aml

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To: aml
Cc: [redacted]
Subject: Submission from Trustees Executors Limited - Review of the AML/CFT Act
Attachments: AML CFT Statutory Review Trustees Executors Limited.pdf

Good afternoon
Please find attached Trustees Executors' submission on the Review of the AML/CFT Act.

Regards

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26 November 2021

AML/CFT Act Consultation Team
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Dear Consultation Team

Review of the AML/CFT Act Consultation Document – Submission by Trustees Executors Limited

We are writing to provide a submission on the Consultation Document. We have not commented on all questions, but rather ones that have the most relevance for our business and customers. Terms and abbreviations used are as per defined within the Consultation Document.

By way of background to our submission, Trustees Executors Limited is a Reporting Entity by way of being a Financial Institution and a Designated Non-Financial Business and Profession (DNFBP). Areas of our business include:

- Acting as a supervisor of debt issuers, managers of managed investment schemes, and as a Statutory Supervisor of Retirement Village Operators
- Acting as trustee and security trustee for other commercial trusts
- Acting as a custodian of managed investment schemes and institutional funds
- Provider of investment accounting and registry services for managed investment schemes
- Providing financial advice and discretionary investment management services
- Acting as a trustee of family trusts and charitable trusts
- Acting as an executor of deceased estates

This means activities as defined under section 5 of the AML/CFT Act capture our business as a Reporting Entity include:

- participating in securities issues and the provision of financial services related to those issues
- investing, administering, or managing funds or money on behalf of other persons
- managing individual or collective portfolios
- investing, administering, or managing funds or money on behalf of other persons
- transferring money or value for, or on behalf of, a customer
- safe keeping or administering cash or liquid securities on behalf of another person;
- managing client funds (other than sums paid as fees for professional services), accounts, securities, or other assets
- acting as a formation agent of legal persons or legal arrangements
- acting as, or arranging for a person to act as, a nominee director or nominee shareholder or trustee in relation to legal persons or legal arrangements

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Areas we would like to highlight within the consultation include:

- Recommending a provision be included within the AML/CFT Act that requires periodic evaluation of the effectiveness of the AML/CFT Act. This is would not be a FATF focused compliance evaluation but rather a domestic assessment to assist guide future policy in what measures are proving effective in reducing financial crime.
- Amendments to existing simplified CDD definitions within section 18(2)(h) and (i) of the AML/CFT Act as it relates to statutory supervisors and trustee corporations. In practice the current definitions allow for very limited application.
- Simplifying the Prescribed Transaction Report (PTR) requirements so this obligation lies only with banks and other money or value transfer services. This will avoid confusion, double reporting and non-reporting.
- We are also supportive of the recognition that typically New Zealand trusts have different uses and therefore risk profiles to those identified as higher risk offshore. Consequently, our view is enhanced due diligence requirements should be relaxed in many instances.
- We support the senior manager delegation proposal in replace of full CDD measures for 'persons acting on a behalf' of a customer.

We would be happy to discuss any part of this submission or provide further feedback at any time.

Your sincerely

Compliance Manager
Trustees Executors Limited

AML/CFT Statutory Review Consultation

Purpose of the AML/CFT Act

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

The purpose of the Act is to:

- detect and deter money laundering and terrorism financing; and
- maintain and enhance New Zealand's international reputation by adopting, where appropriate in the New Zealand context, recommendations by the Financial Action Task Force; and
- contribute to public confidence in the financial system.

The purpose could also explicitly state it is to "*reduce social harms*".

We also recommend de-emphasising adoption of FATF Recommendations from the purpose of the Act. New Zealand should not be limited by the Recommendations or deterred from non-adoption if measures are proven to be ineffective. This does not preclude adopting FATF Recommendations within the body of the Act, but it would place the emphasis on detecting, deterring (and preventing) ML/FT rather than on technical compliance of FATF positions.

To reflect the very high cost to business we also recommend including an "additional purpose" section to the Act, and include:

- *To avoid unnecessary compliance costs.*

Such a provision is similar to that outlined within the Financial Markets Conduct Act 2013.

