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Attachments: RMV AML Submission.pdf

With apologies for the delay, **attached** is Russell McVeagh's submission in response to the Review of the AML/CFT Act consultation paper.

We would be happy to discuss any aspect of our submission with you.

Regards

[redacted]

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10 December 2021 **By email**

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REVIEW OF THE ANTI-MONEY LAUNDERING AND COUNTERING FINANCING OF TERRORISM ACT 2009

1. INTRODUCTION

1.1 This is Russell McVeagh's submission in response to the consultation paper entitled Review of the AML/CFT Act issued by the Ministry of Justice dated October 2021 ("**Paper**") in relation to the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 ("**AML/CFT Act**" or "**Act**").

1.2 A robust, effective, and modern AML/CFT regime is crucial for New Zealand, both in terms of domestic law enforcement and our international obligations. We support the purpose of the Act and welcome the opportunity to have input in relation to its development.

1.3 At the same time, it must be recognised that the compliance obligations imposed on reporting entities create friction in relation to:

(a) the relationship between reporting entities and their customers;

(b) the legitimate movement of funds;

(c) the acceleration of digital innovation; and

(d) ultimately, the efficient operation of the New Zealand economy.

1.4 A balance must be struck between these competing pressures. We are therefore encouraged by references throughout the Paper to the need to not compromise the ease of doing business, not unduly impact the lives of New Zealanders, and carefully balance the need to address the harms of money laundering and terrorism financing while ensuring that businesses can operate efficiently and innovatively. While we do not agree with every aspect of the Paper, we commend the balanced approach that the Ministry has taken to the Paper and look forward to continuing to work constructively with the Ministry throughout the

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statutory review process to ensure that New Zealand's AML/CFT regime is the best it can be.

1.5 Our submissions are based on our experiences as a reporting entity, from the legal sector in general, and from advising various reporting entities. We also make thematic observations in relation to the effectiveness of the Act and the AML/CFT regime.

1.6 Our submission is structured to reflect the structure of the Paper. We have not addressed every topic or answered every question, but we have noted the questions to which our submissions relate in the footnotes.

2. INSTITUTIONAL ARRANGEMENTS AND STEWARDSHIP

Risk-based approach to regulation

Applying for exemptions from the Act

2.1 Our view is that exemptions are absolutely critical for the regime to operate effectively.[1] The AML/CFT Act is drafted in extremely broad terms, and does not contain some of the built in exemptions and minimum activity thresholds that are so helpful in other legislation like the Financial Service Providers (Registration and Dispute Resolution) Act 2008 ("**FSP Act**"). For this reason the AML/CFT Act often has potential application to businesses that were not intended to be in scope (and present little to no ML/CFT risk), and so the exemption regime is critical to ensuring the Act is functioning as designed. The exemptions issued by the Minister to date demonstrate the need for the exemption regime to exist.

2.2 One key point in relation to exemptions is the effect they can have on innovation. Businesses creating new products and services (particularly in financial services) often find that the AML/CFT Act applies to the new offering in an unintended or disproportionate manner. Our experience is that a well-functioning exemptions regime (with appropriate safeguards in place) is crucial to ensuring that innovation by New Zealand's businesses is not stifled. For this reason we agree with the proposal that an operational decision maker such as the Secretary of Justice be established, to avoid the timing implications of having a Minister of the Crown involved in that process.[2]

Licensing and registration

2.3 We do not consider that a separate AML/CFT-specific registration or licensing regime is necessary or helpful.[3] The Financial Service Providers Register ("**FSPR**") already fulfils this function for financial service providers, and the relevant provider's AML status is confirmed in each annual confirmation. In addition, see our comments in response to question 2.12 in relation to aligning

[1] Question 1.14.
[2] Question 1.15.
[3] Question 1.52.

the scope of the two Acts, which would make a separate registration regime unnecessary.

2.4 Reporting entities are already subject to a heavy (and expensive) compliance burden, and to impose an additional registration regime (that arguably does not serve any function) would further exacerbate this problem. We do not agree with the statement in the Paper that "An AML/CFT registration regime would enable supervisors to clearly identify which businesses they are required to supervise".[4] Ultimately it would still be up to the relevant businesses to identify that they have AML/CFT obligations and make the necessary registration, and the supervisors already have that same information available to them. For example, businesses that have identified they are subject to the Act and would make a registration under any new registration requirement are likely to be the same businesses who currently create an AML Online account and lodge an annual report each year.

2.5 From our perspective it is difficult to see how creating a formal registration requirement would materially affect the Department of Internal Affairs' ("**DIA**") understanding of its reporting entity base, given both processes rely on the relevant business identifying they are subject to the Act and making the necessary registration or account application. To the extent businesses are failing to identify that they are subject to the Act, or intentionally not complying, creating a registration regime will not make any substantive difference. The DIA (or other relevant supervisor) would still need to have systems in place to identify those businesses who are not complying with the Act when they should be, which is no different to the current position.

