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Ministry of Justice Consultation Paper on the Statutory Review of the AML/CFT Act

1. Introduction

1.1 This submission is made in response to the Ministry of Justice (**MoJ**)'s consultation paper on the statutory review of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (**Act**), *Review of the AML/CFT Act – Consultation Document,* dated October 2021 (**Consultation Paper**).

1.2 It is made on behalf of MinterEllisonRuddWatts, a national law firm with one of New Zealand's leading anti-money laundering and countering financing of terrorism (**AML/CFT**) practices. We have been extensively involved in this area of law since 2008, including advising clients under the prior regime, leading submissions at the Select Committee on the Bill which became the Act, and then in relation to the Phase Two amendments, as well as advising many clients in relation to the current AML/CFT regime.

1.3 We appreciate very much this opportunity to contribute to the improvement of the AML/CFT regime, to build on the experience of the current regime, and to respond to the significant changes in society and in business since 2009 in order to make the regime more fit for purpose. We also take this opportunity express our appreciation for the constructive way in which the MoJ has conducted this consultation so far, reaching out to a wide range of organisations to ensure that all New Zealanders have their say.

1.4 This submission reflects our own views and not necessarily those of any of our firm's clients. Furthermore, while we have considered the Consultation Paper in its entirety, our submission will only cover the most significant issues we wish to raise in relation to the statutory review of the Act.

2. Structure and approach of this submission

2.1 Our submission is structured as follows:

(a) Part 1 sets out our views on the general policy that should inform New Zealand's AML/CFT regime. In short, we believe that our AML/CFT regime should strike the right balance between taking a strong approach to detecting and deterring money laundering and terrorism financing on one hand, and enabling financial inclusion, innovation, and business efficiency on the other.

(b) Part 2 sets out specific issues that we submit should be addressed as a priority as part of the MoJ's statutory review of the Act. The issues relate to:

(i) the current and proposed treatment of virtual asset service providers (**VASPs**);

(ii) the current address verification requirements for customer due diligence (**CDD**);

(iii) the proposed regulation of auditors, consultants, and agents;

(iv) the proposed licensing of certain “high-risk” reporting entities;

(v) the supervisory model behind the AML/CFT regime;

(vi) the filing of prescribed transaction reports (**PTRs**) in the context of international wire transfers;

(vii) the territorial scope of the Act;

(viii) reliance on others in relation to CDD obligations;

(ix) trusts and the requirement to conduct enhanced customer due diligence (**EDD**);

(x) the power to wholly or partially exempt businesses or classes of businesses or transactions from AML/CFT obligations;

(xi) the interaction between the requirement to terminate a business relationship following a failure to complete EDD and the requirement not to tip off a customer about the possibility of a suspicious activity report (**SAR**) being lodged in relation to them; and

(xii) the interaction between the Act and the KiwiSaver Act 2006.

PART 1

3. We believe that our AML/CFT regime should strike the right balance between taking a strong approach to detecting and deterring money laundering and terrorism financing on one hand, and enabling financial inclusion, innovation, and business efficiency on the other.

3.1 A robust, effective, and modern AML/CFT regime is crucial for New Zealand, both in terms of domestic law enforcement and keeping in line with the march of international obligations. Effectively detecting and deterring money laundering and terrorism financing helps to ensure a safer, fairer society for everyday New Zealanders domestically, and helps to enhance New Zealand’s standing in the international community. We support taking a strong approach as an important part of reducing the level of criminal activity in New Zealand, that is comparable to other developed economies.

3.2 At the same time, it is important to recognise that the compliance obligations that entails does introduce frictions into the operation of the New Zealand economy, which has a negative impact. This is because compliance obligations necessarily involve direct and indirect costs.

3.3 These costs may disincentive reporting entities from providing services to those customers whom they perceive as presenting higher onboarding and monitoring costs,[1] or charging higher fees to those customers to cover those costs.

3.4 These costs could, at the extreme, result in at least some New Zealanders being totally or partially excluded from the traditional financial system and mainstream society.[2] These are people that cannot complete AML/CFT requirements such as core KYC for various reasons, usually due to inadequate evidence or documentation. As a result, these people may be denied access to reporting entities’ products and services, which hinders financial inclusion.

3.5 That is highly undesirable as the Financial Action Task Force (**FATF**) has pointed out,[3] both because it directly impacts the welfare of those people, and because it fosters the growth of a “black

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[1] See High-Level Synopsis of the Stocktake of the Unintended Consequences of the FATF Standards (October 2021) - https://www.fatf-gafi.org/media/fatf/documents/Unintended-Consequences.pdf.
[2] See High-Level Synopsis of the Stocktake of the Unintended Consequences of the FATF Standards (October 2021) - https://www.fatf-gafi.org/media/fatf/documents/Unintended-Consequences.pdf.
[3] See High-Level Synopsis of the Stocktake of the Unintended Consequences of the FATF Standards (October 2021) - https://www.fatf-gafi.org/media/fatf/documents/Unintended-Consequences.pdf.

economy", as excluded people seek to meet their needs outside the legitimate financial sector, and any money laundering is less likely to be detected.

3.6 More broadly for the New Zealand economy, these compliance costs have the potential to contribute to inertia in customers switching service providers (with possible impacts on competition and efficiency), and a reduction in the volume and velocity of certain types of transactions. They may blunt the impact of government-sponsored initiatives such as "open banking". Furthermore, these costs may slow the uptake of particular digital services, potentially impacting productivity and growth generally – at least relative to other developed economies.

3.7 Therefore, New Zealand's AML/CFT regime must strike the right balance between these competing pressures. This means that compliance obligations imposed on reporting entities should be no more than is reasonably necessary to achieve the purpose of the Act in relation to detecting and deterring money laundering and terrorism financing. Where existing legislative requirements no longer effectively support this central purpose of the Act, they should be amended or repealed to reduce compliance pressures and costs on reporting entities, and to enhance and enable financial inclusion and innovation.