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

We support this measure in principle. However, how this is achieved will be the challenge. We would also stress the need to consider additional costs to Reporting Entities and the effectiveness of any new measures.

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

One criticism of the current AML/CFT regime is that it telegraphs the 'rules of the game' to criminals. This makes it very easy for criminals to present as legitimate as they are able to avoid obvious red flags. Consequently, it may be that the objective can be better achieved other than through placing further obligations on Reporting Entities. For example, significant amounts of criminal funds have been confiscated since the introduction of the Criminal Proceeds (Recovery) Act 2009. Other measures that assist police may be more effective.

Applying for exemptions under 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?

Exemptions are necessary. For example, Notice Number 2013-go2954 provides a partial exemption for Statutory Supervisors that hold occupational right agreement deposits on trust for pending residents of a retirement village. Without this exemption, the process would become disorderly. It is unclear how a Reporting Entity could gain comfort the activity is not subject to the Act without an explicit exemption.

Businesses providing multiple types of activities

2.4 Should businesses be required to apply AML/CFT measures in respect of captured activities, irrespective of whether the business is a financial institution or a DNFBP? Why or why not?

Our business is both a Financial Institution and a Designated Non-Financial Business or Profession (DNFBP). We support ensuring all relevant activities are captured, regardless of whether the entity meets the definition of multiple reporting entity types.

While we have not interpreted this to be an issue, we would support any clarification if requested by other reporting entities.

2.5 If so, should we remove "only to the extent" from section 6(4)? Would anything else need to change, e.g. to ensure the application of the Act is not inadvertently expanded?

We would caution about simply removing these words without further qualification. Previously reporting entities have relied on this section to understand that the scope of the Act only applies to captured activities, not other non-captured activities the company may be involved with.

2.6 Should we issue regulations to clarify that captured activities attract AML/CFT obligations irrespective of the type of reporting entity which provides those activities? Why or why not?

Our view is the obligations are currently clear.

2.7 Should we remove the overlap between "managing client funds" and other financial institution activities? If so, how could we best do this to avoid any obligations being duplicated for the same activity?

We have been cognisant of the overlap but do not feel this has provided any significant confusion for our business.

However, we are aware about confusion as to whether tax agents completing tax returns for clients would be a captured activity. DIA guidance suggests this is dependent upon whether this involves "managing client funds". This is interpreted to mean whether money is transferred which is currently better reflected under Financial Institution activities. Consequently, it would be beneficial consolidating "managing client funds" with the other similar activities in one definition and have this definition applied to both Financial Institutions and DNFBPs.

2.8 Should we clarify what is meant by 'professional fees'? If so, what would be an appropriate definition?

There would be benefit in clarifying this definition. While we concur with the DIA's interpretation, the actual position is less clear.

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

No. Payment to a third party is a typical money laundering typology.

Definition of financial institution activities

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

We would support such measures. The FSP Register would then also be a more complete register to capture whether Financial Institutions are Reporting Entities. Consideration could also be given to whether the FSP Register could be used as a Reporting Entity Register to include those that are not financial service providers.

Definition of Financial Institution activities

2.13 Are there other elements of the definition of financial institution that cause uncertainty and confusion about the Act's operation?

The following definition requires updating:

(viii) participating in securities issues and the provision of financial services related to those issues

When this definition was drafted it reflected the relevant financial markets legislation at the time, the Securities Act 1978. Rather than "securities", a more current definition would be "financial product".

However, we would also highlight that the role of 'participants' has also changed since the introduction of the Financial Markets Conduct Act 2013 (FMCA). For example, there is now licensing of certain participants and the role of supervisor has also added to the function of trustees as it relates to registered schemes and retail debt securities issues.

A licensed supervisor, custodian, administration manager, and licensed investment manager may all be 'participants in a securities issue' of managed investment products and consequently be customers in relation to each other. However, the ML/FT risk lies with investors in the managed products, not between the participants.

We recommend updating and clarifying the intent of this definition.

Preparing annual accounts and tax statements

2.35 Should preparing accounts and tax statements attract AML/CFT obligations? Why or why not?

This activity is more likely to capture ML/FT activities than many other activities under the Act, and on that basis, we can see merit in including these activities.

