be resolved?

Our members face many practical challenges in complying with CDD obligations whilst also trying to maintain an efficient and reliable financial system. Some of the challenges in meeting CDD obligations seem to be disproportionate to the obligation’s usefulness in achieving the purpose of detecting or deterring ML and FT. To resolve these challenges, we recommend consideration is given to removing those obligations that that exceed FATF’s requirements.

A prime example of this is the requirement to verify a customer’s physical address. This appears to have nominal value in achieving the Act’s objectives, provides significant practical challenges under the current constraints and has had significant time and cost implications on REs since 2013.

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Collectively, it is also a huge inconvenience to New Zealanders who seek to use financial products or access financial services. This is more onerous than the FAFT recommendations[3] and "for low income individuals particularly the requirement for the "proof of address" can be more challenging than the proof of identity."[4] This limits the ability to adopt a risk based approach which we consider crucial to the improvement of the New Zealand regime. The FATF recommendations state that CDD measures are "Identifying the customer and verifying that customer's identity using reliable, independent source documents, data or information"[5] and we note the support of a risk based approach[6] and no mention of address verification. It is also not part of the comparatively "prescriptive" Australian AML/CFT regime.

We also consider the CDD requirements need to be updated to reflect modern practices. For example, with the development of internet and electronic banking, obtaining a bank deposit slip or going into a branch is not as commonplace as it was at the commencement of the Act. The same can be said for online billing, which has had a negative impact on verifying physical addresses, further emphasising the need for this obligation to be reviewed.

We also support the reduction in who can be a Trusted Referee under the Code[7]. Specifically, it should be limited to those who are members of recognised professional bodies, whose obligations include honesty and integrity, and whose membership of those bodies can easily be verified.

<u>Definition of a customer</u>

4.2. Have you experienced any situations where trying to identify the customer can be challenging or not straightforward? What were those situations and why was it challenging?

One of our members has provided an example of difficulties in conducting CDD on a statutory court appointed entity which we consider unnecessary.

4.3. Would a more prescriptive approach to the definition of a customer be helpful? For example, should we issue regulations to define who the customer is in various circumstances and when various services are provided?

We consider the definition of a customer needs to be clearer, in particular noting that a "facility holder" meets the definition in the Act but it is unclear what this means.

4.5. Do you anticipate that there would be any benefits or additional challenges from a more prescriptive approach being taken?

CDD on entities and trusts is commonly time consuming and complex. Most people, even with internal and industry guides, still struggle to determine all the persons who require CDD under the current regime. This results in demands on compliance staff and even lawyers to help with

[3] FATF Guidance Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion, page 28
[4] ibidem.
[5] International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation, The FATF Recommendations, Updated October 2021, page 14.
[6] ibid, page 15.
[7] FMA, RBNZ and Internal Affairs Amended Identity Verification Code of Practice 2013.

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determining all the persons needing verification. A more prescriptive approach may help, however we consider what would provide most value would be conducting CDD on less people.

Consideration of only conducting CDD on one natural person when establishing a corporate or trust relationship could be a suitable approach, leaving complete enhanced CDD (ECDD) to occur on first withdrawal or if a suspicion is formed about the customer.

For many of FSC members, including those with mass market KiwiSaver schemes and investment products where the client has a financial adviser, CDD is not really CDD at all. It is really verification of identity. That is conceptually very different as CDD carries with it an expectation of aiding in identification of activities and transactions that are suspicious due to knowledge of the customer (or "KYC"). We consider verification of identity provides nominal value in achieving the purposes of the Act, since the customer is either essentially anonymous or one step removed insofar as understanding their goals and personal situation, due to being intermediated.

When CDD must be conducted

4.9. Are the prescribed points where CDD must be conducted clear and appropriate? If not, how could we improve them?

We encourage consideration of CDD being conducted at the time of first withdrawal rather than at time of onboarding. If this became common place customers would expect and anticipate the requirements and appreciate being about to open accounts more easily, knowing that they would be verified later.

Greater clarification as to REs ongoing CDD obligations is required. At present, supervisors are interpretating these obligations as requiring REs to rereview all customer files on a periodic basis commensurate to the level of risk. A more risk based approach needs to be adopted where REs only review a customer's file and require updated CDD where there has been a material change in the nature and purpose of the relationship or a suspicious activity identified.