3.8 Such an approach is consistent with the risk-based approach to regulation that is advocated by the FATF,[4] and which has been endorsed by the MoJ in the Consultation Paper. As the MoJ notes (emphasis added): [5]

> *"[a]t its core, any AML/CFT regime should be risk-based: there should be an assessment of money laundering and terrorism financing at the national, sectoral, and business level, and <u>regulation should be focused on mitigating any risks identified</u>. A risk-based approach should also ensure that an AML/CFT regime is flexible and adapts to changes in risks, and that <u>resources are allocated efficiently and in proportion to levels of risk</u>".*

3.9 Therefore, we are encouraged by the MoJ's comments in many parts of the Consultation Paper where they acknowledge the need for balance, for instance:

(a) "[not] compromising the ease of doing business or unduly impacting the lives of New Zealanders";[6]

(b) avoiding "unintended consequences" and "serious negative effects";[7] and

(c) "careful[ly] balancing…the need to address the harms of money laundering and terrorism financing while ensuring that businesses can operate efficiently and innovatively".[8]

3.10 Nevertheless, the framing in many parts of the Consultation Paper does lean towards an expansion of the AML/CFT regime, and an increase in the burden placed on both the businesses which are directly subject to it, and everyday New Zealanders. This should always be carefully considered in relation to the risks being addressed and the impacts that it will have.

[4] See FATF Guidance on Risk-Based Supervision (March 2021) - https://www.fatf-gafi.org/media/fatf/documents/Guidance-Risk-Based-Supervision.pdf.
[5] See page 4 of the Consultation Paper - https://consultations.justice.govt.nz/policy/aml-cft-review/user_uploads/amlcft-statutory-review-consultation-document.pdf.
[6] See page iii of the Consultation Paper - https://consultations.justice.govt.nz/policy/aml-cft-review/user_uploads/amlcft-statutory-review-consultation-document.pdf.
[7] See page vi of the Consultation Paper - https://consultations.justice.govt.nz/policy/aml-cft-review/user_uploads/amlcft-statutory-review-consultation-document.pdf.
[8] See page iv of the Consultation Paper - https://consultations.justice.govt.nz/policy/aml-cft-review/user_uploads/amlcft-statutory-review-consultation-document.pdf.

PART 2

4. Specific issues that should be addressed as a priority as part of the MoJ's statutory review of the Act.

Executive summary of specific submissions:

4.1 In summary, our main submissions on the statutory review of the AML/CFT regime are that:

(a) A clear and consistent approach to the treatment of VASPs under the regime needs to be implemented, so as to remove the current uncertainty. We recommend that:

(i) the Act should be amended so as to adopt Recommendation 15 of the FATF Recommendations (updated as of October 2021) (**FATF Recommendations**), that all VASPs should be regulated for AML/CFT purposes; and

(ii) if all VASPs are to be included as reporting entities under the Act, the application of the regime should be risk-based (just as it is for others). It should not involve applying heightened AML/CFT obligations as a blanket rule for the entire industry.

(iii) We expand on this at paragraphs 4.3 to 4.8 below.

(b) Section 15 of the Act should be amended to remove the requirement to obtain and verify the address of customers who are natural persons (i.e. not a corporate entity).

We expand on this at paragraphs 4.9 to 4.11 below.

(c) We recommend the introduction of a licensing regime for auditors, consultants, and agents under the Act, to be administered by one of the supervisors (e.g. the Department of Internal Affairs (**DIA**)) to provide greater quality control and supervision of third parties. We also recommend clarifying and expanding the roles that can be outsourced by reporting entities. This would result in an improvement of the quality of services being provided, and enable smaller reporting entities to comply more effectively.

We expand on this at paragraphs 4.12 to 4.18 below.

(d) We do not recommend introducing a licensing framework for certain "high-risk" reporting entities. That is undesirable, as it would create numerous boundary issues, and introduce uncertainty. The compliance costs associated with such a regime would also outweigh any benefit that could be derived from it.

We expand on this at paragraphs 4.19 to 4.21 below.

(e) We recommend a single-supervisor model, as this would result in more consistent and higher quality AML/CFT regulation in New Zealand. If, however, New Zealand was to retain its existing supervisory model of having three different agencies acting as AML/CFT supervisors, formal mechanisms for ensuring consistency between the AML/CFT supervisors should be implemented.

We expand on this at paragraphs 4.22 to 4.33 below.

(f) There is a specific issue, we wish to raise in relation to PTRs, in the context of international wire transfers involving an underlying customer of a non-bank financial institution (**NBFI**) or a designated non-financial business or profession (**DNFBP**) transferring or receiving funds internationally via the banking system. The Act is clear that it is the NBFI or DNFBP which should file the PTR and not the bank, and in our view that is the correct approach and reflects the roles of the entities and who has the relationship with the payer or payee customer. However, the formal and informal guidance issued by the AML/CFT supervisors has been inconsistent on this point and has led to confusion in the private sector. The guidance should be reviewed for consistency between each other, and should be amended to reflect the Act.

We expand on this at paragraphs 4.34 to 4.39 below.

(g) Furthermore, the Act should not be amended to require double reporting of PTRs by <u>both</u> the bank and the NBFI/DNFBP in the situation described above in paragraph (f). Such a change would inundate the Financial Intelligence Unit (**FIU**) with a much greater volume of PTRs (at least double) to process with marginal benefit to the regime, and creates material additional burdens on the private sector – i.e. the additional compliance costs involved (for the banks and the NBFI/DNFBPs) from such a change.

We expand on this at paragraphs 4.40 to 4.41 below.

(h) We recommend that the territorial scope of the AML/CFT regime be clarified by the inclusion of explicit provisions in the Act.