2.6 If the Ministry does consider that there is a need to introduce fit-and-proper checks for certain types of regulated entities, this can be integrated with the FSPR in the same way as the recent introduction of certification requirements for providers of consumer credit contracts and mobile traders under the Credit Contracts and Consumer Finance Act 2003 ("**CCCFA**"). The certification is managed by the Commerce Commission, but the registration is still on the FSPR (rather than being a separate registration regime).[5]

3. SCOPE OF THE AML/CFT ACT

Challenges with existing terminology

"In the ordinary course of business"

3.1 We consider that the current requirement that activities are provided "in the ordinary course of business" should be retained in the Act.[6]

3.2 This is an important provision for ensuring that the application of the Act is proportionate. The obligations imposed on reporting entities under the Act are, of course, onerous. While one-off activities may carry some degree of money

[4] Paper, p 15.
[5] Question 1.54.
[6] Question 2.3.

laundering and terrorism financing risk, that risk is clearly lower where a business is not making an activity ordinarily available to the public. We agree with the observation in the Paper that requiring business to develop full compliance programmes for potentially one-off activities would be disproportionate.

3.3 For example, a common financing technique for a business that sells goods is to sell and assign the receivables arising from the sale of goods. As part of that assignment, the business would receive the income from the receivables on behalf of the purchaser and pass on that income, which would fall within limb (iv) of the definition of "designated non-financial business or profession".[7]

3.4 The existing guidance provided by the AML/CFT supervisors on the interpretation of the "ordinary course of business" requirement is relatively (and, we consider, appropriately) conservative, meaning that any "ordinary" activity is clearly within scope.

3.5 To the extent that the Ministry proposes to approach this issue by adopting a "middle ground", one option would, for example, be to require the reporting of suspicious activities even where they arise in relation to activities provided by a reporting entity that do not form part of its ordinary course of business. However, consideration would need to be given to how a reporting entity would determine "suspicion" in such circumstances, given that it would, by definition, not have a baseline of information about a customer through the CDD process against which to identify suspicious activity.

"Engaging in or giving instructions"

3.6 We agree that the meaning of the phrase "engaging in or giving instructions" is not clear and should be clarified.[8]

3.7 We do not agree that it is clear that it is intended to capture those business which are involved in "preparing and assisting customers" to undertake specified activities. In our view, this suggests that a low level of involvement may be sufficient to meet the "engaging in or giving instructions" test. That perspective is not justified by the legislative history of this provision.

3.8 In particular, we note that:

(a) the exposure draft of the bill that became the Anti-Money Laundering and Countering Financing of Terrorism Amendment Act 2017 used the wording "engaging or giving instructions in relation to";

(b) it was suggested that this should be amended to "prepare for or carry out transactions"; and

(c) the Law and Order Committee considered that this wording would be too broad, so the wording was changed to "engaging in or giving instructions in

[7] There is an existing overlap between this limb and other financial institution activities, as recognised at Question 2.7.
[8] Question 2.10.

relation to" to narrow the scope and "ensure a connection to the actual transaction".[9]

3.9 We agree with the Law and Order Committee's comment that there needs to be a connection to the actual transaction for this wording to be engaged. Merely advisory work relating to an (actual or potential) transaction of the type described should not be sufficient to meet the "engaging in or giving instructions" test.

3.10 Any clarification of the meaning of this phrase should seek to draw as clear a line as possible between *preparing for* and *engaging in* a relevant transaction.

Definition of financial institution activities

3.11 We agree that the terminology in the definition of financial institution should be more closely aligned with the meaning of "financial service" provided in section 5 of the FSP Act.[10]

3.12 In addition, recent changes to the FSP Act mean that the FSP Act also applies to any reporting entity. Accordingly, any alignment would be overridden by this provision in any case. However, given the clearer territorial scope of the FSP Act (as discussed in relation to question 2.56), in our view it may be more logical for any entity that is required to be registered on the FSP Act to be a reporting entity (ie the reverse of the current position).

3.13 We have not, for the purposes of this submission, included detailed comment on each of the financial institution activities. However, we have commonly encountered issues with the interpretation of a number of the definitions and would strongly encourage the Ministry to carefully consider the precise scope of each of those activities, and "refresh" them where appropriate, to ensure that they appropriately capture activities carrying money laundering and terrorism financing risk, and are not unduly over- or under-inclusive.[11]

Stored value instruments

3.14 We agree that the definition of "stored value instruments" should be technology neutral, such that digital means of storing value are subject to the same rules as physical means of storing value.[12]

Potential new activities

Acting as a secretary of a company or partner in a partnership

3.15 We do not consider a proposal to capture persons acting as company secretaries or partners in partnerships is workable.[13]

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[9] Anti-Money Laundering and Countering Financing of Terrorism Amendment Bill 2017 (248-3) (select committee report) at p 4.
[10] Question 2.12.
[11] Question 2.13.
[12] Question 2.22.
[13] Question 2.23.