2.36 If so, what would be the appropriate obligations for businesses which provide these services?

Obligations should be limited to suspicious activity reporting. This would ensure the focus is on the risk that matters.

Please also refer to our comments under question 2.7.

Currently exempt sectors or activities

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

We request amendments to existing exemptions be made in order to effect their risk and intent.

Section 18(2)(h) and 18(i) of the AML/CFT Act allows for a Reporting Entity to conduct simplified CDD on a statutory supervisor and trustee corporation respectively. This reflects the low risk of the beneficial ownership of these organisations. The risk is low as statutory supervisors are subject to the scrutiny of supervisor licensing requirements. The Financial Markets Authority's Sector Risk Assessment also rates ML/FT risk within this sector as "Low". New Zealand's trustee corporations originated in the 19th century and are subject to industry and their own individual Acts of parliament. There are four trustee corporations, one of which is a subsidiary of a crown entity. In this respect the trustee corporations have significantly different attributes to other types of trustee companies and justify the option of Reporting Entities conducting simplified CDD on them.

However, we request an amendment to the above definitions as its application has a limitation in that it can only be applied where the trustee company "acts for itself". In our view there should be no distinction between where the entity acts for itself or where it acts on behalf of others. It is likely the intent of this condition is to ensure the trustee's simplified CDD position could not be used to mask those it was acting for in a trustee capacity; however, this risk does not exist in practice.

Take for example where a trustee corporation is acting as trustee of a family trust. If the Trustee (corporation) places funds with Reporting Entity "A", Reporting Entity "A" will be required to undertake CDD on the family trust. However, due to the limitation of the exemption, Reporting A will typically undertake CDD on the directors and shareholders of the Trustee (corporation). Removing the exemption limitation of 'where acting for itself', would not increase ML/FT risk as Reporting Entity "A" would still be required to undertake CDD on any settlor, protector, co-trustee, or beneficiary with a vested interest of the trust. Source of funds/wealth is also currently required. These are the areas of ML/FT risk that are intended to be addressed, not the otherwise recognised low ML/FT risk of the governance and ownership of a trustee corporation. One of the four mentioned trustee corporations is able to avoid this limitation as it can instead have simplified CDD applied by fact it is a subsidiary of crown entity. In our view there is no material difference to ML/FT risks where a private trustee

corporation is acting as trustee of a family trust compared to where a publicly owned trustee is acting as trustee of a family trust and therefore this anomaly should be addressed.

Since the supervisors have also clarified that a trust should be treated as the client (despite no legal personality) and not the trustee, this further justifies amendment to the definition. This is because prior to this clarification, the likelihood of beneficial owners being overlooked was greater.

In regards to section 18(2)(h), the limitation of "when the person acts for itself" should similarly be removed. A statutory supervisor (generally also a trustee) is required by law (ss 156-157 Financial Markets Conduct Act 2013) to hold registered managed investment scheme assets, and to ensure separation from its own assets. The latter is typically done by holding funds through a nominee company.

The following is an example of the problems of the existing arrangements for this low-risk situation. A supervisor will often be required to open bank accounts to hold certain scheme money (e.g. cash or term deposits for KiwiSaver schemes). The Supervisor is the banks customer, consequently the bank is required to undertake CDD on the supervisor. But the bank is unable to undertake simplified CDD on the supervisor due to the fact the supervisor is not acting for itself but rather for scheme members as the scheme trustee. Even with relaxation of this limitation, as the supervisor is acting through its nominee company, the bank will typically be required to undertake CDD on the directors and shareholders of the nominee company, and then any ultimate ownership. This is placing emphasis on identifying ML/FT risks in the wrong areas. Money held in these schemes are the collective holdings of individual investors, not money from the supervisor or its nominee. The point where ML/FT is likely to occur is the deposits and withdrawals from individual investor accounts, not at the collective portfolio level where investments are made by fund managers but held in the name of the supervisor (or via its nominee).