We expand on this at paragraphs 4.42 to 4.47 below and propose a solution at paragraph 4.45.

(i) The supervisors should proactively activate the approved entity regime found in section 33(3A) of the Act. The benefits of efficiency that could be derived from facilitating entities to undertake the business of providing CDD, which can then be relied upon by others, would be substantial.

We expand on this at paragraphs 4.48 to 4.54 below.

(j) Section 22 of the Act should be amended to de-couple EDD from trusts, so that EDD would only be required where other EDD triggers were also present.

We expand on this at paragraphs 4.55 to 4.59 below.

(k) The exemptions regime found in section 157 of the Act should be retained. However, it should be enhanced to empower officials at a sub ministerial level with the ability to grant the exemptions.

We expand on this at paragraphs 4.60 to 4.64 below.

(l) The Act should be amended such that the lodging of a SAR by a reporting entity does not automatically trigger a requirement to conduct EDD on the customer in question. Only if the Commissioner of Police was to request that EDD be conducted, after receiving and reviewing the SAR, should the reporting entity be obliged to do so. Furthermore, the obligation in section 37(1)(b) to terminate an existing business relationship (in the event that CDD or EDD is unable to be conducted) should be amended to say, "take all practicable steps to terminate any existing business relationship with the customer".

We expand on this at paragraphs 4.65 to 4.70 below.

(m) As outlined above in (l), the obligation in section 37(1)(b) to terminate an existing business relationship (in the event that CDD or EDD is unable to be conducted) should be amended to say, "take all practicable steps to terminate any existing business relationship with the customer". If that recommendation is not adopted, then section 37 of the Act should be amended to include a third subsection to clarify that the obligation to terminate an existing business relationship found in section 37(1)(b) does not apply in situations where Schedule 1 of the KiwiSaver Act 2006 applies to limit the circumstances in which KiwiSaver funds can be paid out.

We expand on this at paragraphs 4.71 to 4.74 below.

4.2 We address these submissions in greater detail below.

The current and proposed treatment of VASPs

4.3 Under the Act as it currently stands, the assessment of whether a VASP falls within the scope of the AML/CFT regime as a reporting entity is determined by whether the VASP is a 'financial institution', a term which is defined in s 5(1) of the Act.

4.4 However, the expectations and practices of the supervisors in relation to VASPs do not reflect the operation of the Act as written. Their view is that all VASPs are covered under the definition of 'financial institution', and therefore have AML/CFT obligations as reporting entities. However, legally speaking, that is not always the case, and there are some VASPs that may fall outside the definition of a 'financial institution' as they don't engage in any of the activities listed under that definition.

4.5 Our recommendation is that a clear and consistent approach to the treatment of VASPs under the regime needs to be implemented in the Act, so as to remove the current uncertainty. This would provide much greater certainty to VASPs as to their regulatory obligations. We would further recommend that the Act be amended so as to adopt Recommendation 15 of the FATF Recommendations, that all VASPs should be regulated for AML/CFT purposes.[9] Furthermore, the Act should include a very clear definition of a VASP such that businesses can properly determine whether or not they fall within the definition.

4.6 If the Act was to be amended so as to adopt Recommendation 15, the application of the regime should be risk-based (just as it is for others). It should not involve applying heightened AML/CFT obligations as a blanket rule for the entire industry. With the increased digitisation of businesses, VASPs compete across the same spectrum as "brick and mortar" businesses, and often there is no bright line between the two.

4.7 A risk assessment can and should be made in relation to the specific VASP in question.[10] It might be that a particular VASP does not pose the same heightened risks of money laundering and terrorism financing that other VASPs do, and therefore it should not be subject to the stricter AML/CFT obligations that other, more high-risk VASPs should. For example, we do not think it would be wise to, as proposed in the Consultation Paper, declare by regulation that all virtual asset transfers are international wire transfers.[11]

4.8 To apply a set of heightened obligations across the board would undermine the risk-based approach to regulation advocated by the FATF[12] and endorsed by the MoJ in the Consultation Paper.[13]

The current address verification requirements for CDD

4.9 Under s 15(d) of the Act, a reporting entity must obtain a customer's address when conducting standard CDD, and then verify it in accordance with s 16.

4.10 However, as outlined in the Consultation Paper, this requirement to obtain a customer's address is problematic on many fronts:[14]

(a) It has a negative impact on financial inclusion. Many customers may not be able to provide the required evidence of an address due to not having permanent accommodation, being homeless, or not being the account holder for any utility bills. The young, the elderly and the poor are most affected by this. This greatly impedes financial inclusion and a person's ability to participate in the broader New Zealand economy, as they might face delays in establishing

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[9] See FATF Recommendations (updated October 2021) - https://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf.
[10] See FATF Guidance for a Risk-Based Approach – Virtual Assets and Virtual Asset Service Providers - https://www.fatf-gafi.org/media/fatf/documents/recommendations/Updated-Guidance-VA-VASP.pdf.
[11] See page 82 of the Consultation Paper - https://consultations.justice.govt.nz/policy/aml-cft-review/user_uploads/amlcft-statutory-review-consultation-document.pdf.
[12] See FATF Guidance on Risk-Based Supervision (March 2021) - https://www.fatf-gafi.org/media/fatf/documents/Guidance-Risk-Based-Supervision.pdf.
[13] See page 4 of the Consultation Paper - https://consultations.justice.govt.nz/policy/aml-cft-review/user_uploads/amlcft-statutory-review-consultation-document.pdf.
[14] See page 59 of the Consultation Paper - https://consultations.justice.govt.nz/policy/aml-cft-review/user_uploads/amlcft-statutory-review-consultation-document.pdf.

a business relationship with a reporting entity or may be unable to access financial services at all.