3.16 Company secretaries are commonly employees of the company. Many businesses (including most law firms) are structured as partnerships. We do not consider that it is appropriate or workable to require employees who act as company secretaries, or individual partners in partnerships, to be reporting entities and to have AML/CFT obligations in relation to their employers or other partners. To the extent that the proposal is to capture only *third parties* who provide these services, that would need to be carefully defined and clearly stated. However, we note that such an approach is likely to simply incentivise companies to obtain those services in-house.

Criminal defence lawyers

3.17 We do not consider that it is appropriate to capture criminal defence lawyers as reporting entities under the Act.[14] While law firms providing designated services are appropriately captured, an obligation on criminal defence lawyers (who are, by definition, defending suspects of crime) to report the activities of their clients to the Financial Intelligence Unit ("**FIU**') cuts to the heart of, and undermines, the lawyer-client relationship. Such an erosion of a person's right to consult and instruct a lawyer[15] who is obliged to act in their best interests[16] cannot be justified by reference to the further intelligence this may produce.

Territorial scope

3.18 We agree that the AML/CFT Act should define its territorial scope and that this is preferable to non-binding guidance.[17]

3.19 By way of contrast, the new formulation at section 7A(1)(a) of the FSP Act provides a clear definition of when an entity falls within the territorial scope, with a series of considerations and appropriate exemptions. There is a requirement that the services are provided to persons in New Zealand, but recognises the circumstances where this may occur without triggering a need to be registered on the FSPR. For example:

(a) the extent to which the service is provided must be greater than the prescribed minimum thresholds;[18]

(b) it does not apply merely because the services are accessible by persons in New Zealand, which recognises that some financial services are provided on a reverse enquiry basis without active solicitation of New Zealand customers; and

(c) there is an exemption for overseas businesses who do not promote their services in New Zealand.

[14] Questions 2.25 and 2.27.
[15] New Zealand Bill of Rights Act 1990, s 24(c).
[16] Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules 2008, r 13.
[17] Question 2.56.
[18] For completeness, we note that some of these thresholds should be considered further in the context of the relevant activity, for example acting as an offeror of financial products is usually a one-off activity.

Russell McVeagh

4. SUPERVISION, REGULATION AND ENFORCEMENT

Agency supervision model

4.1 We consider that the current agency supervision model is working adequately and that the cost, time and disruption of changing the model does not justify any potential benefit it would bring, *provided that* further steps are taken to ensure consistency across the DIA, Financial Markets Authority ("**FMA**") and Reserve Bank of New Zealand ("**RBNZ**").[19]

4.2 We acknowledge the work that the supervisors have done to work closely with each other, including on the "triple-branded" guidance. However, from the perspective of commercial certainty, consistency and equity, it is essential that there are no substantive areas on which the supervisors' interpretation and approaches differ. Unfortunately, as the Paper notes, there have been instances of inconsistency. How the Act applies to a reporting entity should not depend on who their supervisor is.

4.3 While the supervisors cannot be expected to check every interpretation with each other, where substantive issues of interpretation arise and inconsistencies are identified, the supervisors should ensure that they reach a single concluded view.

4.4 While we do not have visibility of interactions between supervisors, we do not understand that this would require legislative change. The supervisors could, for example, enter into a memorandum of understanding style document identifying processes by which they will reach a single concluded view when inconsistencies arise.[20]

Powers and functions

4.5 We agree that (wholly or partial) remote inspections should be permitted.[21]

Regulating auditors, consultants and agents

4.6 We agree that it is important for the sound function of the AML/CFT system that audits are of good and consistent quality. However, we understand that audit demand already far outstrips supply. It will be necessary, therefore, to ensure that any further prescription in relation to audits or auditor qualifications does not impose barriers to entry that are too high and make it even more difficult for reporting entities to access auditors.[22]

4.7 We do not consider any special recognition or regulation or consultants to be necessary.[23] From a statutory perspective a reporting entity is and should remain liable for non-compliance, even where that non-compliance may be the result of reliance on a consultant. A reporting entity is deriving the financial

[19] Question 3.1.
[20] Question 3.2.
[21] Question 3.7.
[22] Questions 3.11 and 3.13.
[23] Question 3.15.

benefit from providing a financial activity or a designated non-financial business or service and it is appropriate that they bear the financial risk of non-compliance.

