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Subject: AML/CFT Statutory Review - Submission from ADLS
Attachments: ADLS Submission on AML&CFT Statutory Review - 10 December 2021.pdf

Good afternoon

Once again thank you for granting ADLS the extension sought on making a submission on the AML/CFT Statutory Review 2021.
Please find our submission attached.

We understand the Ministry will conduct targeted consultation on this subject in February 2022. ADLS welcomes further opportunities in exploring the issues identified in our submissions and any possible solutions. Please do not hesitate to contact [redacted], my manager (copied to this email), and myself, for further engagement.

Warm regards
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December 2021

AML/CFT Statutory Review Consultation 2021

Submission by the Auckland District Law Society (ADLS)

1.0 Introduction

The **ADLS AML/CFT Law Committee** (the **Committee**) comprises senior lawyers and law firm practice managers with extensive experience advising and/or operating in the area of AML/CFT law. It welcomes the opportunity to make submissions on the 2021 statutory review consultation of the AML/CFT framework.

The Committee has chosen to focus on the primary areas of the consultation paper identified as having the most potential to impact on the legal profession. As most of the members of the Committee, and likewise practitioners in the legal profession that ADLS represents, are themselves reporting entities or working within reporting entities, this submission provides practical insight into some of the issues facing many lawyers.

Notwithstanding the above, where possible, the Committee has commented on potential impacts on other sectors when framing its submission, and has also made submissions on some discrete aspects of the legislation.

1.1 Background

Lawyers were the first of the phase two entities brought under the umbrella of the regime but also potentially the most complex, given the professional duties and obligations owed to clients. The legislation was understandably tailored for financial institutions, but there was minimal amendment when it was extended to designated non-financial businesses and professions (**DNFBPs**) and as a consequence it has proven difficult to readily integrate into practice and for many lawyers the burden has been disproportionate both in terms of risk and cost.

The implications for lawyers need to be considered in the unique context that in the event that their supervisor determines they are not, in its view, fully compliant (an opinion of the supervisor as opposed to the result of any legal determination), it can have significant impact on their ability to practice. This includes the potential of disciplinary action by the New Zealand Law Society (**NZLS**) and issues with insurers when trying to secure compulsory professional indemnity insurance.

With limited case law and industry-tailored guidance, the legal profession continues to face difficulties with the application of the legislation to everyday practice, including applying terminology that is not consistent with the profession (such as customer and business relationship), and balancing the inherent nature of the profession to represent and protect client interests, while also monitoring and potentially reporting those clients for suspicious activity.

1.2 The Committee's approach in preparing this submission document

This submission is set out in the order of the consultation paper with comments limited to aspects of the paper that the Committee considers most relevant and of highest priority to the legal community. The submission is not intended as a representation of all issues that arise for members of the profession and it is hoped that additional industry consultation, scheduled to take place from February 2022 under the consultation timeframes for the review, will provide the opportunity for further engagement with law practitioners so that some aspects of the review can be considered in more detail, including how effective changes may be realised.

At this time, the focus is on identifying the areas of concern in respect of which, in the Committee's view, amendments to the regime should be focussed.

2.0 Executive Summary

2.1 The Committee is supportive of the risk-based approach generally adopted in the AML/CFT regime given the breadth of coverage across multiple and varied industries and the purpose of the legislation. At the same time, it acknowledges there are aspects of operational practice that benefit from a more prescriptive approach, such as the customer due diligence (**CDD**) requirements when onboarding a new customer. Such prescriptive approach for common obligations across entities streamlines processes and ensures a level playing field across reporting entities commercially.

2.2 The Committee observes there has been a high level of conservatism in the supervisors' interpretation and application of the law, over and above what the legislation actually requires, with the consequence that best practice guidance has at times been mandated. While this approach was understandable during the initial implementation of the AML/CFT regime, with the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (the **Act**) fully effective for quite some years now, the Committee considers it appropriate for the supervisors to adjust their practice to reflect a genuine application of the risk-based principles to monitoring and enforcement, and to adopt a "high trust, high accountability" mentality in their approach.

2.3 As officers of the Court, it is natural for the vast majority of lawyers, if not all, to have every intention to comply with the requirements of the AML/CFT regime, not least because non-compliance has the potential to lead to severe disciplinary action, including the loss of livelihood. However, due to the lack of case law and industry-tailored guidance, practitioners continue to encounter a variety of obstacles in understanding, interpreting and complying with the law including, but not limited to:

a. Interpreting the activity of "engaging in or giving instructions";

b. Transposition of the concept of a "business relationship" into the lawyer-client relationship, particularly in relation to the timing of when CDD is required which means many practitioners feel the need to utilise the provision for delayed verification which can also lead to issues;

c. Identifying the persons who meet the legislative definition of a "customer" can be difficult, particularly in a complex, multi-jurisdictional transaction;

d. Identifying the beneficial owner/s given the varied interpretations of the definition and the expectations of the Financial Action Task Force (**FATF**);

e. The challenges in filing suspicious activity reports given professional duties of care owed to clients, the role of privilege and as a result of the information system design.

2.4 The Committee submits that criminal defence lawyers should not be subject to the AML/CFT regime for a number of reasons but, most critically, due to the need to protect the fundamental right to access justice.

2.5 The Committee considers the following aspects of the AML/CFT regime that have significant impact on law practitioners (and potentially other reporting entities) could be clarified and streamlined to promote efficiency and effectiveness (not intended as an exhaustive list):

a. A clearer definition of "customer", including examples of who the customer is in specific situations, such as (but not limited to) in the context of limited partnerships, companies, trust and complex company groups.

b. A bespoke provision for lawyers on when CDD must be conducted.

c. Removal of the default position for all trusts requiring enhanced customer due diligence (**EDD**) to be conducted with the decision entrusted to the reporting entity based on a case-by-case risk assessment.

d. A clearer definition of relevant activities, and in particular the meaning and intended parameters of "engaging in or giving instructions on behalf of".

e. A new regulatory exemption for private trust companies and managed trust companies where they are operated as part of the services offered by a DNFBP.

f. Greater clarity around the use of, and reliance on, agents.

g. An expansion to the current definition of "professional fees" to increase the current NZ$1,000 limit, as well as the introduction of new provisions that where a DNFBP recommends, advises, or is involved in the engagement and instruction of a third party, receiving money from the customer for payment to that third party be excluded from the definition of "managing client funds" on the basis that the customer is not in control of the engagement.

h. A review and update of the *Amended Identity Verification Code of Practice* (**IVCOP**) to better recognise and utilise technological advancement and enable a reasoned risk-based approach to verification of identity.

i. Specific legislative provisions regarding access to legally privileged information, particularly in respect of auditors.

2.6 The Committee does not see the need for a comprehensive registration or licensing regime for all reporting entities. However, the Committee supports a more targeted licensing regime for currently unregulated service providers, such as trust and company service providers, who currently are not subject to any professional regulation whilst providing services that have been identified as having a higher risk of money laundering and/or financing of terrorism.

2.7 Members of the Committee have a diverse experience with the quality of section 59(2) audits conducted by AML/CFT auditors, and observes this can lead to an unfair advantage or disadvantage to reporting entities. Moreover, audits can be expensive and there is a risk that they provide a false sense of security, with reporting entities later discovering their supervisor considers there are areas of deficiency. In light of that, the Committee supports:

a. More explicit audit standards including guidelines and/or a framework for audits tailored for each sector/business type; and

b. Minimum qualification requirements/expectations for individual auditors.

The Committee would welcome further engagement on a possible auditing framework to promote consistency in audit quality.

2.8 The Committee supports the removal of the need for address verification given people are more transient in the modern era and it is difficult to obtain reliable documentary proof for some customers.

2.9 The Committee does not support the mandating of prescriptive timeframes for ongoing CDD as this is not a "one-size-fits all" situation.

2.10 For reasons of relevance and also to avoid "tipping off" customers, the Committee does not believe that a reporting entity should have to conduct EDD as currently prescribed under section 22A of the Act.

