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16 September 2016

To the Minister of Justice

Submission on Consultation Paper Phase Two AML/CFT Act:
Improving New Zealand's ability to tackle money laundering and terrorist financing

KPMG welcomes the opportunity to comment on the Consultation Paper ("the Paper"). [We have had the benefit of reading the submission provided by Chartered Accountants Australia and New Zealand and generally support that submission.]

However, we provide our further comments in response to the consultation questions below.

Part 3: Accountants

1. **How should AML/CFT requirements apply to the accounting sector to help ensure the Act addresses the risks specific to it? For example, which business activities should the requirements apply to? At what stage in a business relationship should checks, assessments and suspicious transaction reports be done? Who should be responsible for doing them?**

We note the Financial Action Task Force recommendation 22 applies to accountants[1] - *when they <u>prepare for or carry out transactions</u> for their client concerning the following activities [our emphasis]:*

- *Buying and selling of real estate;*
- *Managing of client money, securities or other assets;*
- *Management of bank, savings or securities accounts;*
- *Organisation of contributions for the creation, operation or management of companies; and*
- *Creation, operation or management of legal persons or arrangements, and buying and selling of business entities.*

[1] As well as Lawyers, notaries, other independent legal professionals.

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The proposed activities in your Paper are widely defined and it is difficult to assess the potential impact without further specificity. For example, the activity "*preparing for or carrying out transactions for a customer related to creating, operating or managing companies*" is particularly broad.

We consider the principal risk in relation to the accounting profession arises through the movement of funds for, or on behalf of, a client. This is consistent with the case studies included in the Paper and our knowledge of international and domestic money laundering typologies.

Accordingly, activity by Accounting Firms that involves the movement of funds should be captured by the AML regime and we suggest that general principle drive the policy settings in this area. However, any such settings should permit flexibility for accountants to complete identification and verification requirements at the point where the prescribed activities are to be provided.

We consider the existing timing for suspicious transaction reports is reasonable[2], that is, as soon as practicable but no later than 3 working days after forming the suspicion.

In our view the client due diligence obligations ("CDD") should be imposed prospectively at the implementation date of Phase 2. We would support the flexibility afforded by section 14(c) of the Act that is to permit firms to conduct due diligence on their existing client base according to the level of risk; and

(i) Where there has been a material change in the nature or purpose of the business relationship; and
(ii) The reporting entity considers that it has insufficient information about the customer.

This would also include completion of CDD on an existing customer in the event of a suspicious transaction report.[3]

Ultimate responsibility will rest on the reporting entity's senior management who are responsible for governance including compliance with applicable laws and regulations (or the individual in the case of a sole practitioner). As occurs for existing reporting entities, senior management will determine their operating model to delegate operational delivery to achieve efficient and compliant delivery.

2. Given the level of risk associated with advisory and assurance services (for example, tax advice, bookkeeping and auditing), should these activities be subject to AML/CFT obligations even where the business is not involved in a transaction for their client?

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[2] Pursuant to section 40 of the AML/CFT Act.

[3] Section 5A Anti-Money Laundering and Countering Financing of Terrorism (Requirements and Compliance) Regulations 2011.

Advisory and assurance services should not be subject to AML/CFT obligations, provided they do not involve the prescribed activities. To include these services would have a significant impact to compliance costs for accountants and we submit are not commensurate to actual or perceived ML/TF risks through these services.

Our view is that to do so would implement obligations over and above that directed by the Financial Action Task Force and there is no risk based rationale for that position.

Part 4: Supervision

1. **Do you think any of our existing sector supervisors (the Reserve Bank, the Financial Markets Authority and the Department of Internal Affairs) are appropriate agencies for the supervision of Phase Two businesses? If not, what other agencies do you think should be considered? Please tell us why.**

We do not consider the existing sector supervisors to be the most appropriate agencies for supervision of the accounting profession. While the Financial Markets Authority undertakes a quality review of FMC audits under the Auditor Regulation Act, we do not see the existing supervisors having sufficient sector experience or technical expertise over the activities proposed in the Phase 2 review. We also have concerns regarding capacity[4] without considering the large volume of reporting entities and complexity additional business sectors will bring.