4.8 We consider that the law of obligations provides adequate remedies for poor quality consultancy work in the AML/CFT space. For example, a reporting entity who has received negligent advice from a consultant may be able to sue a consultant for negligence or breach of contract. These matters are appropriately dealt with between the parties, where parties can freely negotiate the terms of their arrangements, rather than requiring regulation through the Act.

4.9 Similarly, we do not regard regulation of agents, either in the context of money or value transfer service providers, or more broadly, as necessary.[24] Again, it is appropriate that the reporting entity should be liable for any non-compliance by its agent. We do not consider that it is necessary for the Act to be amended to explicitly state this, given that it will generally be the case under the law of agency.

4.10 The Paper states that "The lack of any standards or registration and licensing requirements for agents risks criminals or their associates from providing services on behalf of a registered or licensed business and exposing that business to money laundering and terrorism or financing risks".[25] It is not clear whether this is a theoretical possibility or an actual example. In any event, that risk could be mitigated by amending s 57(1)(a) and (b) to expressly refer to agents and their employees (as well as employees of the reporting entity).[26]

Offences and penalties

Comprehensiveness of penalty regime

4.11 We agree that there is a "gap" in the Act currently for what is described in the paper as "moderately serious non-compliance".[27] That gap could be appropriately filled by the creation of appropriately specific and curtailed infringement offences.

4.12 We do not consider that it is appropriate for the AML/CFT supervisors to be able to unilaterally withdraw a business's licence or registration for non-compliance with the AML/CFT Act.[28] This is a serious consequence for a business (essentially putting it out of business) and court intervention should be required before this step is taken. Enabling the supervisors to stop a business from operating would also arguably cut across the court's power to grant an injunction in s 87.

[24] Question 3.20.
[25] Paper, p 42.
[26] Question 3.20.
[27] Question 3.21.
[28] Question 3.22.

Sanctions for employees, directors and senior management

4.13 Under the existing regime, individuals can be liable as a party to an offence committed by a reporting entity under the AML/CFT Act, where they acted with intention to facilitate the offence by the reporting entity.[29]

4.14 It is therefore not quite correct to say, as the Paper does, that the penalties in the Act can only apply to businesses themselves, and not their directors or senior management. Individuals were convicted as parties to offences under the AML/CFT Act in *R v QF, FC and JFL*.[30] We acknowledge, however, that the Paper's focus is on the possibility of civil liability applying to directors, senior managers, and other employees.

4.15 Given other developing legislation in the financial services space, caution should be exercised before introducing direct liability for directors or senior management into the AML/CFT Act.[31] For example, the exposure draft of the Deposit Takers Bill (which will apply to a number of the most substantial reporting entities) proposes to impose a due diligence duty on directors to ensure compliance with the deposit taker's "prudential obligations". "Prudential obligations" in the Bill is then defined to include obligations under the AML/CFT Act. The RBNZ has indicated that such an obligation may eventually also be applied to other financial institutions within its regulatory remit. Establishing a parallel liability regime for directors in the AML/CFT Act would create the risk of regulatory overlap and potential inconsistency in requirements.

4.16 It will be important that any restrictions on insurance or indemnification are appropriately prescribed and in this respect we consider that the provisions in the Deposit Takers Bill are more appropriate in the AML/CFT context than the equivalent provisions in the CCCFA.

4.17 We consider the position of compliance officers is meaningfully different to the position of directors and senior managers such that, even if civil liability were imposed on those individuals, it should not be imposed on compliance officers.[32] Directors and senior managers, by the nature of their position and role, have the ability to set the tone for a reporting entity in terms of compliance, as well as to make strategic decisions at the company level to ensure that adequate investment in systems and processes is in place to ensure compliance.

4.18 The compliance officer's position is fundamentally different. Recent High Court decisions have demonstrated the difficulties that compliance officers can experience in discharging duties associated with the role of maintaining an AML/CFT programme. For example, in *Financial Markets Authority v CLSA Premium New Zealand Limited* [2021] NZHC 2325, two CLSAP NZ compliance officers resigned over the relevant period due to disagreements with CLSAP NZ directors, with one director saying a "bendier" compliance officer was required.[33]

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[29] *R v QF, FC and JFL* [2019] NZHC 3058 at [240] and [241].
[30] *R v QF, FC and JFL* [2019] NZHC 3058.
[31] Question 3.25.
[32] Question 3.27.
[33] At [47(c)].

4.19 It would be out of step with other financial services regimes that impose liability on individuals for liability to be imposed on someone below the senior manager level, such as a compliance officer, and we do not regard it as justified.