2.11 The Committee does not consider the definition of a "politically exposed person" (**PEP**) should be expanded to include domestic PEPs, as these people are not always high risk but in a small country, usually high profile and well known, making enhanced due diligence both potentially difficult and unnecessary. Furthermore, in the event such an individual was considered to represent genuine higher risk, enhanced due diligence should properly be triggered under section 22(1)(d).

3.0 Institutional Arrangements & Stewardship: Risk-based approach to regulation

3.1 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?

3.1.1 The Committee agrees that this type of legislation is suited to a risk-based approach given the breadth of coverage across multiple and varied industries and the purpose of the legislation. The approach promotes the accountability of reporting entities to consider and identify risks that are bespoke to their business.

3.1.2 The Act should provide a framework that enables reporting entities to implement programmes that can be flexible to changing risks. Too high a level of prescription can make programmes too fixed and unable to respond to changing risk and so, any areas where prescription is preferred need to be focussed and well-articulated.

3.1.3 The current legislation provides a risk-based framework in many areas, although there is room to better define and consider these in light of the experience of both reporting entities and the supervisors since the regime's implementation. The legislation could also specifically call out reporting entities rights to set their own standards with appropriate controls and justifications.

3.1.4 A particular concern the Committee has is that while the legislation is stated to be risk-based, there is increasing pressure on the regulators to provide directives and guidance to give reporting entities a degree of comfort of assurance. The issue with this is that, based on the experience of the members of this Committee, the supervisors (understandably) lean to prescriptive standards including in areas where the Act is silent or open to interpretation, and "guidance" takes on the status of legislative obligation.

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?

3.1.5 In this Committee's view, where there are common obligations across entities it is practical and preferable to have common standards. Obvious areas include CDD identity onboarding requirements and ongoing CDD obligations.

3.1.6. Minimum standards in these areas ensure level playing fields for all reporting entities commercially, while also providing a means of streamlining processes. The Committee considers there is room within both the IVCOP and the legislative requirements, to better clarify the obligations and provide reporting entities with achievable and understandable requirements.

3.1.7 The supervisors clearly state that any guidance they provide is not legal advice, does not provide protection to reporting entities and cannot be relied upon by reporting entities. At the same time, guidance is used by the supervisors to drive compliance and desirable standards, and often will trigger enforcement action. This disconnect needs to be addressed. Compliance comes at significant cost to reporting entities, many of whom are small to medium businesses. Much of that cost is in time spent trying to understand what is required versus what is expected or desirable. It is reasonable that this be more clearly set out for entities liable to significant repercussions for non-compliance.

3.1.8 The Committee also notes that when there is a lack of certainty around the standard of mandatory obligations, such as the parties in respect of whom CDD is required, this can create very real operational and practical issues between reporting entities trying to conduct business, but doing so from a different assessment of the requirements. The Committee has heard of multiple instances where one law firm requires certain documentation and verification and the law firm acting for the other party disputes the level of information being sought.

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

3.1.9 The Committee agrees that aligning proportionate risk with actual obligation is desirable. The Committee appreciates this is practically difficult given level of risk cannot be determined purely by size of business or volume or value of transactions.

3.1.10 The Committee would welcome more consideration of options that might enable this to be factored into the legislative regime.

3.2 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?

3.2.1 The Committee submits that exemptions are still required for the AML/CFT regime to operate effectively.

3.2.2 Given the umbrella approach of the legislation across so many sectors, exemptions remain the best way to mitigate unintended capture or excessive capture where there is minimal risk. The Committee does note however, that the exemption process is not one that is readily available to lawyers, who are captured by the nature of any activity and unlikely to apply (or be granted) an exemption irrespective of their size and perhaps minimal risk. The Committee does accordingly think the exemptions regulations also continue to be important.

3.2.3 The Committee makes the observation that the need for some exemptions may be impacted by amendments to the definitions of captured activities.

1.18. Should the Act specify what applicants for exemptions under section 157 should provide? Should there be a simplified process when applying to renew an existing exemption?

3.2.4 The exemption application as it stands is largely an unknown for reporting entities, with no clear direction as to the information to be provided or the process of review itself. Clarification of the requirements and transparency into the process would increase confidence in the regime and ability to access appropriate review processes, although as noted above, the process is not one that lawyers can likely access effectively.

3.2.5 It would appear to be desirable for both reporting entities and the Ministry that renewals be a simpler process than the initial application. Requirements around notification of any changes that might have impacted the original application and the decision to grant the exemption in the first place should be the focus.

1.20. Are there any other improvements that we could make to the exemptions function? For example, should the process be more formalised with a linear documentary application process?

3.2.6 The current exemption process lacks transparency and certainty with no indication of timeframes to applicants (and no obligations in respect of the same). This can result in a real sense of inconsistency and lack of fairness with some applications being turned around in a matter of weeks and others languishing for months.

3.2.7 It is also difficult for entities to identify where exemptions of a similar nature have been considered and potentially granted. There is no ability to search exemptions via business or industry type.

3.2.8 A linear documentary application process would better streamline the process.

4.0 Institutional Arrangements & Stewardship: Powers & functions of AML/CFT agencies

4.1 Powers of the Financial Intelligence Unit

1.30. Should the FIU be able to request information from businesses on an ongoing basis? Why or why not?

4.1.1 In the Committee's opinion the Financial Intelligence Unit (**FIU**) should not be able to request information from businesses on an on-going basis. In the context of legal practice there is the ever-present issue of privilege. However, for all reporting entities this could create an unrealistic and unmanageable burden. With respect, reporting entities are not extensions of the police. The regime already imposes significant obligations that impact on the operation of businesses and interaction with customers and clients. Any extension of power in this way has the potential to unduly disrupt businesses unreasonably.

5.0 Institutional Arrangements & Stewardship: Licensing and registration

5.1 Registration for all reporting entities

1.52. Should there be an AML/CFT-specific registration regime which complies with international requirements? If so, how could it operate, and which agency or agencies would be responsible for its operation?

5.1.1 The Committee does not see the sense of having a comprehensive registration regime given that the supervisors will have identified all reporting entities who have disclosed their status to their respective supervisor accordingly. A business ignoring (or genuinely unaware of) its AML/CFT reporting entity status – and that has therefore not identified itself to its AML/CFT supervisor – would presumably not register in any event. The Committee also notes that to some extent, at least as far as lawyers, there is an information register created via the Law Society, demonstrated by the generic mail sent to all law firms seeking information on their status prior to the Act's extension to the profession.

5.2 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?

5.2.1 Keeping in mind the Committee's position of opposition to a registration regime, the Committee submits that a comprehensive licensing regime would also be excessive and arguably unnecessary, particularly for already regulated professional services such as lawyers and chartered accountants holding public practising certificates with Chartered Accountants Australia & New Zealand (**CAANZ**). However, a more targeted licensing regime for currently unregulated service providers should in the Committee's opinion be considered.

5.2.2 Lawyers and chartered accountants are already subject to strong ethical obligations and regulatory oversight by their professional bodies. Breaches of professional and ethical rules can lead to financial penalties and/or loss of practising certificates – therefore loss of livelihood.

5.2.3 The particular window of risk the Committee has identified in the context of common experience in legal practice, is in relation to trust and company service providers (**TCSP**s) who are not currently subject to any professional regulation. It is likely there are other sectors who also present a higher risk of money laundering and/or terrorist financing where licensing should be considered.

5.2.4 The Committee considers the requirement to be licensed for otherwise largely unregulated sectors will drive higher standards of performance to retain a license to operate which will in turn better enable supervision of all reporting entities.

1.56. If we established an AML/CFT licensing regime, how should it operate? How could we ensure the costs involved are not disproportionate?

5.2.5 The Committee believes it would be appropriate to look at light-handed regulation rather than overly prescriptive regulation, but with sufficient ethical and professional standards to ensure that licensed parties behave acceptably and do not create reputational risk for New Zealand and/or heighten the risk of non-compliance with the AML/CFT regime.

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?