Closely related to the above is the application of the Licenced Managing Intermediary Exemption. While this could be an option to avoid the above scenario, as the supervisor (for prudent reasons) uses a nominee, the bank is unable to apply this exemption as the supervisor, not the nominee is a licenced managing intermediary. While amendments to the managing intermediary exemption could address this, a simpler solution would be to amend the existing exemptions where there are known issues.

We request the section 18(2)(i) definition be amended as required to give the following effect:

> *a trustee corporation, within the meaning of section 2(1) of the Administration Act 1969. For the purpose of this section, trustee corporation includes any wholly owned nominee company the trustee corporation may use to hold client money or property as permitted by section 67(1)(c) of the Trusts Act 2019.*

And that the section 18(2)(h) exemption be amended as required to give the following effect:

> *person licensed to be a supervisor or statutory supervisor under the Financial Markets Supervisors Act 2011, whether the person acts for itself, or in a statutory supervisor capacity. Where it acts in a statutory supervisor capacity, includes any nominee company controlled by the supervisor or statutory supervisor:*

Acting as 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?

Trustees Executors Limited is a trustee company pursuant to the Trustee Companies Act 1967. All trusteeship is conducted through this entity.

However, Trustees Executors Limited uses numerous nominee companies for holding assets for commercial trusts such as managed investment schemes and securitisation trusts. They are used to help separate client money from company money, in accordance with expected custodial practice. While a nominee company may be used, the client contractual relationship exists with the trustee company, not its nominee. The nominee companies do not employ staff and have no revenue.

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?

Yes, there would be efficiencies created be adopting this proposal.

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?

It is not clear why there should be additional conditions if a parent reporting entity's compliance programme and risk assessment covers these services. There could be some benefit for supervisors to be aware about the status of the nominees or trustees; however, this information could be easily sought through questions within AML/CFT Annual Reports.

Mechanisms for ensuring consistency

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

The consultation acknowledges the at times inconsistent positions of the supervisors. However, this simply reflects the ambiguities of the legislation as drafted. These inconsistencies could be minimised by more timely response to known issues through updates to codes of practice, granting ministerial exemptions or other regulatory changes. Sector Codes of Practice could also be considered; however, to avoid explanatory notes and updates to explanatory notes, those impacted sectors should be consulted with widely first.

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

Reporting Entities are supervised by one supervisor; however, it is not uncommon for a reporting entity to have a significant part of its business that would otherwise by supervised by another supervisor.

Consideration should be given to consolidating aspects of the three supervisors AML resources such as guidance material, FAQs, Annual Reports, and training material. An AML/CFT website hub could be

created for this purpose. Reporting Entities should also be encouraged to engage with the supervisor with the most experience in a given area of its business rather than the supervisor it is formally assigned to. This would also ensure supervisors have a more complete picture of the sectors under their supervision that could otherwise be missed. This could be achieved within the existing framework and without the need for establishing a new entity. It would further formalise the existing consultation that occurs between the supervisors.

Sanctions for employees, directors, and senior management

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

Broadening civil sanctions is unlikely to increase the detection or deterrence of money laundering or the financing of terrorism in New Zealand. However, it may add to the cost of compliance.

Companies are already spending significant resources on ensuring compliance. Expanding regulatory penalties may result in further resources directed on compliance by those already complying but is unlikely to improve this amongst those oblivious to intricacies of the AML regime.

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?

As provided by example within the consultation, where a trustee is involved in forming a trust and also acting as trustee, it is not clear who the customer is for CDD purposes. The supervisors guidance is that a trust itself should be the customer despite a trust not having legal personality. However, a more accurate interpretation from the perspective of a trustee is the settlor is the client of the trustee, not the trust. The later places ongoing focus on the trustee, which results in the Reporting Entity monitoring itself.

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?

For known situations such as the above, a more prescriptive approach would be useful.

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?

The Act refers to a customer's address details as being part of their identity information. There is nothing apparent within the FATF Recommendations that requires address information to be part of CDD. Address details can be easily obtained should a person seek to manufacture a temporary address. We therefore question whether this information provides meaningful value in identifying a person's identity.