5. PREVENTIVE MEASURES

Customer due diligence

Definition of a customer

5.1 The definition of "customer" under the Act offers limited assistance in identifying who a reporting entity's customer is.

5.2 The definition of "customer" exists in isolation to the broad groups of *activities* captured by the Act. This leads to a lack of clarity in circumstances which are non-routine (eg when many parties are involved in a complex transaction). Various reporting entities find it challenging to identify their customer, particularly where they interact with various third parties and do not necessarily communicate with the person who may be regarded as the "underlying" customer. In a number of scenarios (for example, (ii) in relation to factoring and (viii) in relation to securities issues), it is not immediately clear who the customer is and who the reporting entity is. A common theme of unclear situations is where there are various intermediary institutions and/or back-to-back contracts.[34]

5.3 In our view, more prescription would be helpful.[35] For example, the Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (Cth) in Australia usefully sets out each designated service captured by the Act and the corresponding customer (at s 6). We recommend that this structure should be adopted in New Zealand. The United Kingdom has also moved towards a prescriptive approach in identifying the specific customer involved in the relevant captured activity.[36]

5.4 Adopting this approach would ensure consistency of approach and allow the reporting entities to adopt standardised approaches to on-boarding international and/or complex clients.[37]

When CDD must be conducted

Simplified CDD

5.5 In our experience, the simplified CDD provisions in the AML/CFT Act (set out in sections 18 to 21) frequently create practical issues when dealing with overseas clients.[38]

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[34] Question 4.2.
[35] Question 4.3.
[36] The Money Laundering and Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (UK), at part 2 (chapter 1).
[37] Question 4.5.
[38] Question 4.9.

5.6 The list of entities eligible for simplified CDD does not include many overseas entities who operate under supervisory regimes equal to or, in excess of, the requirements set out in 18(2).

5.7 For example, large investment managers, pension funds, nano-banks, insurers, and Fortune 500 companies regularly do business in New Zealand but do not fit within the categories listed in section 18. These entities usually have large boards and senior leadership teams, are publicly known and often will be already subject to regulatory review. They are often of the same nature as many of the New Zealand based entities that qualify for simplified CDD under the existing rules; and they present very low money laundering or terrorism financing risk. However, because of the simplified CDD provisions of the Act, these entities are commonly subject to standard or enhanced customer due diligence.

5.8 We suggest that regulations are passed in respect of section 18(2)(q) of the Act in order to designate as eligible for simplified, any entity corresponding to an entity listed in section 18(2) that is located in a country that has sufficient AML/CFT systems in place.[39]

"Acting on behalf of" requirements

5.9 In August 2013, the AML/CFT supervisors released a fact sheet on "acting on behalf of a customer" ("**PAOB Fact Sheet**"),[40] which relates to Phase 1 entities such as banks and other financial institutions. In particular, the PAOB Fact Sheet states that a person is acting on behalf of a customer when that person is "operating or transacting *on an account or facility* that is held by another party (the customer)".[41] The PAOB Fact Sheet gives various examples, including a person with authority to sign, amend account holder details, transfer, and spend in the customer's name. In the context of financial institutions, the guidance is reasonably clear.

5.10 The PAOB Fact Sheet was not updated after 1 July 2018, when Phase 2 entities became subject to the Act. For reporting entities that are not financial institutions, there is often no clear parallel to such persons in their relationships with customers. In the context of a law firm's customer, there might be many people from whom instructions are received, and it is currently not clear if all of these individuals are to be regarded as "acting on behalf" of that client.

5.11 We understand that in other jurisdictions (for example, the United Kingdom and Australia), information on the person acting on behalf of a client is not required when conducting CDD on individuals or entities.

Conducting customer due diligence in all suspicious circumstances

5.12 While we can see the potential benefit of requiring CDD to be conducted in suspicious circumstances outside a business relationship, we consider that there

[39] Question 4.9.
[40] FMA, RBNZ and DIA "'Acting on behalf of a customer' fact sheet" (August 2013). See https://www.fma.govt.nz/assets/Guidance/acting-on-behalf-of-a-customer-fact-sheet.1.pdf
[41] "'Acting on behalf of a customer' fact sheet" at p 1.

are significant practical limitations to this option.[42] In particular, often the only incentive a customer has to comply with a reporting entity's request for CDD information is because they want to access the service that the reporting entity provides (and can only do so once CDD has been completed). If CDD was required to be conducted on a person conducting an occasional transaction through a reporting entity, potentially after the transaction has been conducted and the reporting entity has formed a relevant suspicion, it is difficult to see what incentive the person will have to comply with a reporting entity's requests.

What information needs to be obtained and verified

Source of wealth versus source of funds

5.13 We agree that greater prescription in terms of the following would be helpful:[43]

(a) what "source of wealth" and "source of funds" means;

(b) in what circumstances "source of wealth" and/or "source of funds" information is required to be obtained.