Conducting customer due diligence in all suspicious circumstances

4.13. How can we ensure that this obligation does not put businesses in a position where they are likely to tip off the person?

We consider the expectation and requirement not to tip off a customer when ECDD is conducted is unrealistic. We propose either requiring ECDD and that the RE should not "intentionally" tip off a customer (which also poses evidential challenges) or to allow the RE when submitting an SAR, to determine whether ECDD is actually needed in the circumstances. We consider the requirement to do both is unrealistic.

Anyone who is in fact committing ML or FT will be tipped off if they are asked for unusual information, which causes needless compliance effort and even stress for REs' staff. For example, if an SAR is made, the customer will need to ECDD to be conducted, yet they may have already had this conducted only one week prior.

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Source of wealth versus source of funds

4.25. Should we issue regulations to prescribe when information about a customer's source of wealth should be obtained and verified versus source of funds? If so, what should the requirements be for businesses?

The requirements to identify source of funds or source of wealth is considered particularly difficult and should only be required in circumstances where it is logical, primarily when a potential suspicious activity is identified. At that juncture, source of funds information may add value because the suspicion could either be eliminated, reduced or increased depending on the customer's response.

We consider that the current universal requirement needs to be refocused to a more risk based approach. For example, REs are required to conduct ECDD on all customers who are trusts and trusts are more widely used in New Zealand compared to overseas and therefore ECDD should not be required for lower risk, longstanding family trusts.

Beneficiaries of life and other investment-related insurance

4.28. Should we issue regulations to require businesses to obtain information about the beneficiary/ies of a life insurance or investment related insurance policy and prescribe the beneficiary/ies as a relevant risk factor when determining the appropriate level of CDD to conduct? Why or why not?

As noted at Question 2.28, this sector is globally considered low risk and so we do not agree with the adoption of any unnecessary compliance costs where there is an absence of information that this sector is being exploited.

Although there are no specific CDD requirements for life Insurance, adequate controls and processes are in place, particularly during claims assessment process, to identify fraud and or suspicious activity. For example, the beneficiaries of any insurance product are the policyowners whose identities are verified at the claims assessment stage, proof of bank account in the policyowner's name is always required and evidence of the triggering event is required (death certificate or medical records).

Definition of beneficial owner

4.30. Have you encountered issues with the definition of a beneficial owner? If so, what about the definition was unclear or problematic?

We consider that the CDD requirements on the current definition of beneficial owners need to be reconsidered. From a starting point, there is general confusion on what a beneficiary or beneficial owner is which can prove challenging for REs when attempting to conduct CDD. This is particularly the case for trusts and where conducting CDD on multiple beneficiaries can be difficult and time consuming for compliance staff and as noted at Question 5.8 there are possible privacy issues.

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4.31. How can we improve the definition in the Act as well as in guidance to address those challenges?

Clarification in simple terms is required on what a beneficiary or beneficial owner is to enable better understandings and perhaps also guidance in this space. It is important that the true beneficiaries are correctly identified and have CDD conducted on them to reduce the prevalence of using these often opaque vehicles to hide the source of funds and wealth and launder funds.

Ultimate' ownership and control

4.32. Should we issue a regulation which states that businesses should be focusing on identifying the 'ultimate' beneficial owner? If so, how could "ultimate" beneficial owner be defined?

We do not consider that further regulation is required given the complexity and costs of compliance of the regime at present and attention should be placed on streamlining and simplification.

Verifying the address of customers who are natural persons

4.50. What challenges have you faced with verification of address information? What have been the impacts of those challenges?

We refer to our response to Question 4.1.

4.51. In your view, when should address information be verified, and should that verification occur?

We refer to our response to Question 4.1 and consider address verification requirements should be reconsidered.

4.52. How could we address challenges with address verification while also ensuring law enforcement outcomes are not undermined? Are there any fixes we could make in the short term?

We refer to our response to Question 4.1. Although we consider that address requirements should be removed, an exception could be in the cases where ECDD is conducted on filing a SAR. At that point the customer's physical address(es) may be relevant for law enforcement. This, of course, would be a tiny percentage of the address verification completed today and would be truly risk based.