4.19 Are the obligations to obtain and verify information clear?

No. Particularly in regard to electronic identity verification. Attempts to clarify this has been made through the Amended Verification Code of Practice and updated explanatory notes.

We are also aware about significant differences in interpretation by Reporting Entities in the requirements to verify details of 'persons acting on behalf' of a customer.

Source of wealth versus source of funds

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

Situations when source of wealth/funds is required requires revaluation as in many situations there is a reality gap between what information is theoretically and practically possible to obtain.

For example, meaningfully being able to verify the intergenerational wealth of a family trust is dependent upon records being retained for generations.

By narrowing the source options, this further exacerbates the ability to onboard what may be low risk customers.

4.26 Are there any instances where businesses should not be required to obtain this information? Are there any circumstances when source of funds and source of wealth should be obtained and verified?

We recommend removing most trusts from mandatory enhanced due diligence requirements (and thus the need for source of wealth or funds). This is not consistent with the purpose of the Act, as it neither reflects what is appropriate for New Zealand nor FATF Recommendations.

Ultimate ownership and control

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

The limb that includes "persons on whose behalf a transaction is conducted" (POWBATIC) is obscure. Its most obvious application within our business exists in the managing intermediary chain such as a trustee holding assets on behalf of KiwiSaver members. However, as this was not intended, a class exemption was issued to cover this scenario.

In the absence of a clear statutory provision or guidance, "effective control" is also problematic. The default position of many Reporting Entities, auditors and inferred by some supervisors is that under Standard CDD situations, this includes all directors of a company. This is inconsistent with the Act, Beneficial Ownership Guidelines and FATF Recommendations. However, interpretation has been derived from the Customer Due Diligence Fact Sheet – Companies, where there is refence to "some directors" being beneficial owners. This in itself is problematic under company law, as directors do not act individually. Consequently generally speaking Reporting Entities are subjecting all directors of a company to CDD.

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

The above two issues can be clarified within the legislation. Further examples, including complex examples, rather than simple ones, should also be included in any guidance.

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?

As guidance is not law, regulations should be made.

Identifying a natural person who may own more than 25% of an entity is not always achievable or meaningful. For example, a private organisation may have extensive global operations, yet with a ultimate shareholder that owns more than 25% of the global business. Where a Reporting Entity is dealing with its New Zealand subsidiary, it is difficult to be aware about this situation, and secondly if obtained generally not particularly useful given the remote and lack of involvement in the local operation.

For this reason, in regards to New Zealand companies, ownership by natural persons identified on the ownership chain of the Companies Register up to the 'ultimate holding company' should be sufficient (also refer to 4.34). Where there is no natural person included, then the senior managing official should be identified.

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

In standard or enhanced CDD situations, ownership checks are made on the ultimate beneficial owner.

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

In relation to New Zealand companies, costs could be minimised and efficiencies gained, by leveraging off the ultimate holding company information on the Companies Register. While this may not always fully exhaust the ownership chain, it would provide more information than is currently prescribed by statute. Also refer to answer in question 4.32.

<u>Process for identifying who ultimately owns or controls legal arrangements</u>

4.42 Should we issue regulations or a Code of Practice that allows businesses to satisfy their beneficial ownership obligations by identifying the settlor, the trustee(s), the protector and any other person exercising ultimate effective control over the trust or legal arrangement?

We welcome any clarification for Reporting Entities. The areas that need to be addressed include:

- Who to identify when a trustee is a company (e.g. a company established by a law firm)?
- Where DNFBP's are involved as acting as trustee and assists form the trust, what identification obligations exist? (Also refer to question 4.2).

4.43 Would there be an impact on your compliance costs by mandating that this process be applied? If so, what is the impact?

Any change would need to reflect that not all persons will be able to be identified. For example, a settlor may be elderly with limited identity documents, or they may be deceased. There also may not be a protector, or similar powers may lie with a settlor instead. Any requirement would need to be clear

that these mandatory details may not exist, otherwise, considerable time will be spent on unobtainable information.

Consideration also needs to be given to the different types of trusts, e.g. Commercial trusts.