Identifying the beneficial owner

Definition of beneficial owner

5.14 We strongly urge reform of this area: we consider that the way in which the definition of "beneficial owner" has been interpreted is the single biggest issue with the Act as it currently stands.[44]

5.15 We are aware of considerable uncertainty amongst reporting entities in relation to identifying persons on whose behalf a transaction is conducted ("**POWBATICS**"), in particular.[45] The current New Zealand position on POWBATICS (at least as it is set out in guidance) is also not currently in alignment with FATF and other jurisdictions.

5.16 We acknowledge that the reference to POWBATICS in the definition of "beneficial owner" is intended to ensure consistency with FATF's guidance. However, as the Paper notes, it has had the opposite effect. As we understand it, the purpose of the FATF guidance is to ensure that reporting entities have regard to transactions being conducted on behalf of another person *when determining who has effective control of a customer*, rather than for a "standalone" purpose. We do not consider that those references to POWBATICS have to be included in the definition of "beneficial owner" in order to convey this requirement.

[42] Question 4.11.
[43] Question 4.25.
[44] Question 4.30.
[45] Question 4.30.

5.17 We therefore consider that the best solution to this issue would be:[46]

(a) to **repeal** the references to POWBATICS in the definition of "beneficial owner", such that it would read:

> beneficial owner means the individual who—
>
> (a) has effective control of a customer; or
>
> (b) owns a prescribed threshold of the customer

(b) for the supervisors to issue **guidance** stating that, in determining who is a beneficial owner of a customer, reporting entities should have regard to transactions being conducted on behalf of another person which might imply that the other person has effective control or ownership of that customer.

5.18 Given the confused state of New Zealand law on this point, we do not consider that it can be adequately resolved through regulation or guidance alone and we encourage the Ministry to adopt a definitive legislative solution to this major issue affecting New Zealand reporting entities.

Beneficial owners in general

5.19 More generally, it can be difficult to identify beneficial owners of complex customers, who often have no direct relationship or communication with the customer "on the ground".

5.20 Without good access to reliable information on beneficial ownership, reporting entities have limited ability to understand who is behind the legal entities and legal arrangements. Reporting entities therefore are significantly disadvantaged as a result of New Zealand's and other countries' limited beneficial ownership transparency. We acknowledge that this issue cannot be resolved by law change alone. However, we suggest that an appropriate starting point would be extensions of simplified CDD eligibility to capture entities that are already subject to transparency and public disclosure in both New Zealand and other jurisdictions, in order to reduce the burden of identifying beneficial owners of those entities.

Reasonable steps to verify information obtained through CDD

Identity Verification Code of Practice

5.21 We agree with the observations in the Paper that there are gaps in the Identity Verification Code of Practice that could usefully be filled, including in terms of the approach for higher risk customers and expansion of the forms of acceptable identification.[47]

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[46] Question 4.31.
[47] Questions 4.45 and 4.46.

5.22 The current Act and the Code of Practice are predominantly geared towards historic ways of client interaction, predominantly face-to-face and reliant on paper documents, or copies thereof. Whilst the updated explanatory note[48] goes some way to recognising the growth of biometric solutions and providing advice around the use of them, it is still rooted in the notion of physical copies being the primary source of identity.

5.23 We consider that identity verification will increasingly occur electronically, and we have already seen this trend accelerate as a consequence of COVID-19 lockdowns. It will therefore be important that the Code of Practice is more regularly updated than has been the case in the past in response to technological developments.[49]

5.24 Whilst the new explanatory note is helpful in terms of electronic verification, we suggest that the view offered in example 6 in respect of RealMe is developed to provide greater guidance around what other biometric measures provide *"a high degree of confidence in an individual's identity"*.[50] In our experience, many electronic identity verification providers now follow the process as set out in that example.

Verifying the address of customers who are natural persons

In general

5.25 Address verification has proven to be difficult for both reporting entities and customers. We are not sure whether it is materially useful from an enforcement perspective.[51]

5.26 The most common forms of photo identification (passports and driver licences) do not typically satisfy the requirement to verify a person's address. As reporting entities move away from paper-based CDD procedures, they must rely on databases such as New Zealand Transport Agency and DIA to verify name and date of birth. None of these are authoritative in terms of confirming address. There is no high-quality address database with broad coverage in New Zealand.

5.27 When conducting due diligence relying on biometric interrogation of Australian Driving Licenses, a customer may fail address verification against Australian databases. This is because the addresses assessed are historic ones from when a (potentially) decade old document was issued.