Mandatory enhanced CDD for all trusts

4.58. Should we remove the requirement for enhanced CDD to be conducted for all trusts or vehicles for holding personal assets? Why or why not?

We support the removal of the requirement for ECDD to be conducted for all trusts and as noted throughout this submission, a risk based approach. Only those trust which have been identified as high risk should be required to have ECDD conducted, such as foreign trusts, and not low risk family trusts that constitute the bulk of trusts in New Zealand. This is subject of course to any suspicions being raised.

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Avoiding tipping off

4.72. Should the Act set out what can constitute tipping off and set out a test for businesses to apply to determine whether conducting CDD or enhanced CDD may tip off a customer?

Our members consider that there is a real risk of tipping off a customer when conducting ECDD upon identifying AML/CFT concerns or suspicions. We refer to our response to Question 4.13 for our proposed requirements and guidance as to what constitutes tipping off would be helpful as well as practical tips for achieving enhanced CDD without alerting the customer to suspicions.

Politically Exposed Persons

4.79. Do you have any challenges with complying with the obligations regarding politically exposed persons? How could we address those challenges?

Some members support the definition of a PEP to be extended to include domestic PEPs. Other members do not agree that the definition of a PEP should be extended to include domestic PEPs given the lower level of corruption in New Zealand and consider this extension would amount to an additional compliance burden without justification.

Some members consider that PEP screening for low risk entities contributes a huge compliance cost with nominal return in achieving the purposes of the Act. Add to that the inability to exit the business relationship even if a PEP is found (for example you cannot compulsorily cease the KiwiSaver membership) means that the PEP regime requires considerable review.

Including TFS implementation in an AML/CFT programme

4.103. Should legislation require businesses to include, as part of their AML/CFT programme, policies, procedures, and controls to implement TFS obligations without delay? How prescriptive should the requirement be?

TFS is an area that potentially would add considerable compliance costs to REs. This is especially so if the rules and requirements were made one size fits all. An expansion of the regime in this area needs to be proportionate to the risks involved.

Prescribed transaction reports

4.156. Are the prescribed transaction reporting requirements clear, fit-for purpose, and relevant? If not, what improvements or changes do we need to make?

Our members have raised concerns regarding the potential multiple reporting of the same transactions when there is more than one entity in the supply chain or where an intermediary is involved, for example. Clarification is sought on circumstances where several providers collectively meet the reporting thresholds. We suggest consideration of alignment with the Australian model in this space is appropriate.

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Compliance programme requirements

4.187. Are the minimum requirements set out still appropriate? Are there other requirements that should be prescribed, or requirements that should be clarified?

We do not consider that there is need for more prescription to compliance programme requirements. The regime is currently prescription heavy, and we consider the emphasis needs to be placed on better education and illustration of practical implementation of Risk Assessments and case studies of how those were applied in practice.

4.188. Should the Act mandate that compliance officers need to be at the senior management level of the business, in line with the FATF standards?

We disagree that the Act should mandate that compliance officers should be at the senior management level as any possible risks are mitigated by requiring compliance officers to report directly to senior management or an entity's board.

We agree that the compliance officer should be a natural person rather than an entity so that it is clear that there is an appropriately qualified person within a RE is responsible for ensuring compliance with the Act.

Review and audit requirements

4.193. Should legislation state that the purpose of independent audits is to test the effectiveness of a business's AML/CFT system?

We agree with this purpose subject to the clarification that testing effectiveness is achieved via general sampling, focusing on material issues rather than granular findings. Some of our members have noted that auditors often focus on minor compliance issues (such as updated passport details have not been obtained when recently expired) rather than whether internal processes and controls are working effectively to detect ML and FT.

Whilst such findings are helpful, it is preferable that they are noted suggestions rather than formal recommendations or impacting the final audit findings. However, we acknowledge that this would be dependent on the impact of such granular findings in their totality on the overall effectiveness of a RE's AML/CFT compliance programme.

4.194. What other improvements or changes could we make to the independent audit or review requirements to ensure the obligation is useful for businesses without imposing unnecessary compliance costs?