(b) It can result in disproportionate compliance costs for reporting entities. Errors with address verification which require fixing are common within reporting entities. Correcting these errors often requires staff to contact customers and reobtain the correct proof of address. This is time-consuming and imposes costs on both the reporting entity and the customer.

(c) Current processes for verifying a person's address are not robust. Currently, most reporting entities rely on statements from third-party institutions such as banks to verify a customer's address. However, customers are often able to update their address with these third parties without providing any actual verification of their address. Further, as the postal service becomes less frequent and less reliable, many customers now conduct all their correspondence with their bank online.

4.11 Therefore, our recommendation is that s 15 be amended to remove the requirement to obtain the address of customers who are natural persons (i.e. not a corporate entity). The current requirement to obtain a natural customer's address fails to actually detect and deter money laundering and terrorism financing to any material degree, as natural persons are often able to update their address with third-party institutions, upon which reporting entities rely for proof of address, without actually verifying that address. Furthermore, the compliance costs associated with address verification, and its negative implications for financial inclusion, warrant its removal.

The proposed regulation of auditors, consultants, and agents

4.12 Third parties such as auditors, consultants, and agents are now often relied upon by reporting entities which seek to comply with their obligations under the Act. In our view, this is a good thing. Even greater reliance on well-qualified third-party providers would assist smaller reporting entities in better complying with the regime, for example, in relation to administration, because they would allow expertise to be shared.

4.13 However, the Act currently does not set out who can be an auditor, consultant, or agent, or what is expected of people who step into these roles and provide such services.

4.14 In the Consultation Paper, for instance, the MoJ acknowledges that "[w]e did not anticipate the potential role of consultants in supporting businesses with complying with AML/CFT when we were developing the Act".[15] Therefore, these third parties are, in practice, unregulated under the Act, despite the fact they are often relied upon by reporting entities in the course of complying with their obligations. This creates a risk that the services they provide are of variable quality, and that they do not have common professional standards, potentially causing smaller reporting entities to breach their obligations under the Act.

4.15 Our recommendation it that a licensing regime for auditors, consultants, and agents should be introduced under the Act, to be administered by one of the supervisors, for instance the DIA. This would provide greater quality control and supervision of third parties, fostering greater confidence from reporting entities that the third parties they engage are qualified to provide the services they need to ensure they comply with their obligations under the Act. Overall, having quality control and supervision of these third parties would result in an improvement in terms of the quality of services being provided.

4.16 While there are legitimate concerns about the compliance costs that would be imposed on third parties if they were brought within the purview of the AML/CFT regime in this way, our view is that the parties which mainly benefit from the current situation are exactly those whose services are not up to standard. The likely impact on third parties who provide quality services to reporting entities, on the other hand, should be minimal, as they are already incurring greater costs in terms of time and money to do so.

[15] See page 41 of the Consultation Paper - https://consultations.justice.govt.nz/policy/aml-cft-review/user_uploads/amlcft-statutory-review-consultation-document.pdf.

4.17 However, we acknowledge that, at the extreme, disproportionate compliance costs may lead to an adverse result where third parties who provide quality services to reporting entities are driven out of the market, and therefore the pool upon which reporting entities can draw upon for AML/CFT support contracts. Ultimately, care will be needed to ensure that the costs imposed on these third parties remain proportionate to the goal of ensuring that the services they provide are robust.

4.18 Furthermore, we also recommend that the Act be amended to clarify and expand the roles that can be outsourced by reporting entities. This would provide greater certainty to reporting entities as to exactly what functions they can contract out to third parties, and an expansion in the roles that can be outsourced would enable greater efficiency by allowing those functions to be performed by those with greater expertise and experience in doing so (for instance, the filing of PTRs).

The proposed licensing of certain "high-risk" reporting entities

4.19 In the Consultation Paper, the MoJ comments that:[16]

> *"[w]e also want to explore including a licensing framework in the AML/CFT regime. A licensing framework would involve agencies (e.g. AML/CFT supervisors) making a positive assessment about whether a business should provide particular services … A licensing regime would likely be risk based, and only be used for businesses which are at high risk of being misused for money laundering and terrorism financing and are not currently required to be licensed. For example, the Act could require remitters, trust and company service providers, and virtual asset service providers to hold licenses instead of only being registered".*

4.20 Our submission is that such a licensing framework is undesirable. Ultimately, there would need to be a determination of what amounts to a "high-risk sector", and that would be an extremely difficult determination to make. It would create numerous boundary issues and introduce uncertainty. Furthermore, the compliance costs (in terms of both time and money) in relation to obtaining a licence, and the barriers to entry this would create, would likely outweigh any benefit that could be derived from such a regime. This would be particularly so in fast-moving industries such as that for VASPs.

4.21 Licensing also implies merit regulation and active oversight in a manner which we doubt the current supervisors could sustain. It would therefore create risks for the supervisors in the event of a failure by these "high-risk" reporting entities to comply.

The supervisory model behind the AML/CFT regime

4.22 The current supervisory model of New Zealand's AML/CFT regime involves the existence of three different agencies acting as AML/CFT supervisors:

(a) the Financial Markets Authority (**FMA**);

(b) the Reserve Bank of New Zealand (**RBNZ**); and

(c) the DIA.

4.23 Our submission, which we repeat from our previous submission on the introduction of Phase 2 of the Act, is that a single-supervisor model is the preferred option. It would result in more consistent and higher quality AML/CFT regulation in New Zealand.

4.24 We would like to be clear that this submission is not a criticism of the highly skilled and dedicated personnel who work within each of the existing AML/CFT supervisors. Our experience has been that they are very competent and deliver the best results they can within the current architecture.