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?

Paragraph 10(d) of Part 2 causes many issues for corporate customers. This prevents a trusted referee from being "a person involved in the transaction or business requiring the certification".
Larger organisations may have numerous solicitors or accountants that can certify identity documents; however, this wording can be interpreted to mean they are unable to certify documents as it relates to staff of their company. This adds cost and time for these organisations.

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?

It is common for address matching to cause electronic identity verification attempts to fail. The IVCOP should make allowance for situations where address information is unable to be obtained through electronic sources. In this situation the IVCOP should allow a 'hybrid' approach where identity documents can be verified electronically, and address details received in hard copy.

However, we question the strength that address information provides in verifying the identity of a client.

Verifying the address of customers who are a natural persons

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

Challenges include:

- Customers not being able to obtain recent proof of address details. While the currency of the documentation is able to be set by a Reporting Entities compliance programme, if dated documents are accepted it loses its relevance. Similarly, it would be easy for a person to manufacture a short-term address which also makes proof of address less useful.

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

We do not see any significant benefit in requiring address information to be verified. Money launders will only provide address details they wish to Reporting Entities to know about.

We recommend the FIU be consulted on how many times this information has been used in identifying the location of a convicted money launderer to establish whether the benefit outweighs the compliance cost.

Conducting simplified CDD on persons acting on behalf of large organisations

4.56. Are there ways we can enhance or streamline the operation of the simplified CDD obligations, in particular where the customer is a large organisation?

The solution proposed under 4.57 is a reasonable measure to address this issue.

4.57. Should we issue regulations to allow employees to be delegated by a senior manager without triggering CDD in each circumstance? Why?

We support this proposal.

However, we recommend this is not limited to 'large' customers or customers that are subject to simplified CDD only. We recommend this is also extended to Managing Intermediaries. Some institution may be smaller in size yet are still required to have numerous authorised signatories.

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?

Trusts take many forms and considering the AML legislation is meant to be a risk-based regime, this subjects many clients to enhanced due diligence where their risk profile may be low.

Please also refer to our comments in question 2.48 as it relates to lower ML/FT risk trusts. Our view is different trustees pose different ML/FT risks. For example, where a trustee corporation acts as trustee, the likelihood the said trustee company will be compromised by money launders is likely to be significantly less than a small professional trustee. This is because money launders would be required to influence numerous individuals throughout the organisation and overcome company followed processes[1].

Nevertheless, a further reason to remove enhanced CDD requirements for all trusts is that trustees from the 1 April 2021 tax year have additional tax return reporting obligations as it relates to trust settlements, distributions and appointer details. This further differentiates New Zealand trusts from many overseas and lends further weight to removing enhanced due diligence requirements.

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?

Foreign trusts (including variations with non-resident trustees), particularly where there is no obvious connection by a settlor to New Zealand, is likely to be higher risk and could be subject to enhanced CDD. However, we do note that since the introduction of the foreign trust registration and reporting requirements, the number of New Zealand foreign trusts has declined significantly.

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?

The above example could be identified in legislation.

[1] Refer Andrew Simpson conviction by way of example.

Ongoing CDD requirements where there are no transactions

4.66 If you are a DNFBP, how do you currently approach your ongoing CDD and account monitoring obligations where there are few or no financial transactions?

In regards to trusts, suspicious activity is more likely to be observed in the moment, particularly at time of initial trust establishment, rather than through ongoing monitoring of transactions. This is because as trustee, the reporting entity is the person making decisions in accordance with the trust deed. Suspicious activity could present through a beneficiary's unusual behaviour or questioning, or requests for further unusual settlements on a trust, such as from a person with no obvious connection to the beneficiaries. Removing the trustee could also potentially be suspicious in some circumstances.

While this is identified directly at the time, information held and known about the customer (trust, settlor, beneficiaries) is also reviewed periodically to determine whether there has been any behaviour that may appear unusual over a period of time, rather than solely from one-off behaviour.