We refer to our response to Question 3.11 that the frequency of audits in proportion to risk, namely every two years for higher risk sectors, and five years for lower risk and due to the cost to business, not only in fees for service but also the costs to business. It is important that the inherent risk of the entity's sector is taken into account (for example money remitters generally should be audited more frequently than life insurers), as well as the result of the most recent audit, namely residual risk, should also drive the frequency of AML/CFT audits.

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Privacy and protection of information

5.8. Does the AML/CFT Act properly balance its purposes with the need to protect people's information and other privacy concerns? If not, how could we better protect people's privacy?

We consider a more risk based approach should be adopted to the requirement to obtain ECDD so that REs are not unreasonably interfering with a customer's privacy.

FSC members have raised concerns in the context of the recent reforms introduced under the new Privacy Act 2020 and whether the Act is in alignment. An example is in the case of ongoing CDD where the CDD that was conducted at the commencement of the relationship may have pre-dated the new Privacy Act. Therefore, the customer would not have been given sufficient information as to the purpose of collecting their personal information to cover requirements of the Act and is therefore in breach of new privacy laws when conducting ongoing CDD and passing on personal information to other agencies.

Privacy is also a concern in relation to opening accounts for trusts where beneficiaries of a trust may not be aware that their personal information is being provided as part of the account opening process.

Enabling the adoption of digital identity

5.14. What additional challenges or barriers may exist which would prevent the adoption of digital identity once the Digital Identity Trust Framework is established and operational? How can we overcome those challenges?

Whilst we support the development of the Digital Identity Trust Framework and the potential efficiencies this may bring to the CDD process, there remains a residual risk of identity fraud and there are also access limitations for some members of society which need to be worked through.

Harmonisation with Australian regulation

5.15. Should we achieve greater harmonisation with Australia's regulation? If so, why and how?

Where a risk based approach can be adopted which is consistent with Australia this is supported especially as many New Zealand entities have Australian parent companies.

**PART 6: Minor Changes**

6.2. Are there any other minor changes that we should make to the Act or regulations?

- Consistency is sought on training for AML/CFT training providers, not only on training material but also to ensure consistent standards.
- We do not support the proposal to amend section 58(2) to ensure that a business' risk assessment reflect government advice about national and sectoral risks. Higher risk aspects within Sector Risk Assessments may be inapplicable to some REs despite being in a sector. For example, if a RE has a "closed" book of business" many risks are not present. Such a RE's risk assessment does not need to "reflect" a SRA. The current wording, "have regard to", provides the flexibility needed.

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- We do not support the proposal to issue regulation which explicitly requires businesses to verify any new information obtained through ongoing CDD. This would add unnecessary compliance costs, namely CDD is of little value in most cases where it is completed and increasing requirements regarding such CDD would not improve detection or deterrence of ML or FT.
- We do not support the proposal to issue regulation which requires businesses to retain copies of records in New Zealand to ensure they can be easily accessible when required. We note many REs store such records in cloud services. Those services are often overseas, so requiring copies to be stored in New Zealand does not reflect the reality of globalisation. However, the expectation that records are readily accessible is reasonable.

Definitions and terminology (Issues identified and proposals for change)

- We note that lawyers on settlement of transaction are not intended to be covered (as there is no business relationship) but clarification on that would be helpful.
- We consider the definition of high risk requires clarification in the National Risk Assessments or in the Act.

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**Appendix One: Exemptions for workplace savings**

Most workplace savings retirement schemes rely on the exemption contained in:

- regulation 20A of the Anti-money Laundering and Countering Financing of Terrorism (Exemptions) Regulations 2011 (Regulation 20A) for relevant services provided in respect of certain employer superannuation schemes as defined in that regulation; or
- Part 3 of the Schedule to the Anti-money Laundering and Countering Financing of Terrorism (Class Exemptions) Notice 2018 (Class Exemption Notice) for services provided in relation to certain retirement schemes.

Other retirement schemes have bespoke exemptions which have been granted by the MoJ, several of which will be brought within the scope of the Class Exemption Notice effective 1 December 2022 (under paragraph (d) of the "specified retirement scheme" definition). We understand these are not within the scope of the Review, however, we note that the MoJ is reviewing the process for granting such exemptions. As noted at Question 1.14 of this submission, we support a more efficient exemption or exclusions process.