4.25 Instead, our submission is that the structural difficulties recognised by the Foreign Affairs, Defence and Trade Select Committee considering the AML/CFT Bill in 2009 have eventuated. In our view,

[16] See page 16 of the Consultation Paper - https://consultations.justice.govt.nz/policy/aml-cft-review/user_uploads/amlcft-statutory-review-consultation-document.pdf.

these outweigh the sector-familiarity and efficiency considerations which caused the Government to reject the single-supervisor option at that time.

4.26 The view of many reporting entities is that the three current supervisors have taken subtly different approaches, and accord different priorities to their AML/CFT work compared to their other responsibilities. This should not be a surprise, as it was identified as a risk by the Select Committee in 2009.[17]

4.27 However, it is not too late to move to a single-supervisor structure, drawing together (if necessary, over a transition period) the AML/CFT functions of the FMA, RBNZ, and DIA. This would have multiple benefits including:

(a) consistent culture and approach – naturally, each of the three existing supervisors has their own culture built over years, which means they have different approaches;

(b) prioritisation of AML/CFT issues – for none of the FMA, RBNZ, or DIA is AML/CFT the number one priority, so in each organisation AML/CFT is a lower priority than it would be for a single supervisor;

(c) reducing the battle for AML/CFT talent and creation of a centre of excellence – New Zealand has a limited pool of people with the knowledge and experience to supervise AML/CFT issues, and currently that pool needs to be split between the three supervisors; and

(d) greater guidance for reporting entities and the public – having a single supervisor would enable guidance to be developed and issued more efficiently, which would reduce uncertainty and costs for reporting entities and the public. This is particularly important with principles-based legislation like the Act, where it was always anticipated that the general statements in the Act would be supplemented by extensive and detailed guidance.

4.28 It is not clear to us whether or not there would be a benefit to drawing in the FIU of the NZ Police. We do suggest that the policy role of the MoJ should remain separate, as policy development is often best separated from implementation. An analogy which we are familiar with and which works well is the separation in relation to financial markets conduct matters between the Ministry of Business, Innovation and Employment as policy ministry and the FMA as supervisor.

4.29 In addition, international best practice, including in Australia, Canada, and Spain, has been to have one central AML/CFT supervisor. This is also the practice in many smaller jurisdictions such as Guernsey (of which one member of our Financial Services Team has first-hand knowledge). The FATF has previously identified the strength of having a single AML/CFT supervisor, commending Spain for its single-supervisor model, allowing for a “sophisticated approach to risk analysis”.[18]

4.30 Opposition to a single-supervisor model has been based on the cost of creating a new dedicated supervisor rather than building on existing regulatory bodies. We submit that this is a false economy. The purported cost savings in utilising existing regulators for AML/CFT supervision are negated by the deficiencies in the multi-supervisor system that is delivering inconsistent, and in some areas, sub-optimal levels of guidance. Further, it is sometimes argued New Zealand is too small a jurisdiction to support a single supervisor. However, small jurisdictions such as Guernsey have found that a single supervisor is actually easier to support, and is more efficient.

4.31 If, however, New Zealand was to retain its existing supervisory model of having three different agencies acting as AML/CFT supervisors, then we would submit that formal mechanisms for ensuring consistency between the AML/CFT supervisors should be implemented.

4.32 While, in practice, the FMA, RBNZ, and DIA work closely together to ensure, where possible, that AML/CFT supervision is consistent, there are some areas where the supervisors have differed. For

[17] Anti-Money Laundering and Countering Financing of Terrorism Bill (46-2) (commentary) at 2 and 8.
[18] See FATF Anti-Money Laundering and Counter-Terrorist Financing Measures - Spain, Fourth Round Mutual Evaluation Report (2014) - https://www.fatf-gafi.org/media/fatf/documents/reports/mer4/Mutual-Evaluation-Report-Spain-2014.pdf.

an example of this, see our discussion below between paragraphs 4.34 and 4.40 on PTRs. These inconsistencies are undesirable as they can result in unfair treatment across sectors.

4.33 Under the Act as it currently stands, there are few formal mechanisms in place to ensure consistency in terms of interpretation and application of the law between the supervising agencies, beyond the requirements in s 131(e) of the Act for supervisors to co-operate to ensure the consistent, effective, and efficient implementation of the Act. Our recommendation, therefore, is that a formal mechanism be developed and implemented to ensure that the supervisors issue guidance in relation to the Act which is consistent with each other's.

The filing of PTRs in the context of international wire transfers

4.34 The obligation to file PTRs under s 48A(1) of the Act was introduced in 2015 and provides the FIU with an overview of how transactions are occurring across the New Zealand economy, including risky transactions. Only two types of transactions are classified as "prescribed transactions", being international wire transfers and domestic physical cash transactions over defined thresholds.

4.35 In the context of international wire transfers involving an underlying customer of a NBFI or a DNFBP transferring or receiving funds internationally via the banking system, there is uncertainty in the market as to who needs to file the PTR.

4.36 One view is that the bank is actually the one engaging in the transaction, and therefore is the entity which needs to file the PTR, not the NBFI or DNFBP. However, as identified by the Consultation Paper, the bank itself does not have visibility over the underlying customer, and a PTR submitted by the NBFI or DNFBP would provide this valuable information.[19] Therefore, another view has emerged, primarily from the DIA, that it is the NBFI or DNFBP itself which has the obligation to submit the PTR. In essence, this is a dispute over who exactly the "ordering institution" or "beneficiary institution" (as appropriate) is under the international wire transfer regime.

4.37 Our view is that the Act itself is clear and reflects the correct approach. The ordering/beneficiary institution in this type of situation is the NBFI or DNFBP, not the banks (which are intermediary institutions). This properly reflects the roles of the reporting entities and who has the relationship with the payer or payee customer. Ultimately, this also aligns with the position of the FATF, which does not confine ordering/beneficiary institutions to only financial institutions.[20]

4.38 Accordingly, in our view, no amendments to the Act are necessary; rather, the guidance issued by the supervisors should be reviewed for consistency, and should be amended where necessary to support the view that the NBFI or DNFBP is the party which files the PTR. This would help to clarify the obligations of the parties involved in international wire transfers, providing greater certainty.