5.28 These challenges lead to disproportionate resources being allocated to manually verifying addresses and collection of paper-based evidence. Typical methods of manual address verification, such as bank statements or utility invoices, are very simple to forge. A criminal with any level of sophistication will easily navigate the address verification requirement. As acknowledged in the Paper, people often

[48] "Explanatory Note: Electronic Identity Verification Guideline".
[49] Question 4.49.
[50] "Explanatory Note: Electronic Identity Verification Guideline" at p 11.
[51] Question 4.50 and 4.53.

change addresses and it is relatively easy to update one's address with a utility provider without providing proof.[52]

5.29 After a customer's name and date of birth have been verified from an independent and reliable source, address verification does not materially increase the confidence of correctly verifying that customer's identity.

5.30 We suggest that the costs of address verification far outweigh any benefits, and it should be removed as a legislative requirement.[53]

5.31 Alternatively, we suggest consideration of the Australian regime in respect of address verification, which can be broadly summarised as follows:[54]

(a) for individuals (including sole traders and beneficial owners of a trust), there is a need to verify either their address or their date of birth;

(b) for government bodies, there is a need to verify their address; and

(c) for others (ie companies, partnerships), there is a need to collect addresses, but no need to verify them.

Persons acting on behalf of customers

5.32 The current requirement to collect address material, and to take reasonable steps to verify that information, are particularly disproportionate insofar as they relate to "persons acting on behalf of customers".[55]

5.33 By collecting information which evidences the individual's authority to act and any professional identifier, a reporting entity can clearly link the individual to the client and understand that they act with that customer's authority.

5.34 Any concerns/red flags should then be assessed in light of the customer's overall risk profile and any subsequent FIU submissions should detail the customer's address(es) rather than that of the person acting on behalf.

5.35 The FIU would be able to request employee/contractor records to contact any persons of interest, including persons acting on behalf of a customer.

5.36 It is suggested that the requirements for persons acting on behalf of customers be confined to *identity* of the person acting, and on linking that person authoritatively to the client. The requirement to identify and verify the address should be removed.[56]

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[52] Paper, pages 59 to 60.

[53] Question 4.51.

[54] Australian Transaction Reports and Analysis Centre ("**AUSTRAC**") "Customer identification and verification: easy reference guide" (10 October 2019). See: https://www.austrac.gov.au/business/how-comply-and-report-guidance-and-resources/customer-identification-and-verification/customer-identification-and-verification-easy-reference-guide

[55] Questions 4.18 and 4.20.

[56] Question 4.18.

Obligations in situations of higher and lower risk

Mandatory enhanced CDD for all trusts

5.37 We agree that the requirement that enhanced CDD be conducted for all trusts should be removed.[57] There are a variety of situations in which the risk posed by trusts is not high and the "one size fits all" approach therefore does not align with a risk-based approach. We agree that it would be helpful for guidance to the provided which identifies which types of trusts are high risk and do require enhanced CDD.[58]

Ongoing customer due diligence and account monitoring

Ongoing CDD requirements where there are no financial transactions

5.38 We agree that the application of the obligation to review "account activity and transaction behaviour" to DNFBS is not clear and this should be clarified.[59]

Conducting CDD on existing (pre-Act) customers

5.39 We consider that steps should be taken to resolve the lack of clarity around the timeframe within which reporting entities are required to conduct CDD on existing customers.[60] The current circumstances in which a business is required to conduct CDD on an existing customer are open to interpretation and can be difficult to apply:

(a) Because by definition a reporting entity has not carried out CDD on an existing customer, it may not have sufficient information about the customer to determine whether a material change has occurred. We do not consider that this issue would be resolved by removal of the word "material" from the trigger.

(b) While to some extent that may be resolved by the "insufficient information" trigger, the measure against which "sufficiency" is to be determined is not clear.

5.40 To the extent that the review of the Act results in significant changes to preventive measures, careful thought should also be applied to transitional arrangements to ensure that the changes do not have retrospective effect for reporting entities.

Record keeping

5.41 We agree that it is appropriate for reporting entities to be required to keep records of the parties to a transaction outside a business relationship or below the occasional transaction threshold.

[57] Question 4.58.
[58] Question 4.59.
[59] Question 4.67.
[60] Question 4.71.

5.42 We do not agree with the view that all records must be available "immediately".[61] While this may be workable for certain types of records, such as transaction records, it does not appropriately reflect the breadth of a reporting entity's record keeping obligations, which extend (for example) to:

(a) "records that are relevant to the establishment of the business relationship"; and

(b) "any other records (for example, account files, business correspondence, and written findings) relating to, and obtained during the course of, a business relationship that are reasonably necessary to establish the nature and purpose of, and activities relating to, the business relationship".