5.2.6 The Committee agrees that the licensing regime should apply only to sectors which have been identified as being highly vulnerable to money laundering and terrorism financing, and which are not currently licensed under any professional framework.

5.2.7 Further to the comments in paragraph 5.2.3 above, the Committee acknowledges there may be multiple sectors of significant risk. However, in line with the perspective stated in the background section, the Committee focusses this part of its submission on the potentially at-risk group of TCSPs who perform many services that are currently also performed by licensed lawyers and chartered accountants. This includes the incorporation of companies and the creation of trusts, provision of registered office services, provision of directors and nominee shareholders – all services captured within the definition of DNFBP.

5.2.8 In the Committee's view, to escape licensing under this proposal a TCSP should be subject to regulation governing professional standards, in circumstances where the ability to conduct the business will be lost if the TCSP or its officers are ejected from that regulatory body for breaches of professional standards.

5.2.9 The Committee observes that it is very common overseas for trustee companies and TCSPs to be licensed and regulated. The Committee expects that regimes currently in operation in other jurisdictions may provide good guidance for the type of licensing regime which might apply to TCSPs and similar businesses.

5.2.10 One advantage of going down the licensing route for not presently regulated businesses is that the licensing rules could include clear directions regarding the operation of internal trust accounts. Internal trust accounts and associated transactions are a severe area of risk compared with transactions which go through the banking system in the name of a specific entity (such as a company or a trust) and are subject to full due diligence and vetting by the bank in discharging its AML/CFT obligations. For transactions which pass through an internal trust account there is a much greater need for proper processes to be followed given that it is more challenging for the banks to provide oversight of each underlying transaction which will be recorded internally and not through the bank account.

5.3 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?

5.3.1 The Committee submits that any levies imposed in relation to licensing as per the suggestion above should be paid exclusively by those newly licensed businesses. The cost should not be shared across other reporting entities who already pay practising fees. Any costs should however take into account the size of the relevant entity and not impose a disproportionate burden or discourage competition in any sector.

6.0 Scope of the AML/CFT Act – Challenges with existing terminology

6.1 "In the ordinary course of business"

2.3. Should "ordinary" be removed, and if so, how could we provide some regulatory relief for businesses which provide activities infrequently? Are there unintended consequences that may result?

6.1.1 The Committee is very concerned at any suggestion that "ordinary" be removed in terms of determining capture in the course of business, certainly without very careful provision to ensure there is not inadvertent capture or potential capture that causes concern for entities and ensuing consequences for clients. For example, law practitioners may on occasion step in to assist another practitioner in a situation of urgency. If that practitioner is not a reporting entity but the services required are captured activities, it is likely a practitioner will not feel able to offer assistance.

6.2 "Managing client funds"

2.9. Should the fees of a third party be included within the scope of 'professional fees'? Why or why not?

6.2.1 The Committee submits that the fees of a third party should be included within the scope of "professional fees".

6.2.2 As drafted, Regulation 24AB of the Anti-Money Laundering and Countering Financing of Terrorism (Exemptions) Regulations 2011 only provides an exemption from the Act for the payment of third-party fees (e.g. expert fees) where the value is less than $1,000. In practice this does not alleviate much of the compliance burden for DNFBPs because third party fees often exceed this threshold.

6.2.3 In terms of balancing this exemption with the money-laundering/terrorist financing risks, the Committee submits that the definition should provide that where a DNFBP recommends, advises, or is involved in the instruction of the third party, receiving money from the client for payment to that third party is not managing client funds. This approach mitigates the risk of collusion between the client and the third party because the client is not in control of the engagement.

6.3 "Engaging in or giving instructions"

2.11. Have you faced any challenges with interpreting the activity of "engaging in or giving instructions"? What are those challenges and how could we address them?

6.3.1 The Committee heard extensively of the challenges in interpreting the activity of "engaging in or giving instructions". Specific challenges lawyers face arose from the following:

a. Where lawyers provide advice only on conveyancing activities then such advice may be captured by the Act given definition of "conveyancing". This is the case even if, in some instances, such advice does not turn into the sale or purchase of real estate (which is arguably where the money laundering/terrorist financing risk lies). This also presents an issue for matrimonial barristers where they:

   i. act for a client in relation to the transfer of property pursuant to New Zealand relationship property laws (e.g. on separation or death, pursuant to a Court order, or pursuant to the Property (Relationships) Act 1976);

   ii. provide advice to a client as to how a shared relationship property asset should be divided on separation; and

   iii. give instructions to another person (e.g. an instructing solicitor) on behalf of their client for legal work carried out to effect a variation of legal rights in real property in order to formalise a separation agreement.

   Such work should not, in the Committees' opinion, be captured by the Act as the risk of money laundering/terrorist financing is negligible.

b. By comparison, where a DNFBP is providing only advice in respect of other captured activities (e.g. structuring options for the establishment of a new business – which may involve a recommendation that a company is established; or personal estate planning options for an individual – which may involve a recommendation that a trust is established), this is not captured by the Act.

c. The Committee considers that the provision of advice only should not be captured by the Act in any circumstances. If the customer subsequently engages the reporting entity to carry out a captured activity (e.g. act for them on the sale or purchase of real estate, or the establishment of a new trust) then the activity is captured at that point and the law firm will have to satisfy its obligations under the Act.

d. There needs to be clarification and guidance as to when an engagement is not captured (on the basis the law firm is providing advice only) and when an engagement is captured (on the basis the line has been drawn and the law firm is no longer providing advice but is instead 'engaging in or giving instructions'). For example, if a law firm is asked to comment on a draft trust deed but does not actually attend to the execution of the trust, is this a captured activity, or is it the provision of advice only? Similarly, when advising on terms of a commercial agreement at what point does that cease to be considered the provision of advice and rather, engaging in a captured activity?

6.3.2 The Committee submits that the wording of this activity needs to be completely re-drafted on the basis that currently it is not clear how the activity should be interpreted and, as a result, law practitioners are not able to readily determine whether a particular piece of work is captured by the Act.

6.3.3 These challenges are further heightened as the Department of Internal Affairs (**DIA**), as the supervisor for DNFBPs, has not provided any commentary or examples as to how this activity should be interpreted (even though they have provided commentary and examples for all of the other DNFBP captured activities).

7.0 Scope of the AML/CFT Act – Potential new activities

7.1 Criminal defence lawyers

2.25. Should criminal defence lawyers have AML/CFT obligations? If so, what should those obligations be and why?

7.1.1 The Committee submits that criminal defence lawyers should have no AML/CFT obligations because:

a. it could jeopardise a person's right to seek legal advice and a person's right to access justice;

b. it arguably conflicts with the innocent until proven guilty system operates in New Zealand because individuals may be hesitant to seek legal advice;

c. it would burden criminal defence lawyers with AML/CFT reporting obligations when contemporaneously they are pleading their clients not guilty and putting the prosecution to proof;

d. it arguably undermines the trust which is implicit and fundamental to a lawyer-client relationship because clients may be hesitant or non-trusting of their lawyer who not only has a duty to act in their best interests but also a duty to report potentially suspicious activity under the Act; and

e. the legal profession already struggles with balancing legal professional privilege with their AML/CFT obligations and this would only become more of an issue for criminal defence lawyers.

8.0 Scope of the AML/CFT Act – Potential new regulatory exemptions

2.48. Should we issue any new regulatory exemptions? Are there any areas where Ministerial exemptions have been granted where a regulatory exemption should be issued instead?

8.0.1 The Committee notes that there is room for the Ministry to carve out low risk activities or activities that are already captured by a primary or first touchpoint reporting entity. Examples within the legal profession include lawyer to lawyer transactions where the lawyer processing the payment (ordering institution) undertakes that they have conducted the appropriate due diligence on the originator.

8.0.2 The Committee also considers relationship property services and legal service in connection with estates should be wholly exempted from the legislative regime. Both these areas can give rise to considerable challenges in terms of source of wealth/funds (may arise if relationship property in a trust) and historical wealth accumulation. Trustee services are, in this Committee's view, properly captured within the context of the legal practice as a whole and are discussed separately below.