4.39 If smaller NBFI and DNFBP reporting entities have difficulty complying with their obligation to file PTRs in the situation outlined above, then that would best be addressed by allowing them to outsource that function to approved third parties as submitted above in paragraph 4.18.

4.40 In line with our discussion above in paragraph 4.37, the Act as it currently stands does not provide for double reporting by both the bank and the NBFI/DNFBP. While some have suggested expanding the obligation to file PTRs such that they fall on both the bank and the NBFI/DNFBP, our submission is that such a change is undesirable as it would inundate the FIU with a greater volume of PTRs to process with little marginal benefit as their information will overlap.

4.41 Furthermore, consideration should be given to the additional compliance costs involved (for the banks and the NBFI/DNFBPs) in such a change, and the fact that double reporting is not envisaged

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[19] See page 87 of the Consultation Paper - https://consultations.justice.govt.nz/policy/aml-cft-review/user_uploads/amlcft-statutory-review-consultation-document.pdf.

[20] See paragraph 181 of the FATF Guidance for a Risk-Based Approach – Virtual Assets and Virtual Asset Service Providers - https://www.fatf-gafi.org/media/fatf/documents/recommendations/Updated-Guidance-VA-VASP.pdf.

in the FATF Recommendations (and their singular framing of the ordering and beneficiary financial institution definitions).[21]

Territorial scope of the Act

4.42 The territorial scope and application of the Act is vitally important. There is an incentive for entities, if they can, to domicile themselves in overseas jurisdictions with less robust AML/CFT regimes, and to carry out activities directed into New Zealand, rather than submit themselves to New Zealand's more stringent AML/CFT regime. This tends to disadvantage locally domiciled businesses who compete with these overseas entities. Over time, it also incentivises New Zealand businesses to relocate overseas. Accordingly, clarity as to the territorial scope of the Act is vital.

4.43 Currently, the territorial scope of the Act for entities operating in, or conducting their activities into, New Zealand is not set out in the Act, but is determined according to supervisor guidance by whether the entity is carrying on certain activities "in New Zealand in the ordinary course of business".[22] An entity will only fall under the Act, and therefore incur AML/CFT obligations, if they carry on a prescribed activity to such a level of intensity that they can be classified as doing so "in the ordinary course of business" in New Zealand.

4.44 Although the supervisor guidance (which was jointly published by the FMA, RBNZ and DIA) has clarified that the appropriate test is whether the entity is "carrying on business in New Zealand",[23] it remains ambiguous and of little assistance in how to treat borderline cases. Furthermore, case law around that term in other contexts has shown that it is a fact-specific analysis that involves much uncertainty.[24] In addition, other regulators e.g. the Privacy Commissioner and the Registrar of Companies, have taken differing interpretations to what "carrying on business in New Zealand" means, which only adds to the ambiguity and confusion as to the threshold of the test.

4.45 Accordingly, our submission is that a specific provision relating to the territorial scope and application of the Act needs to be inserted. To an extent, whatever provision that may be included would still be better than the current ambiguity. In our view, there are two potential alternatives:

(a) A "place of business" test, which we understand is the most common approach in other FATF compliant regimes and was the original approach towards the territorial scope and application of the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (**FSP Act**). But this has the disadvantage that a "brick and mortar" presence is fast becoming an outdated approach, which in part is the reason why the FSP Act was amended; or

(b) A test based on whether services are provided to persons in New Zealand. In our view, this is the preferred approach, but would need to be carefully designed so as to ensure that it did not have unintended consequences. We develop this further below.

4.46 Under such a regime, if an entity carries out a relevant activity (such as those listed under the definitions of financial institution and DNFBP), and the service is provided to persons in New Zealand (beyond a prescribed threshold), they will come within the scope of the Act and be subject to all the obligations of a reporting entity unless they fall within an exclusion on the basis that their home jurisdiction is one listed in the regulations as having a comparable AML/CFT regime, which also applies to the relevant activities. One could also consider adding conditions to the regulatory exclusion which provides that the entity has an address for service of process in New Zealand, and undertakes to provide SARs to the FIU when appropriate in relation to customers in New Zealand. But these additional features would need careful consideration such as to avoid unintended consequences.

[21] See Interpretive Note to Recommendation 16 – Glossary – FATF Recommendations (updated October 2021) - https://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf.
[22] See Territorial Scope of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (November 2019) - https://www.fma.govt.nz/assets/Guidance/191122-AML-CFT-territorial-scope-of-the-AML-CFT-Act-2009.pdf.
[23] See Territorial Scope of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (November 2019) - https://www.fma.govt.nz/assets/Guidance/191122-AML-CFT-territorial-scope-of-the-AML-CFT-Act-2009.pdf.
[24] See for instance *Probus South Pacific v Probus New Zealand Inc* [2015] NZHC 2250 and *Commerce Commission v Visy Board Pty Ltd* [2012] NZCA 383 in New Zealand, and *Luckins v Highway Motel Carnarvon Pty Ltd & Anor* [1975] 7 ALR 413 from Australia.

4.47 Such a change will help to ensure that overseas entities which offer services into New Zealand are not given a competitive advantage over local businesses for not having to comply with, and therefore not having to incur any costs or customer inconvenience in relation to, AML/CFT obligations. At the same time, it could give the FIU greater visibility over transactions of concern involving New Zealand customers.

Reliance in relation to CDD obligations

4.48 Currently, section 33 of the Act allows for a reporting entity (in this example, **Reporting Entity A**) to rely on another reporting entity (**Reporting Entity B**) to conduct CDD on a customer on their behalf. However, section 33(3) sets out that, despite relying on Reporting Entity B, Reporting Entity A is still responsible for ensuring that CDD is carried out correctly.