However, we would like clarification or guidance on monitoring requirements as it relates to transactional monitoring as our experience is the expectation is monitoring arrangements should be akin to the transaction monitoring systems carried out by financial institutions that offer transactional accounts to clients. This is despite the two having very different characteristics. This situation is due to the interpretation of the trust as being the customer.

When acting as a trustee of a family trust, a reporting entity does not provide a customer with access to an account whereby funds can be deposited and withdrawn, rather the trustee holds trust assets for the benefit of beneficiaries but subject to the terms of trust. There will be a number of transactions that occur for a trust; however, these are expenses paid by the trustee, funds reinvested by the trustee, or distributions made by the trustee to beneficiaries. Further settlements cannot be made without the agreement of the trustee. In this respect, applying transactional account monitoring involves monitoring the behaviour of the Reporting Entity rather than a customer, and provides questionable benefit.

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?

We would like this area clarified; however, regulations should make clear that transactional monitoring activity may not be necessary for DNFBPs where the risks lie with activity rather than transactions. While some areas of the Act require more prescription, in this area a risk-based approach is appropriate as there is significant divergence in activity types and what services may be provided to a customer.

Prescribed Transaction Reporting

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

The prescribed transaction reporting requirements as they relate to international wire transfers are unclear, not only amongst reporting entities but also amongst auditors and AML/CFT Supervisors.

Our view is there is also potential double reporting or no reporting occurring because of a misunderstanding of the reporting obligations.

We recommend the reporting responsibilities within the Act are clarified.

4.157. Have you encountered any challenges in complying with your PTR obligations? What are those challenges and how could we resolve them?

For statutory trustee companies (both a DNFBP and Financial Institution), in regards to international wire transfers, it is often difficult to interpret whether it is an ordering Institution in certain situations and therefore has reporting obligations. Important elements within the definition of an ordering institution are whether the institution has been "instructed by a person (the payer)" to "electronically transfer funds controlled by the payer".

It would be expected similar issues would arise for other reporting entities, most notably lawyers dealing with trust accounts. However, it is likely to be far more reaching with many institutions failing to recognise they may potentially have reporting obligations. For example, any Financial Institution that transfers funds to clients overseas could be an ordering institution.

Take for example where a statutory trustee acts as a trustee of a discretionary family trust. A trustee is not the agent of a beneficiary or settlor, rather it is directed by the trust deed. The trustee may decide to initiate a payment to a discretionary beneficiary who has relocated overseas. The beneficiary is not conducting a transaction through the reporting entity, as the funds are not controlled by them. Rather the decision to initiate the payment is made and controlled by the trustee. In this case we would expect the bank/remitter to be the ordering institution.

A second example is where the statutory trustee company acts for a client under an enduring power of attorney. In some circumstances, such as when a donor has lost capacity, the attorney will not be directed by the client, and therefore would not have a reporting obligation. In this instance the bank facilitating the payment would be the ordering institution. However, had the attorney been acting under instruction from the donor, then the statutory trustee would be the ordering institution.

A further point to note is there is a partial regulatory exemption for reporting entities that act as an executor or administrator of an estate. This exemption extends to PTR reporting reflecting the risk. In this scenario, the executor will not need to file a PTR, but the bank could still be an ordering institution. Even if the bank is not the ordering institution, it will likely still require the prescribed information from the executor, as a matter of process.

The above demonstrates how there can be significant confusion, or more likely, unawareness by financial institutions about reporting obligations. This means there is either a double-up of reporting, or potentially no reporting occurring.

To resolve the issue, the reporting obligation should lie with the bank (or similar transfer provider). These institutions are also the ones with the resources to make use of automated processes. These institutions can also ensure that payments are not made without the required information.

Consideration should also be given to clarifying requirements within the custody sector of the $250 billion managed funds industry, much of which is invested in overseas assets. A view could be taken that international trades made to maintain portfolios should be reportable, in which case it would swamp the Financial Intelligence Unit with unhelpful information.

4.158. Should we issue regulations or a Code of Practice to provide more clarity about the sorts of transactions that require a PTR?

To achieve clarity, reduce the risk of non-reporting, and to reduce the burden on small reporting entities, our view is only banks/money transfer providers should have reporting obligations as it relates to international wire transfers. A Code of Practice may be beneficial in the absence of amending legislation; however, it would need to be clear with complex examples included.