8.1 Acting as a trustee or nominee

2.49. Do you currently use a company to provide trustee or nominee services? If so, why do you use them, and how many do you use? What is the ownership and control structure for those companies?

8.1.1 Many lawyers and law firms use companies to provide trustee and/or nominee services for the following reasons:

a. Administrative ease – Where a company provides trustee or nominee services, any two directors of such company can generally authorise transactions. The alternative is that such services are provided by individuals. The company option is preferable as the law firm can then nominate a number of directors (who are usually partners/directors of the law firm itself) to be directors of the trustee/nominee company. Therefore, where directors are away from the office transactions can still proceed as the other directors (or alternate directors) can provide the requisite authority.

b. Managing fiduciary risk – Trustees act personally. This means that a trustee is liable for losses incurred, even if the trustee cannot benefit from the trust. Although a trustee will have a right of indemnity from the trust, if the trust is insolvent the trustee can be left meeting the cost of any shortfall. A trustee company can reduce the risk of personal liability.

c. Independent and professional governance – It is generally advisable that trusts should have at least one independent trustee (meaning a trustee that is not also a beneficiary) who is experienced in the law relating to trust governance and administration. Lawyers (or law firm trustee company's) often fulfil this role.

8.1.2 It is difficult to quantify how many of these companies are being used by law practitioners as the approach may vary between law firms:

a. Some law firms have one company that acts as trustee/nominee for all clients to which such a service is provided.

b. Some law firms establish a new company for each client.

c. Some law firms adopt a mixed approach to the two mentioned above (often a historical issue).

d. Some law firms establish a new company every year to act as trustee/nominee for all clients such service is provided to during that year.

8.1.3 The Committee understands that law firms provide this information to the DIA in their annual AML/CFT report.

8.1.4 Based on the experience of the members of this Committee, there are generally three types of trustee companies – Firm Trust Companies (**FTC**s), Private Trust Companies (**PTC**s) and Managed Trust Companies (**MTC**s):

a. FTCs are the legal practice's in-house trust companies. These will generally act as co-trustee with clients (individuals or a family company). FTCs may be owned in a number of ways; including by the practitioners (or one or more of them), or their family trusts – just as 2 examples. However, in the broad sense these are clearly entities owned and controlled by the practice/law firm.

b. PTCs can have a variety of shareholders. For example, the ultimate beneficial owner, a family entity, a non-charitable purpose trust, a charitable trust, law firm partners, a law firm entity. PTCs tend to be used for a single trust or certainly a single family. Generally, they are not "in business" entities – in other words they are not charging trustee fees. They are captive entities controlled by existing reporting entities such as a law firm.

c. MTCs are somewhat different. These are generally only seen in the Foreign Trust space. They will act as a trustee for multiple trusts for diverse clients. Usually, the MTC will be the subsidiary of an overseas trust company. These tend to operate with shared administration between New Zealand service providers (such as the lawyer) providing local services, and staff of the parent or affiliated trust entity overseas. Full AML due diligence is covered twice; once by the parent trust company in its own jurisdiction, and again by the local reporting entity (e.g. legal practice) – usually after receiving CDD materials from the parent entity.

2.50. Should we issue a new regulatory exemption to exempt legal or natural persons that act as trustee, nominee director, or nominee shareholder where there is a parent reporting entity involved that is responsible for discharging their AML/CFT obligations? Why or why not?

8.1.5 The Committee submits that FTCs, PTCs and MTCs operated by a regulated professional firm should be permitted to come under the umbrella of the local managing law firm, accountancy firm or trust company (where it is a reporting entity, perhaps under the proposed licensing regime) as essentially captive entities, rather than being standalone reporting entities that duplicate compliance machinery and require each entity to have a separate risk assessment, AML/CFT programme, compliance officer, audit etc.. This would avoid unnecessary duplication of AML/CFT obligations.

8.1.6 The suggested exemption for a "subsidiary" will often not work as these companies are often not owned by the law/accounting firm. As a result, an exemption for only subsidiaries will not fully alleviate the compliance burden or issues currently faced.

8.1.7 Instead, the exemption should be available to all companies which for all intents and purposes are a part of the legal/accounting/ TCSP, given that the law firm/accounting firm will always provide one or more of the directors of the company.

8.1.8 Until very recently MTCs in New Zealand could, where applicable, take advantage of the "family trust exemption" which existed under section 20 of the AML/CFT (Definitions) Regulations 2011. That regulation was in effect from the inception of the Act for trustees and was extended, but has not been extended beyond its recent expiry.

8.1.9 It should also be noted that in a New Zealand context there is no such thing as a "nominee director". Internationally, some jurisdictions allow for nominee directors which are persons whose primary responsibility is to fulfil the wishes of a business owner. These nominee directors must only act on the business owners' behalf and cannot make any decisions in relation to the company independently. However, in a New Zealand context, a person is either a named director, with all of the duties and obligations of a director under New Zealand company law, or they are not named as a director. The Companies Act 1993 is prescriptive with the duties and obligations that attach to directors of a company. An individual cannot avail themselves of these duties and obligations on the basis they claim to only be a 'nominee director'.

2.51. If so, what conditions should be attached to such an exemption to ensure it does not raise other money laundering or terrorism financing vulnerabilities?

8.1.10 The Committee submits that, if this exemption was given, there would have to be a clear statement and acknowledgement that the parent professional practice will ensure that all AML/CFT obligations are discharged for the trust company as if the trust company itself was a reporting entity. The Committee's view is that this would be reflective of how lawyers, at least, currently operate their associated trustee companies.

9.0 Supervision, Regulation & Enforcement – Regulating auditors, consultants and agents

9.1 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?

9.1.1 The Committee agrees that there are wide variations in the quality of the independent audits.

9.1.2 In relation to the audit process the supervisors may consider providing guidance on the auditing system, including the principles of AML/CFT auditing, managing and conducting the audit programme, as well as guidance on the evaluation of competence of individuals involved in the audit process, including the person managing the audit programme, auditors and audit teams.

9.1.3 Guidance on audit methodology could include providing the independent auditor with guidelines on such areas as sampling for CDD. For example, random sampling for higher risk customers could be set, including where the reporting entity has overseas exposure, with parameters around testing size samples from these jurisdictions. Ultimately the Committee would support guidance with more prescriptive, but still risk-based, testing and assessment to ensure higher quality and more consistent auditing.

9.1.4 There is a relatively small pool of qualified independent auditors in New Zealand who currently conduct audits under section 59(2) of the Act. In particular, the Committee observes that there is a shortage of auditors appropriately qualified to audit law firms in New Zealand. Since 2018 there is an increasing number of organisations offering section 59(2) audits but many do not understand law firms, the specific AML issues facing them or a lawyers' obligation of client confidentiality and privilege.

9.1.5 The difference in quality of audits can result in an unfair advantage or disadvantage to reporting entities. A thorough audit by an appropriately qualified auditor is likely to reveal deficiencies in a law firm's risk assessment and/or AML/CFT programme (which then needs to be disclosed to the supervisor in the annual report). The same deficiencies may not be picked up by a less experienced or qualified auditor or by an auditor carrying out a less thorough audit. The Committee submits that quality of audits is also an issue that other sectors face.

9.1.6 The Committee has noted that there are variations in the quality of the audit report being provided to the reporting entity after the audit. The supervisors may wish to provide more explicit standards such as guidelines and/or framework tailored for each sector/business type (i.e., DNFBPs (lawyers, accountants, real estate agents), TCSPs, financial institutions, high value dealers, virtual asset service providers etc). This framework can be used as a guideline to help reporting entities understand what areas will be included but reporting entities may not be required to comply with all the requirements set out in the framework depending on the captured activities that are carried out by the business and whether the reporting entity is a low, medium or high-risk business. This ensures auditors cover those areas which are important to the supervisor and reduces the variation in the quality of the report the auditor produces after the audit.