4.49 In practice, this means most reporting entities decline to rely on CDD carried out by other reporting entities. Reporting Entity B will carry out CDD on a customer and its beneficial owners. Then, rather than relying on the CDD already completed under section 33, Reporting Entity A will instead insist on duplicating the CDD and go through the same process again, leading to inefficiency and a substantial waste of resources. It can also be a barrier to competition and switching.

4.50 Alternatively, Reporting Entity A may seek to “supervise” Reporting Entity B’s processes by insisting on an agency arrangement under section 34 of the Act (rather than operating under section 33) and effectively imposing their own risk judgments and compliance requirements in place of Reporting Entity B who has the primary relationship and ability to make that assessment. This is also highly inefficient. There can also be considerable tension between two reporting entities inherent in the concept that one needs to be the “agent” of and be supervised by the other.

4.51 There is, however, the approved entity regime under section 33(3A) of the Act, which potentially offers a solution. This provides that Reporting Entity A is not responsible for ensuring CDD is carried out in accordance with the Act if, among other things, Reporting Entity B is an “approved entity”. This concept was introduced when the Act was amended in 2017. The intention was that the supervisors would identify particular “approved entities” upon which reporting entities could rely to conduct CDD on their behalf, and the reporting entities themselves would not be liable if the CDD was not carried out properly.

4.52 To date, however, no “approved entities” have ever been designated by the supervisors, and we understand there is limited appetite to do so. Furthermore, neither the MoJ nor any of the AML/CFT supervisors have taken any steps to promote the use of the regime. The market view is that there is little official support for its use.

4.53 Our recommendation is that the supervisors activate the approved entity regime found in section 33(3A) of the Act, promoting its availability to the market. In doing so, it will likely lead to greater use of the CDD reliance provisions found in section 33 of the Act. Reporting Entity A will no longer be incentivised to duplicate the CDD which Reporting Entity B has already conducted, as Reporting Entity A will no longer be liable for the failure of Reporting Entity B to carry out the CDD properly.

4.54 This would lead to greater efficiency within the AML/CFT regime, as reporting entities could more readily delegate their CDD obligations to third parties who may have greater expertise and capabilities in such an area.

Trusts and the requirement to conduct EDD

4.55 Under section 22(1) of the Act, EDD must be conducted on all customers who are trusts. This is a blanket rule which applies to all trusts regardless of the actual money laundering and terrorism financing risks posed by the specific trust in question.

4.56 New Zealand’s current approach to trusts and EDD is problematic as it fails to adequately balance compliance costs with risk (contrary to the FATFs recommended approach). As not all trusts inherently pose the same risk of money laundering and terrorism financing, the requirement to conduct EDD on all of them leads to disproportionate compliance costs. As noted by the Law Commission in its August 2013 paper 'Review of the Law of Trusts: A Trusts Act for New Zealand':[25]

> *"Trusts form an important part of New Zealand's economic and social life. While the exact number of trusts is unknown, and probably unknowable, we have heard throughout this review that there may be anything between 300,000 to 500,000 trusts currently in New Zealand. The uses of trusts reach from holding the family home to high finance. Trusts are an important mechanism for the holding of Māori land, and have been extensively used by iwi as way to hold, and provide governance, for assets from the Treaty settlement process. The trust is the mechanism which the Government prefers iwi to use as "post settlement governance entities". This makes New Zealand heavily dependent on the trust mechanism for the holding and governing of a large amount of its wealth, and consequently trusts are an important component of the economy".*

4.57 As the use of trusts in New Zealand is widespread, the actual ML/TF risks posed by most of them are low. Therefore, having a blanket rule which requires EDD to be conducted on all customers who are trusts is problematic, inefficient and wasteful. As noted in the Consultation Paper, it is inconsistent with the FATF standards and the risk-based approach to regulation endorsed by the MoJ.[26]

4.58 Our recommendation is that section 22 should be amended to de-couple EDD from trusts, so that EDD would only be required where other EDD triggers were also present. This would allow reporting entities to conduct standard CDD on trusts where there are no other factors which indicate that they are at high risk for money laundering and terrorism financing. This would reduce unnecessary compliance costs which fail to detect and deter money laundering and terrorism financing to a material degree, for both reporting entities and the trusts themselves.

4.59 We also support the MoJ's suggestion that they could specifically identify high-risk categories of trusts which do require EDD, to provide further clarity for reporting entities.

The power to wholly or partially exempt businesses or classes of businesses or transactions from AML/CFT obligations

4.60 Under section 157 of the Act, the Minister of Justice is able to wholly or partially exempt businesses or classes of businesses and transactions from AML/CFT obligations. The purpose of the exemptions regime is to allow businesses which pose a low-risk of ML/TF to seek relief from various compliance obligations under the Act.

4.61 Our submission is that the exemptions regime is an integral part of the AML/CFT regime and should be retained, and enhanced. In considering applications for an exemption, the Minister considers the factors set out in section 157(3) of the Act, which include the intent and purpose of the Act and any regulations, the ML/TF risks associated with the business, the impacts on the prevention, detection, investigation, and prosecution of offences, the level of regulatory burden imposed on the business in the absence of an exemption, and whether the issuance of an exemption would create an unfair advantage for the reporting entity or disadvantage competing third party reporting entities. In our view, where the factors under section 157(3) point towards the issuance of an exemption, it would be inappropriate for there not to be an exemption.

4.62 By ensuring that businesses which pose a low risk of ML/TF can seek relief from various onerous compliance obligations, it helps to ensure that the compliance burden they face is proportionate to the ML/TF risks that they are exposed to. Such a regime reinforces the risk-based understanding of regulation which is advocated by the FATF,[27] and which has been endorsed by the MoJ in the Consultation Paper.[28] If the exemptions regime were to be removed from the Act, it would lead to the imposition of onerous compliance obligations on some reporting entities which pose limited ML/TF risk, without providing them with a practical avenue to seek relief.