5.43 On their face, these provisions capture broad categories of documents. While it is of course appropriate that such records are retained, it is not reasonable for the Act to impose an obligation on reporting entities to produce them "immediately" upon request. Some time will necessarily be required in order for a supervisor to be furnished with copies of such records, for example when records are kept in a language other than English (as permitted by s 52).

5.44 In *Perpetual Trust Ltd v Financial Markets Authority* [2012] NZHC 2307, the High Court held that notices issued under s 25 of the Financial Markets Authority Act 2011 that purported to require the supply or production of documents "immediately" were issued unlawfully. The Court stated:[62]

> In my view, the nature and extent of the information and documents required by the Authority in its s 25 notice was such that no reasonable recipient could have supplied it "immediately".
>
> …
>
> Having said that, in a case where a small number of readily accessible documents are sought, a request for immediate delivery is not likely to be unreasonable.

5.45 Consistent with this approach, the Act should clearly define which (if any) records are required to be retained in a form enabling their "immediate" production, and which are not.[63]

Implementation of targeted financial sanctions

5.46 We agree that more can be done to ensure that businesses are aware of and supported in implementing their obligations in relation to targeted financial sanctions ("**TFS**").[64]

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[61] Paper, p 113.
[62] At [36].
[63] Question 4.76.
[64] Question 1.6.

5.47 Although there are differences between a (risk-based) AML/CFT regime and (prescriptive) TFS obligations, in our view it is sensible for these matters to be addressed in conjunction. We agree that better mechanisms for government to communicate information in relation to designated persons and entities to reporting entities is a necessary precursor.

Wire transfers and prescribed transaction reports ("PTR")

5.48 In our experience, difficulties arise in the application of the wire transfer (and therefore the PTR) provisions in the Act for a number of connected reasons:[65]

(a) the wire transfer provisions of the Act were in force before the PTR obligations were, and the PTR obligations were "overlaid" on top of the wire transfer provisions in an imperfect manner;

(b) the Act was designed for financial institutions and has been subsequently re-purposed for DNFBPS. This means that it is not as clear as it should be in the Act as to whether, and in what circumstances, law firms have PTR filing obligations; and

(c) the definitions do not reflect how bank payment systems operate in practice.

5.49 We agree with each of the challenges with the definitions used that are set out at pages 82 and 83 of the Paper. In addition, the exclusion from the definition of "wire transfer" of "transfers and settlements between financial institutions or other reporting entities if both the originator and the beneficiary are financial institutions or other reporting entities acting on their own behalf":[66]

(a) could be interpreted as excluding transfers and settlement between two financial institutions, regardless of whether they are acting on their own or someone else's behalf. It appears to us that this is a drafting error arising from the addition, in 2017, of the words "or other reporting entities" into this provision; and

(b) could be interpreted to exclude every wire transfer between two financial institutions (or reporting entities) acting on their own behalf, even where those wire transfers are conducted through other financial institutions, such as banks, who are not acting on their own behalf. It is not clear if this is intended.

5.50 We suggest that the wire transfer provisions (and in particular the definitions) are redrafted "from the ground up" to clarify the roles of the relevant parties (as things stand, the Paper describes this better than the Act or the wire transfer guidance), reflect the value of the information collected and, wherever possible, ensure that obligations align with bank payment systems.

[65] Question 4.139.
[66] Question 4.141.

Russell McVeagh

Internal policies, procedures, and controls

Compliance programme requirements

5.51 We have considered the suggestion that groups of financial and non-financial business implement group-wide programmes to address the risks groups are exposed to.[67] This is a situation where non-binding guidance from the AML/CFT supervisors would be helpful without being overly prescriptive.

5.52 Where parts of the group have similar risks or it is logical to consider the group as a whole, we would expect that entities would take advantage of such efficiencies and have a common programme, given that compliance costs for the Act is often significant.

5.53 However, if group-wide programmes are mandated, it will be difficult for groups to cater for different parts of the group which face different risks and may not necessarily be appropriate in all cases, for example where group members are in a number of different jurisdictions.

Higher risk countries

5.54 We agree that it is not always possible or proportionate to require reporting entities to assess country risk given the complexity of this exercise.

5.55 In our view this is an area where further (joint) guidance from the supervisors would be welcome.[68] While we acknowledge that different countries might pose different levels of risk depending on the sector a reporting entity is operating in, we consider it should be possible for the supervisors to generally categorise countries by risk level (in the same way that they currently do for business and activities in the sector risk assessments). Reporting entities could then rely on that centralised risk assessment as a form of "safe harbour": if they treat a country as having at least the risk level identified by the supervisors, they should be regarded as compliant; if they treat a country as having a lower risk level, they would be required to justify that assessment.

Yours faithfully
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[67] Question 4.191.
[68] Question 4.195.