9.1.7 With particular reference to section 59B(3), the Committee is aware of third party services where related entities provide both consultancy and audit services, including auditing of a programme prepared by the related entity. The Committee considers related entities should be prohibited from providing auditing services in these situations. The Committee also submits that employees changing employment or directors being appointed to the boards of either the auditor or reporting entity should be required to declare their interests annually to avoid AML conflicts of interest and ensure compliance of that section.

9.1.8 As per the Act, the auditor should be "appropriately qualified". However, there is no specific guidance on the minimum qualifications of a section 59(2) auditor.

9.1.9 The Committee recommends the supervisors set some minimum qualification requirements/expectations for individual auditors. Considering the complex nature of the Act and compliance requirements, the Committee recommends that an auditor should at least have formal qualifications including a degree at postgraduate level or an undergraduate degree with certification in CAMS (Certified Anti-Money Laundering Specialist) from ACAMS (or equivalent). Alternatively, an auditor should have at least three years of AML compliance experience working for a financial institution or DNFBP and have been supervised and trained by a senior staff member (with appropriate qualifications).

9.1.10 The Committee considers the current auditing provisions of the legislation are costly for reporting entities to implement and can result in reports that provide a false sense of security only for reporting entities to later discover their supervisor considers there are areas of deficiency. The Committee would welcome further engagement on a possible auditing framework to ensure more consistent audit quality.

3.12. Who would be responsible for enforcing the standards of auditors?

9.1.11 The supervisors will be in the best position to enforce the standards of auditors.

9.2 Agents

3.18. Do you currently use agents to assist with your AML/CFT compliance obligations? If so, what do you use agents for?

9.2.1 The Committee is aware that a significant number of reporting entities use agents to carry out functions such as vetting of the reporting entity's customers, reviewing ongoing client due diligence and account monitoring.

9.2.2 The Committee also draws attention to the particular pressure placed on law practitioners by other reporting entities (most commonly real estate companies) to provide the CDD it has completed on its clients and to release clients' confidential information such as passport details. The Committee considers greater clarity around the use and reliance of agents and what parties constitute agents, would assist relieve some of this pressure on practitioners.

9.2.3 As the AML/CFT regime is in its infancy relative to other countries (because the regime has only been in place for 8 years), reporting entities may not be aware of or know how or what steps to take to ensure that they appoint appropriate persons or entities who are able and competent to act as agent. Ultimately liability for responsibility with compliance of the Act lies with the reporting entity and consideration needs to be given as to whether appropriate safeguards need to be put in place.

3.20. Should there be any additional measures in place to regulate the use of agents and third parties? For example, should we set out who can be an agent and in what circumstances they can be relied upon?

9.2.4 As set out there is a lack of clarity about who can act as an agent and when the use of an agent is appropriate. This includes clarifying circumstances where a reporting entity can expect another reporting entity to share the CDD it has conducted, and the procedures or matters that an agent can be expected or asked to undertake – especially activities beyond CDD.

10.0 Preventive Measures – Customer due diligence

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

10.0.1 The majority of Committee members are also reporting entities or work within reporting entities and are well positioned to comment on the challenges of implementing the current CDD obligations (as interpreted by the supervisors) within the legal profession.

10.0.2 The most significant challenges are around the timing of CDD, the transposition of the concept of a "business relationship" into the lawyer/client relationship and the determination of the parties in respect of whom CDD must be conducted when working on a multi-party transaction that may involve multiple professional advisors.

10.0.3 Lawyers commonly rely on the delayed verification provisions of the legislation in order to discharge professional obligations to provide legal services promptly (e.g. advice sought prior to auction for a property). Similarly, there may be issues where clients do not have the accepted requisite identity documentation for the legislation but are still professionally bound to act.

10.0.4 While all reporting entities face challenges with CDD and refinement and clarification of the requirements to ensure greater standardisation across entities would assist this, the Committee also considers that the legal profession have specific issues that should be addressed in the legislation. Lawyers are subject to professional standards and obligations and failure to meet these can have significant disciplinary consequences. Not only are lawyers expected to accept instructions except in prescribed circumstances, they are also expected to carry out the instructions in a timely manner. In many instances practitioners' advice being instructed and having to start work immediately in order to respond to the urgency of the instruction - but CDD creates a potential barrier.

10.0.5 The Committee considers there needs to be bespoke provision for lawyers about when CDD can be conducted.

10.1 Definition of a customer

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?

10.1.1 Yes. Legal practice can range from the provision of simple personal services to advice on high risk and highly complex multi-jurisdictional transactions. In many instances, identifying the persons who meet the legislative definition of a customer can be difficult.

10.1.2 For example:

a. High profile international investment structures can involve many entities and numerous individuals at which it becomes practically impossible to conduct CDD on all persons. Most significantly, CDD on all those persons is unlikely to mitigate any risk in this Committee's view. The current approach seems designed to capture as many beneficial owners as possible which will often result in significant and disproportionate compliance obligations.

b. Urgent advice needed on the review of documents before an auction the following day and the urgency dedicates such instruction need to be done before CDD could be completed – this is further complicated by the possibility that another family member/shareholder may be entering into the sale and purchase of real estate agreement subsequently and no CDD was done for that in the first instance.

c. Property investment disputes usually involved funds from many parties/customers and usually only one customer would approach the law firm for initial advice. CDD would not have been completed for all those investors.

d. A customer (a vendor) may own a property for many years before the sale. How far are lawyers expected to go in confirming the source of funds used to acquire that property?

10.1.3 The Committee notes that at present the supervisors are (understandably) interpreting the definition of a customer very broadly which is enabling inconsistent and potentially unfair application of the Act across various sectors and entities.

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?

10.1.4 While the Committee supports a risk-based regime, there is also recognition that a clearer definition of customer, including who the customer is in specific situations, could be of significant assistance.

10.1.5 It is important in considering such definitions however, to ensure that it is not simply blanket capture and that definitions properly require CDD on parties where there may be genuine risk or relevance.

10.1.6 At present, in this Committee's opinion, there is a blanket approach to conduct CDD on multiple parties with relatively vague connection to a customer and with limited power. This imposes a heavy onus and cost on reporting entities without necessarily mitigating risk in any meaningful way.

10.1.7 The Committee would accordingly support further engagement with reporting entities before any definitions were agreed and implemented.

10.1.8 The Committee would support regulations to define customers in various situations subject to these regulations be discussed with reporting entities prior to development to ensure that there is a balanced approach that incorporates the risk-based principles of the regime.

4.4. If so, what are the situations where more prescription is required to define the customer?

10.1.9 The Committee considers it would be appropriate to consider definitions of customer in the context of limited partnerships, companies, trusts and complex company groups.

10.1.10 However, central to this would be the manner in which the definitions were approached as in this Committee's opinion, prescribing an overly broad capture of individuals will not achieve the requisite balance between risk and efficacy and sustainability.

10.1.11 Persons identified as customers through occasional transactions need to be better defined. The definition currently refers to persons conducting the transaction (the originator) but there are other provisions that refer to beneficiaries (passive recipients, not conductors) as being subject to CDD in occasional transactions (refer wire transfers definitions regulation). These are the types of conflicts that need to be properly addressed now that the regime has been operational for a number of years.

10.1.12 The Committee notes again that in the event the Ministry seeks to amend the current definition of a customer and in particular looks to be prescriptive for certain customer types, additional consultation should be sought.

10.1.13 The Committee also notes that the legal profession refers to customers as clients and the legislation should properly therefore include clients in a customer definition. There should also be a review for consistency where the term client is used (e.g. client funds) given it is not defined.

10.2 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?

10.2.1 The Committee considers the Act is generally clear as to the triggers of CDD but it could benefit from some refinement.

10.2.2 There are some potential cross-overs that would benefit from clarification and the use of more consistent language. For example, a reporting entity may conduct simplified CDD on a customer that is listed "in New Zealand or on an overseas stock exchange that has sufficient disclosure requirements and that is located in a country that has sufficient AML/CFT systems" (section 18(2)(p)) while section 22 triggers EDD on a customer that is a non-resident customer "from a country that has insufficient anti-money laundering and countering financing of terrorism systems in place" (section 22(1)(a)(ii)). It would appear that where a listed company is located in a country with sufficient AML/CFT reporting entities can conduct simplified CDD but if that the customer is "from" a country with insufficient systems EDD is required. Such anomalies or uncertainties should be addressed.