[25] See Review of the Law of Trusts: A Trusts Act for New Zealand (August, 2013) - https://www.lawcom.govt.nz/sites/default/files/projectAvailableFormats/NZLC%20R130.pdf.
[26] See page 62 of the Consultation Paper - https://consultations.justice.govt.nz/policy/aml-cft-review/user_uploads/amlcft-statutory-review-consultation-document.pdf.
[27] See FATF Guidance on Risk-Based Supervision (March 2021) - https://www.fatf-gafi.org/publications/fatfrecommendations/documents/guidance-rba-supervision.html.
[28] See page 4 of the Consultation Paper - https://consultations.justice.govt.nz/policy/aml-cft-review/user_uploads/amlcft-statutory-review-consultation-document.pdf.

4.63 However, we submit that the exemptions regime as it currently stands could be enhanced by empowering officials at a sub-ministerial level with the ability to grant exemptions under the Act. Currently, the Minister of Justice is the person who makes decisions as to whether or not an exemption should be granted. However, it may would be more efficient if this power could be delegated to officials within the MoJ itself or senior officials at the AML/CFT supervisors.

4.64 An analogy can be drawn with the Financial Markets Conduct Act 2013 (**FMCA**). Under section 556 of the FMCA, the FMA itself is empowered to grant exemptions from the substantive parts of the FMCA, various transitional provisions, and the Financial Markets Conduct Regulations 2014. This power is exercised by the FMA itself, and by extension, senior officials within the FMA.

The interaction between the requirement to terminate a business relationship following a failure to complete EDD and the requirement not to tip off a customer about the possibility of a SAR being lodged in relation to them

4.65 Within the Act itself, there are competing obligations which are not easily reconcilable. One of these relates to the interaction between the requirement to terminate a business relationship following a failure to conduct EDD and the requirement not to tip off a customer about the possibility of a SAR being lodged in relation to them.

4.66 Under section 40(3) of the Act, a reporting entity must, as soon as practicable but no later than 3 working days after forming its suspicion, report suspicious activities to the Commissioner of Police in accordance with section 41. This then also triggers a requirement to conduct EDD on the customer under sections 22(1)(e) and 22A(1)(a) of the Act.

4.67 If, however, the reporting entity is unable to complete EDD on the customer, then under section 37(1)(b) of the Act they “must terminate any existing business relationship with the customer”. There is also an obligation found in section 37(1)(e) of the Act to only disclose the possibility of making a SAR to a very limited range of persons (which, significantly, does not include the subject).

4.68 However, in many situations involving those experienced in money laundering and/or terrorism financing (and therefore likely to be familiar with New Zealand’s AML/CFT regime and laws), the mere fact that the business relationship has been terminated after their refusal to comply with a request to conduct EDD may actually reveal the possibility of a SAR being lodged in relation to them. Therefore, compliance by the reporting entity with one obligation may in fact put it in breach of another. This inconsistency between the obligations imposed on reporting entities puts them in a very difficult position when confronted with this problem.

4.69 Furthermore, in some cases, it is not legally possible, or at least not reasonably practicable, to terminate the relationship. This might be for example, because the reporting entity holds property on trust for the customer (e.g. in a custody relationship or a managed investment scheme) and there is no power to terminate the customer’s beneficial interest.

4.70 Our recommendation is that the Act be amended such that:

(a) the lodging of a SAR by a reporting entity does not automatically trigger a requirement to conduct EDD on the customer in question. Only if the Commissioner of Police was to request that EDD be conducted, after receiving and reviewing the SAR, should the reporting entity be obliged to do so. Section 22A(1)(a) could be amended to read “that the reporting entity concerned (other than a high-value dealer) has reported to the Commissioner under section 40, and the Commissioner has requested that enhanced customer due diligence be conducted”; and

(b) the obligation in section 37(1)(b) should be amended to say, “take all practicable steps to terminate any existing business relationship with the customer”.

Interaction between the Act and the KiwiSaver Act 2006

4.71 The issue we raise above in relation to the impossibility of terminating a business relationship, can also arise as a result of inconsistencies between the Act and other pieces of legislation which often apply to reporting entities. The most notable of these relates to the relationship between the Act and the KiwiSaver Act 2006, in relation to fund managers which provide KiwiSaver.

4.72 Where an existing KiwiSaver member passed CDD when they were first onboarded, subsequently requires source of wealth verification, and fails to adequately provide that, then technically under section 37(1)(b) of the Act, the fund manager must terminate the business relationship with, and exit, them. This obligation, however, is inconsistent with Schedule 1 of the KiwiSaver Act 2006, which is highly prescriptive in relation to when amounts can be withdrawn.

4.73 The RBNZ has made clear in an October 2018 presentation that they don’t expect the business relationship between the fund manager and the customer to be actually terminated, and that the MoJ is aware of the inconsistency. We have not identified any comparable statement from the FMA, however, and the legal basis for the RBNZ’s pragmatic position is not clear.

4.74 Our recommendation is that section 37(1)(b) of the Act should be amended as set out above in paragraph 4.70(b) to say “take all practicable steps to terminate any existing business relationship with the customer”. If our recommendation is not accepted, then we recommend including a third subsection to clarify that the obligation to terminate the existing business relationship found in section 37(1)(b) does not apply in situations where Schedule 1 of the KiwiSaver Act 2006 applies to limit the circumstances in which KiwiSaver funds can be paid out.

5. Final comments

5.1 Thank you for taking the time to consider this submission. We would be happy to discuss our submission in more detail in due course if this would be of assistance. Please contact us (details below) if you wish to discuss any of the matters raised above further.

Yours faithfully
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