4.159. If so, what transactions have you identified where the PTR obligation is unclear? What makes the reporting obligation unclear, and how could we clarify the obligation?

Refer to 4.157.

4.160. Should non-bank financial institutions (other than MVTS providers) and DNFBPs be required to report PTRs for international fund transfers?

No. This is unnecessary and provides no benefit. Costs are also placed on smaller businesses. It also increases the risk of non-reporting.

We would also note that it is proposed that regulations require records of PTRs be retained for 5 years (refer page 113 of the consultation). Many non-bank and DNFBs will use manual reporting process to submit a PTR. This requires them to manually export copies of the record from the FIU's AMLgo system and save them on to other systems. Banks have automated systems and can deal with this requirement more efficiently.

4.161. If so, should the PTR obligations on non-bank financial institutions and DNFBPs be separate to those imposed on banks and MVTS providers?

There should be no PTR obligations imposed on non-bank financial institutions and DNFBPs.

4.162. Are there any other options to ensure that New Zealand has a robust PTR obligation that maximises financial intelligence available to the FIU, while minimising the accompanying compliance burden across all reporting entities?

The FIU received five million international wire PTRs last year. However, many DNFBPs will only be required to report a handful of reports annually. The fact that for many the low volume means that it is unlikely these reporting entities will invest in automated reported processes, resulting in the compliance burden being disproportionately high.

Regulations could be made to prevent a Reporting Entities initiating a payment on behalf of a client through a bank or other remitter without including all the required PTR information. This would result in all the required information being reported but with only one reporting entity having to file a report. It would also avoid the uncertainty about whose obligation it is to make the report.

<u>Review and audit requirements</u>

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

The consultation discusses how other jurisdictions have an audit function with the purpose to test whether the system is effective at detecting money laundering or terrorism financing.

If New Zealand wishes to make gains in reducing financial crime, a more informative audit process would be to place less importance on a Reporting Entities compliance with FATF Recommendations and more emphasis on determining what aspects of the AML/CFT Act has helped detect ML/FT.

From the perspective of Reporting Entities, it would be valuable to know how effective the Act has been. What has been observed is that:

- Approximately 10,000 suspicious activity reports are filed by Reporting Entities annually.
- A high proportion is disseminated across various government departments.
- Estimated money laundering charges typically range from 60 – 180 per annum (refer p8 FIU National Risk Assessment). However, it is unclear whether any of these charges were laid as a direct result of the 10,000 SARs submitted by Reporting Entities.
- The Criminal Proceeds (Recovery) Act 2009 has been of significant help to police in seizing property gained from criminal activity. However, the success of this needs to be separated when determining the effectiveness of the AML/CFT Act.

We recommend a provision in the Act be made that requires an appropriate body to periodically report on the Act's effectiveness. It has been estimated that globally, the cost of AML compliance is 100 times greater than that of laundered funds recovered. It is therefore important to be able to assess whether the costs placed on New Zealand businesses are making a difference within our own jurisdiction. This would help guide New Zealand policy in how to best prevent, detect or deter ML/FT.

<u>Improving the quality of reports received</u>

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

Our view is this will be due to 'defensive reporting'. One reason will be due to recent convictions against Reporting Entities for the failure to issue such reports.

We are aware the FIU has the view that many SARs are of low quality; however, in past years supervisors have also repeated their concerns about the low volume being reported by certain sectors (refer AML/CFT Monitoring Report 2016 and 2018 as examples). This may also be driving the defensive reporting.

In addition to the above pressures, Reporting Entities are also unsure about the 'reasonable grounds' test. For example, a SAR could simply be filed because it is outside of the normal activity for that customer (i.e. what they have done to date), not necessarily because there is a suspicious it could relate to a ML offence.

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

It needs to be acknowledged that some sectors will have very infrequent activity that will ever present as suspicious on reasonable grounds.

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

If any criminal offending is identified, then reporting entities should report this.

We are also unsure how identifying low-level offending could be identified.