4.10. For enhanced CDD, is the trigger for unusual or complex transactions sufficiently clear?

10.2.3 No. The trigger for unusual or complex transactions can and does cause debate among reporting entities. A definition that provides some parameters would assist. The Committee note that the following trigger, that requires EDD where the level of risk is such that it should apply, is also sufficiently broad to capture situations that might not be captured within any definition, but would warrant EDD. This reduces the risk that a definition inadvertently restricts the application of EDD to higher risk transactions.

10.3 Managing funds in trust accounts

4.14. What money laundering risks are you seeing in relation to law firm trust accounts?

10.3.1 Internal trust accounts and associated transactions are a severe area of risk compared with transactions which go through the banking system in the name of a specific entity (such as a company or a trust) and are subject to full due diligence and vetting by the bank in discharging its AML/CFT obligations. For transactions which pass through an internal trust account there is a much greater need for proper processes to be followed given that it is more challenging for the banks to provide oversight of each underlying transaction which will be recorded internally and not through the bank account.

10.3.2 Solicitors' trust accounts at least have the benefit of coming under the Law Practitioners' Regulatory regime, and some level of audit or inspection review. The level of scrutiny may differ with other professional regulatory bodies.

4.16. Should this only apply to law firm trust accounts or to any DNFBP that holds funds in its trust account?

10.3.3 While the Committee is aware that it is important that trust accounts be subject to due review in the context of money laundering and terrorist financing risk, the Committee also considers that where trust accounts are subject to a form of professional or independent review, they will generally present less risk than those are not subject to any independent review. Accordingly, lawyers' trust accounts, which are subject to a form of regular review and strict regulations including reporting, should not in the Committee's view be considered the primary or sole risk in respect of managing client funds.

10.3.4 From a New Zealand reputational point of view, the Committee submits that there may be more concern with trust accounts operated by other service providers who are not subject to any oversight. The Committee is not entirely sure what the position is for chartered accountants – it is understood that there is some level of practice review, but not specifically a trust account review given that most accountants do not operate trust accounts.

10.3.5 In the experience of some Committee members, the risks appear most profound for TCSPs who are not within any professional regulatory regime and where there is ample scope for things to go wrong. For this reason, this Committee would suggest that TCSPs not captured by NZLS or CAANZ regulation should have their own licensing regime and some level of trust account audit and review. (See paragraphs 5.2.7-5.2.10 of this submission)

10.3.6 As things presently stand, the Committee imagines it would even be feasible for a TCSP to operate an informal trust account internally without its bank's knowledge. The Committee does know that banks operating solicitors' trust accounts will raise queries concerning transactions because they are obviously fully aware that the accounts are being operated for multiple clients, whereas it is conceivable that might not be the case for some other service providers operating undisclosed trust accounts.

10.3.7 The Committee also considers there are other sectors where funds are held in trust accounts and could be subject to the same or similar ML/FT risks as solicitors. Accordingly, it seems important to focus on the activity and the context in which it arises rather than by assigning capture by reference to the name of the business.

10.4 What information needs to be obtained and verified

4.18. Is the information that the Act requires to be obtained and verified still appropriate? If not, what should be changed?

10.4.1 The Committee submits that the information the Act requires to be obtained and verified is still appropriate in principle.

10.4.2 The basic level of information for identity verification seems in line with international standards with the exception of address verification which this Committee considers should be revisited.

10.4.3 The Committee considers the additional EDD requirements should be reviewed.

10.4.4 The Committee suggests some clarification on whether a reporting entity can rely on certification of source of wealth/funds from other professionals such as chartered accountants or other registered professionals (lawyers) overseas.

10.4.5 The Committee submits that source of wealth and source of funds should not be required if the work is not a transactional matter, such as dealing with a property dispute/caveat where the client contributed large sum in acquisition of the property but that happened years ago.

4.19. Are the obligations to obtain and verify information clear?

10.4.6 On the whole this Committee considers what needs to be obtained and verified for identity is clear.

10.4.7 However, reporting entities would benefit from more clarity around the obligations relating to nature and purpose and source of wealth and funds.

10.4.8 It is also not particularly clear what is required to meet the requirement to collect enough information to determine whether the customer should be subjected to EDD (please note that the consultation paper incorrectly refers to person rather than customer here).

10.4.9 In the event that address verification is retained, there should also be greater guidance about the standard required to meet this obligation given it falls outsider the IVCOP.

10.4.10 The Committee also notes that, as set out, CDD involves two stages, the collection of information and the verification of that information. As written, the delayed due diligence provisions appear to enable the delay of verification but not the delay of collection of information, however these sections are not consistently interpreted and applied across reporting entities and should be clarified.

4.20. Is the information that businesses should obtain and verify about their customers still appropriate?

10.4.11 In most instances where EDD is mandated, the additional verification obligations relate to source of wealth and funds. In this Committee's view this is not always appropriate and neither does it always address the actual risk presented. For example, where the activity that has given rise to additional risk is not transactional, wealth and funds may be of secondary importance to understanding about the identity of the parties involved. The Committee considers source of wealth and funds, while often significant, should not be mandated given the risk-based principles on which the Act is founded. Rather a reporting entity should be tasked with considering what additional verification is appropriate in the circumstances having regard to the specific risk factors.

10.4.12 In conjunction with clearer definitions of customer, the Committee also consider it would assist reporting entities if there were clear rules around what information must be gathered in respect of particular structures such as trusts and limited partnerships. Currently trusts are all deemed higher risk requiring EDD, but the obligations are "catch-all", with very wide capture of parties exercising control of a trust.

10.4.13 Please also refer to the response given above to consultation question 4.18.

10.5 Obligations for legal persons and legal arrangements

4.22. Should we issue regulations to require businesses to obtain and verify information about a legal person or legal arrangement's form and proof of existence, ownership and control structure, and powers that bind and regulate? Why?

10.5.1 The Committee recognises that the current requirements in respect of collecting and verifying information about customers that are legal persons or legal arrangements are not in line with the FATF standards. However, it does not support additional prescriptive regulations increasing obligations in this regard. More prescriptive requirements have the potential to not only increase compliance costs, but also to create more barriers to discharging professional obligations to provide legal services promptly.

10.5.2. Law practitioners commonly report concerns at the delays that the CDD process creates. Additional requirements will potentially extend such delays even further, and may also create more situations where the CDD cannot be completed give that access to offshore information is not always easy to obtain or verify and what is accessible can vary significantly across jurisdictions.

10.5.3 The Committee considers that reporting entities properly discharging their CDD obligations and managing their risks will ensure they obtain sufficient information. However, the Committee recognises some reporting entities may not make sufficient enquiries. Given this issue and the discrepancy with FATF standards, the Committee would support some additional non-prescriptive obligations around the level of information and understanding about the customer required.

10.6 Identifying the 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?

10.6.1 Yes. Many law practitioners have raised concerns over properly identifying beneficial ownership.

10.6.2 The supervisors have used a three-limb approach despite the definition having two limbs. This has created confusion when trying to properly assess the obligation and how it may be discharged. The concept of effective control is clearly important but can be difficult to apply e.g. a corporate trustee company shareholder, where there has been mixed guidance about the parties that are subject to CDD.

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

10.6.3 Most importantly any supervisor guidance must align with the actual definition. At present it does not. There is also a degree of overlap with "acting on behalf of" so for instance guidance refers to instances where directors "may" be beneficial owners where many practitioners would consider them to be acting on behalf of the company.

10.6.4 The Committee also seeks guidelines on the effort expected of a reporting entity when dealing with overseas entities, especially where entities are set up in tax haven countries, for it is hard to verify ultimate controlling ownership or source of funds in these situations.