We consider there to be no need to revisit Regulation 20A or the Class Exemption Notice and we support the continuance of Regulation 20A and Part 3 of the Schedule to the Class Exemption Notice for the following reasons:

- there is no evidence to suggest that the risk profile of the retirement schemes which rely on these (appropriately conditional) exemptions has changed. We consider these schemes pose a very low risk of ML or TF, which is further mitigated by the strict exemption conditions;
- any risks posed by additional voluntary contributions, transfers from international sources and withdrawals which are permitted in the Class Exemption Notice are addressed by the conditions in the Class Exemption Notice; and
- requiring the relevant retirement schemes to comply in full with the Act would require them to incur significant compliance costs which are not justified given the low risk profile of the schemes. It is also highly probable that any such compliance costs would be passed onto members of the schemes, impacting their retirement savings.

<u>Clarifying the scope of Regulation 20A</u>

Regulation 20A currently permits additional contributions through payroll, provided they are determined as a percentage of salary or wages (clause (c) of the definition of limited employer superannuation scheme). In practice, there has been confusion amongst retirement schemes and regulators regarding the interpretation of clause (c) and it has been read as superimposing requirements that it must be expressed in the trust deed a maximum percentage that members can contribute as a voluntary contribution.

We do not consider this is what was intended, particularly given that allowing unlimited voluntary contributions from salary will not change the risk profile of the schemes as accepting further contributions from salary or payroll is low risk.

Not requiring retirement schemes or members to be bound by maximum limitation in trust deeds will assist many members with their retirement saving goals, particularly as they get closer to retirement age, by allowing them to contribute additional amounts from salary or payroll when feasible.

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We recommend that the MoJ uses this opportunity to clarify in Regulation 20A that there is no maximum percentage that members can contribute as a voluntary contribution and that members may make unlimited voluntary contributions provided that they are from salary or payroll and do not exceed their salary.

Extending the scope of the Class Exemption Notice

Part 3 of the Schedule to the Class Exemption Notice applies to "specified retirement schemes" being a scheme that either:

- does not meet the requirements of Regulation 20A because it permits transfers from equivalent overseas retirement schemes and regular leave of absence contributions; or
- is listed in clause (b), (c) and, from 1 December 2022, clause (d) of the definition of "specified retirement scheme".

Part 3 of the Schedule to the Class Exemption Notice differs from Regulation 20A in that it permits schemes subject to the notice to allow the following types of voluntary contributions:

- specified voluntary contributions, being:
  - regular leave of absence contributions from non-payroll sources during an unpaid leave of absence;
  - contributions for the purpose of purchasing additional pensionable service or restoring pensionable service;
  - voluntary contributions made other through payroll to a complying fund to enable a member to maximise any Government Contributions; and
  - these contributions are subject to conditions and standard CDD or ECDD requirements.

There is no scope within the Class Exemption Notice to allow for schemes to accept voluntary contributions outside of the above exceptional circumstances without requiring a scheme to comply in full with the Act. However, many of these schemes have members nearing retirement who do not require their full net salary to live on and who would like to make significant additional contributions from their salary into their retirement scheme.

We submit that such voluntary contributions from salary or payroll should be included in the definition of "specified voluntary contributions" in the Class Exemption Notice without any conditions. Though such additional contributions come through payroll they cannot reliably be said to comply with the requirements of Regulation 20A unless they are determined as a percentage of salary or wages.

Allowing such contributions will not change the risk profile of the schemes as accepting further contributions from salary/payroll is low risk. It will also assist many members with their retirement saving goals by allowing them to contribute additional amounts from salary or payroll. For consistency, we submit that allowing such additional voluntary contributions from salary or payroll that are not determined by as a percentage for salary or payroll should also be considered for other employer superannuation schemes under Regulation 20A.

Finally, the FSC submits that the Class Exemption Notice should be amended to clarify that voluntary contributions are permitted for the schemes listed in clause (b), (c) and, from 1 December 2022, clause (d) of the definition of 'specified retirement scheme' provided that they are determined as a percentage of salary or wages (consistent with Regulation 20A). Any such amendments should

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reflect any clarifications made to Regulation 20A as suggested under the heading 'Clarifying the scope of Regulation 20A'.