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?

10.6.5 The Committee supports the issuance of a regulation on this because it would align to the position the supervisors have taken.

10.6.6 Any definition should align with the FATF standards. It must also include provisions for identifying the ultimate beneficial owner of complex structures and offshore corporates (particularly in tax havens) where there are no easily accessed registers or information.

4.33. To [what] extent are you focusing beneficial ownership checks on the 'ultimate' beneficial owner, even though it is not strictly required?

10.6.7 Based on the experience of this Committee members, many reporting entities already apply a form of an ultimate beneficial owner measure when determining the concept of exercising control. However, this is not always easy particularly in relation to companies based offshore, including in tax havens. In many instances access to information and documentation is limited.

4.34. Would there be any additional costs resulting from prescribing that businesses should focus on the 'ultimate' beneficial owner?

10.6.8 It is likely that some reporting entities would face increased costs if they have not already applied a form of ultimate beneficial ownership test. However, the Committee also considers this could be offset if there was a clearer definition that enable reporting entities to eliminate some of the parties in respect of whom they currently conduct CDD (clear provisions around directors of trustee companies; situations where directors are beneficial owners).

10.7 Process for identifying who ultimately owns or controls legal persons

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4.39. Should we issue regulations or a Code of Practice which is consistent with the FATF standards for identifying the beneficial owner of a legal person?

10.7.1 Yes, if the additional prescription would enable more efficient and effective processes and reduce the current burden on reporting entities tasked with trying to identify who should be treated as a beneficial owner especially where there are multiple stakeholders and not thresholds are triggered.

10.8 Identity Verification Code of Practice

4.45. Do you encounter any challenges with using IVCOP? If so, what are they, and how could they be resolved?

10.8.1 While the Code has not been amended for some time, the supervisors have updated guidance to the IVCOP on several occasions with the consequence that it has materially impacted how reporting entities have been expected to discharge the requirements.

10.8.2 There is also limited provision for exceptions and how they work, particularly in respect of electronic verification.

10.8.3 The IVCOP does not apply to higher risk customers but no additional advice has been provided about how verification of those customers should differ.

10.8.4 The Committee also notes that the emergence of COVID-19 and the significant changes to working conditions, with staff and clients restricted to their homes for long periods, has highlighted the shortcomings of the IVCOP and in particular its inability to be flexible and accommodate the need to change the way processes are undertaken. The Committee acknowledges the supervisors attempts to address this, but that is not ideal in the long term. The IVCOP needs to be capable of reflecting technological advances and provide verification processes that still reflect risk, but enable agility and flexibility.

4.46. Is the approach in IVCOP clear and appropriate? If not, why?

10.8.5 The Committee notes the IVCOP is not entirely clear and appropriate. As noted above the IVCOP has been subject to changing supervisor interpretation and guidance which has the consequence of making it potentially more prescriptive than intended. However, in concept it provides for a range of means through which verification can be achieved.

4.47. Should we amend or expand the IVCOP to include other AML/CFT verification requirements, e.g. verifying name and date of birth of high-risk customers verifying legal persons or arrangements, ongoing CDD, or sharing CDD information between businesses?

10.8.6 Yes. The IVCOP should be expanded to include higher risk customers, customers other than natural persons, and it should specifically include references to acceptable documentation such as an Australian Driver Licence.

4.48. Are there any identity documents or other forms of identity verification that businesses should be able to use to verify a customer's identity?

10.8.7 As noted in paragraph 10.8.6 an Australian Driver Licence should be acceptable and it is readily verifiable if relying on electronic verification.

10.8.8 The Committee also considers that there should be clarification around the requirement for originals of certified documents as advised is necessary by the supervisors. This imposes significant delays and issues on reporting entities in terms of completing CDD "before" entering a business relationship and risks could be managed through other reasonable methods (e.g. copy emailed from the business email of the person certifying the ID).

4.49. Do you have any challenges in complying with Part 3 of IVCOP in relation to electronic verification? What are those challenges and how could we address them?

10.8.9 Yes. Many clients may be resident in New Zealand but not hold New Zealand documents that can be readily verified online and the verification tools available for international identifications do not easily integrate into the New Zealand regime. The requirement for two name verification is particularly difficult where clients do not hold a New Zealand passport.

10.8.10 The Committee considers the current supervisor definition of a single independent electronic source should be reviewed (currently only enables RealMe to be relied upon) or there should be an alternative to reduce the high level of failures that still occur when trying to verify electronically.

10.9 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?

10.9.1 It is difficult to obtain documents that genuinely verify an address, given that many documents such as bank statements are sent by email rather than posted.

10.9.2 There are also issues when accounts are held by reference to initials (rather than a full name), held in associated entities such as family trusts, and where clients do not own property or hold accounts (e.g. flatting, boarding).

10.9.3 There are also challenges dealing with source documents from overseas and/or for overseas clients.

10.9.4 The difficulties make it difficult to streamline the CDD process.

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

10.9.5 This Committee does not consider that address information should be verified as part of the CDD process. People are transient, addresses can change and it is difficult to obtain documentary information for some clients.

10.10 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?

10.10.1 The Committee supports the removal of mandatory EDD requirement for all trusts, as it is common for many families to hold their family home in trust in New Zealand. These are not high risk or higher risk clients.

4.59. If we removed this requirement, what further guidance would need to be provided to enable businesses to appropriately identify high risks trusts and conduct enhanced CDD?

10.10.2 Guidance about the type of trust, the nature of assets held and type of dealings could be included in guidance. Reporting entities could also be required to undertake EDD in situations where any transaction was not in line with the nature and purpose of the trust when it was established.

4.60. Should high-risk categories of trusts which require enhanced CDD be identified in regulation or legislation? If so, what sorts of trusts would fall into this category

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10.10.3 The Committee supports high-risk categories of trusts, such as foreign trusts and trusts predominantly settled by non-resident or residents recently obtained their residency status (with an appropriate time period clearly defined in law upon public consultation), be identified in the legislation as requiring EDD.

10.11 Ongoing customer due diligence and account monitoring

4.61. Are the ongoing CDD and account monitoring obligations in section 31 clear and appropriate, or are there changes we should consider making?

10.11.1 The Committee notes that section 31 of the Act is vague and agrees that it may be helpful to provide regulations which set out the factors that should be considered in the ongoing CDD process. In particular, this could clarify when customer information should be reviewed in relation to customers on whom CDD has previously been conducted. The Committee does not necessarily think this would lead to an increase in compliance costs but would ensure clarity.

10.11.2 The Committee considers that one helpful provision to add to section 31 or in regulations would be to provide that customer information formerly received should be reviewed and new information obtained where there is a material change in the instructions received by the reporting entity. Without limiting general ongoing CDD and account monitoring obligations, it would be helpful for reporting entities to know that in these situations they should carry out CDD. However, the Committee does not consider that every instruction requires CDD to be conducted anew.

4.65. Should we mandate any other requirements for ongoing CDD, e.g. frequency it needs to be conducted?

10.11.3 The Committee does not consider that mandating timeframes for ongoing CDD would be sensible and opposes this suggestion. This is a further layer of compliance which would not have any appreciable benefit. If a reporting entity considered that it should carry out, for example, annual CDD, its compliance programme could contain this requirement. An identical timeframe is clearly not appropriate for all reporting entities and all their customers.

4.67. Should we issue regulations to require businesses to review activities provided to the customer as well as account activity and transaction behaviour? What reviews would you consider to be appropriate?

10.11.4 The Committee notes that a reporting entity already has obligations in relation to considering suspicious activities and has to be alive to activities sought to be conducted through it. However, the Committee cautions against being prescriptive on the activities and behaviours in regulations and suggests to entrust the reporting entity with the capability in making judgement calls on a case-by-case basis as per its risk assessment.

4.69. Do you currently review other information beyond what is required in the Act as part of account monitoring? If so, what information do you review and why?

10.11.5 The Committee does not feel that prescriptive obligations for ongoing CDD in the form of regulations would add considerably to the AML/CFT regime. The additional compliance costs to this would far outweigh the benefit. It is unrealistic to expect reporting entities to consider the customer's IP address (the example used in the Consultation Document) or what purpose this would serve.

4.70. Should we issue regulations requiring businesses to review other information where appropriate as part of account monitoring? If so, what information should regulations require businesses to regularly review?

10.11.6 For the reasons stated above, the Committee would not be in favour of prescriptive regulations being issued as suggested.

10.12 Conducting CDD on existing (pre-Act) customers

4.71. How could we ensure that existing (pre-Act) customers are subject to the appropriate level of CDD? Are any of the options appropriate and are there any other options we have not identified? What would be the cost implications of the options?

10.12.1 The Committee notes that the exclusion on conducting CDD on existing (pre-Act) customers (unless there is a material change and the reporting entity considers it has insufficient information) means that CDD may never need to be carried out on certain customers. The Committee appreciates that this is a vulnerability.

10.12.2 The Committee considers that the words "material change" are helpful and would not amend the trigger to be simply "change".

10.12.3 The other two options mentioned in this section of the Consultation Document ("Making the trigger an 'or' rather than an 'and'" and "Introducing a timeframe or 'sinking lid' for existing (pre-Act) customers") would ensure that up to date CDD would be carried out.

10.12.4 Whichever option is proposed, reporting entities would need to be given sufficient time to take the necessary steps to ensure compliance.

10.13 Avoiding tipping off

4.71. 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?

10.13.1 The Committee does not believe that a reporting entity should have to conduct EDD under section 22A. First, the reporting entity has gathered information which has led it to believe that there is a suspicious activity – this should suffice. Second, as is noted in the Consultation Document, carrying out enhanced CDD on a customer when it was not originally mentioned could be a warning sign / tip off the customer. Further, the Committee also notes the elements of EDD as currently required may not always be relevant – for example a client selling a property who appears willing to accept a below value settlement for no apparent reason. In such scenario the source of wealth or source or funds are irrelevant.

11.0 Preventive Measures – Record keeping

4.76 Do you have any challenges with complying with your record keeping obligations? How could we address those challenges?

11.0.1 The Committee is aware that auditors may request records that are properly subject to legal privilege. The issue of privilege has been referenced in this submission in the context of reporting suspicious activities and audits, but it should also be considered in respect of record keeping obligations. While the provisions of the Act support the view that auditors are not entitled to request privileged information, there is no specific prohibition. The Committee considers this would be helpful in clarifying the position.

12.0 Preventive Measures – Politically exposed persons

12.1 Definition of a politically exposed person

4.82 Should the definition of 'politically exposed persons' be expanded to include domestic PEPs and/or PEPs from international organisations? If so, what should the definitions be?

12.1.1 The Committee does not consider that the definition of "politically exposed person" should be expanded to add domestic PEPs. As is noted in the Consultation Document these persons are not always high risk. Furthermore, given the relatively small population of New Zealand, they are often well known and it can be unnecessarily intrusive based on risk to enquire into their source of wealth or funds, particularly if they are not the actual client. Clearly if the circumstances of a customer mean that there is increased risk, a reporting entity has to conduced enhanced CDD under section 22(1)(d). However, the Committee does not think that this should be mandated for all domestic PEPs.

13.0 Preventive Measures – Internal policies, procedures and controls

13.1 Compliance programme requirements

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?

13.1.1 The Committee is of the view that it should not be a mandatory requirement for the compliance officer to be at senior management level of the business (as prescribed by FATF standards) and that this decision should be left to each reporting entity. The key is that if an individual is not appointed within senior management, then it should be mandated that the employee should report to senior management (as is currently required).

13.1.2 A small reporting entity may more than likely appoint an employee at senior management level (either director or partner or principal) due its small workforce. However, a medium to large reporting entity may employ an individual (who already has appropriate qualifications and/or AML/compliance experience) or appoint an existing employee who reports to senior management.

4.189 Should the Act clarify that compliance officers must be natural persons, to avoid legal persons being appointed as compliance officers?

13.1.3 The Committee supports clarifying the Act that the compliance officers must be natural persons employed by the reporting entity. It is preferable that the compliance officer is not a legal entity and the function may not be outsourced to a third party as the responsibility for compliance with the Act ultimately lies with the reporting entity.

13.2 Review and audit requirements

4.192 Do we need to clarify expectations regarding reviewing and keeping AML/CFT programmes up to date? If so, how should we clarify what is required?

13.2.1 The Committee considers that it would be helpful for some clarity regarding reviewing and keeping AML/CFT programmes updated. It could be in the form of guidance notes issued by the supervisors and be flexible enough to accommodate the businesses' risk level and captured activities rather than a codified, prescriptive set of complex rules.

13.2.2 It is expected that a reporting entity's AML/CFT programme should take into account new guidelines and/or updated guidelines issued by the relevant supervisor. Frequency of updates should be explicitly included in the reporting entity's AML/CFT programme.

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

13.2.3 It may be useful for legislation to state that the purpose of independent audits is to test the effectiveness of a reporting entity's AML/CFT system.

13.2.4 In summary, the reporting entity's AML/CFT programme should be sufficient to cover the reporting entity's particular business, bearing in mind the requirements of the Act.

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?

13.2.5 Please refer to section 9.1 of this submission, where the Committee has recommended that some explicit standards be provided to independent auditors in relation to the independent audit and review requirements.

13.2.6 In summary, the Committee recommends that independent auditors be provided with an auditing framework to promote consistency and quality audit. The framework could be based on a risk managed approach for sectors, transactions, and industries rather than a codified catch-all set of complex requirements. The Committee welcomes further opportunity to discuss details of any proposed auditing framework.

14.0 Preventive Measures – Suspicious activity reporting

14.1 Improving the quality of reports received

4.203 How can we improve the quality of reports received by the FIU and avoid low-quality, defensive reporting?

14.1.1 There are a number of barriers to effective reporting for reporting entities at present. This includes the system through which reports are filed and operational issues, the high level of rejection of reports or challenges (e.g. the FIU may dispute your assessment of the particular risk which seems at odds with the report being the reporting entity's suspicion), the threshold for filing versus the messaging from the FATF that there is under-reporting, particularly with DNFBPs.

4.204 What barriers might you have to providing high quality reporting to the FIU?

14.1.2 As noted, there is a general disconnect about when and what to report. The constant messaging from the FIU is they want quality reports. However:

a. Reporting entities are not the police and do not have the right to demand information from parties, especially parties who are not their customers/clients.

b. The report must be filed within three days of forming the suspicion and you may form a suspicion but still not have collected all relevant information.

c. The filing process is onerous and overly complicated. This could dissuade entities from filing.

d. There is no requirement or provision to update a report once it has been filed.

e. There is an additional burden on lawyers to, also within the three-day frame, determine whether information has lost privilege. Lawyers are not protected from filing a SAR in the same way as other reporting entities as they may be subject to consequences where they should have known information was privileged. In such circumstances, lawyers will err on the side of caution and likely withhold any information where there is a risk it may be privileged.

f. The issue of privilege is challenging and the threshold for loss of privilege is much higher than the standard required to form a suspicion. The Committee is not sure the FIU are fully appreciative of the complexities facing the profession in this regard.

4.205 Should the threshold for reporting be amended to not capture low level offending?

14.1.3 No. It would be too difficult to effectively define low level offending and low-level offending could hide much higher-level offending or operate as a step into higher offending.

The ADLS AML/CFT Law Committee would welcome the opportunity for further engagement (by meeting or an alternative arrangement similar to oral submissions), especially during the targeted consultation stage in February 2022, where the Ministry and ADLS may come together to discuss a range of solutions to the issues identified in this submission.

The Committee also acknowledges the contributions to this submission by its following members:

- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted] (Committee Secretary).

If you have any questions or queries please contact the Professional Services Manager, [redacted], by email: [redacted]@adls.org.nz or DDI: [redacted]

Ngā mihi

[redacted]

Convenor
ADLS AML/CFT Law Committee