The 'single supervisor' (listed in the consultation as alternative 1) may be preferable to facilitate collaboration and consistency of approach, provided such a model has regard to the existing risk and regulatory framework applying to firms such as ours. That framework is outlined further in Appendix A.

Another option is for the suitably qualified professional bodies to take on the supervisory responsibilities as part of their existing regulatory and oversight function and we would also be comfortable with that approach.

Of particular concern, in our view, are those accountants who are not members of a professional body and not subject to any particular regulatory oversight (as compared with the environment outlined in Appendix A applying to Chartered Accountants). This is where ML/TF risk in NZ is heightened. We consider it essential that the supervision of accountants not under the oversight of a professional body is credible both in nature and degree. This is consistent with FATF's *Risk Based Approach Guidance for Accountants*[5] stating supervisors should identify the risks in this accountancy business sector and prioritise their resources and supervisory activities accordingly.

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[4] For example the observation in the Shewan inquiry that 6 of 109 (<3%) of TCSP's had been subject to an onsite visit. TCSP's are risk rated by the DIA as a high risk sector.

[5] FATF publication 17 June 2008 para 67.

Implementation of Phase 2 requirements will result in significant additional costs to the accountancy professions. We endorse CAANZ's position on ensuring the supervisory costs are met by the government and understand this is occurs within the existing supervisory model. Those costs would of course be reduced if existing regularity systems are leveraged.

Part 5: Implementation period and costs

1. **What is the necessary lead-in period for businesses in your sector to implement measures they will need to put in place to meet their AML/CFT obligations?**

We endorse the CAANZ submission regarding the level of regulatory change and its impact to the accountancy business sector generally.

Following additional consultation and subject to the outcome and subsequent regulations, KPMG like many larger firms will need to understand the impact and design policies, procedures and controls to meet its obligations. For larger firms like KPMG this will require system changes which will take time to schedule test and implement, particularly around monitoring of transactions.

The new obligations will also require sufficient time to train staff and for any new supervisors to understand the sector, complete a risk assessment and engage with affected entities and individuals. While the necessary lead in period is difficult to estimate, KPMG is of the view that a two year implementation period may be required to ensure that the reporting entities are sufficiently prepared and able to comply.

2. **Where possible, please tell us how you calculated how long it will take to develop and put in place AML/CFT requirements.**

Based on qualitative assessment and experience of implementing similar regulatory change projects.

Part 6: Enhancing the AML/CFT Act

1. **Should the current requirement to report suspicious transactions be expanded to reporting suspicious activities? Please tell us why or why not.**

We would support extending the definition to suspicious activity rather than the existing definition where a person 'conducts or seeks to conduct a transaction' through a reporting entity. We understand the existing definition has resulted in the NZ Police FIU rejecting suspicious reports by TCSP's on the basis that it does not involve a transaction made through the NZ reporting entity.[6] We observe equivalent jurisdictions have cast the net wider with the

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[6] For example a Trustee performing their fiduciary responsibility and obtaining information of observing activity around transactions or actions performed overseas.

UK and US requiring reporting of suspicious 'activity' and Australia requiring reporting of suspicious 'matters', both extending past transactions.

2. Should industry regulators be able to share AML/CFT-related information with government agencies?

This is an important issue for a broad range of individuals and businesses (not just those potentially affected by changes to the AML regime). In our view, consideration of potential changes in this area should be addressed separately, following further consultation and with the benefit of more detailed proposals. As the Paper notes, the nature of the information and the purpose of sharing it are key. We note, for example, the Inland Revenue Department already has a broad range of powers to assist the detection of tax evasion.

3. Should AML/CFT supervisors be able to share customers' AML/CFT-related personal information with government agencies?

See above.

4. What are the appropriate circumstances under which the FIU can share financial intelligence with government agencies (such as the sector supervisors, industry regulators, intelligence agencies, IRD and Customs) and reporting entities? What protections should apply?

See above. It is difficult to comment without a fuller understanding of the current impediments and precisely how they might be removed.

5. What restrictions should be placed on information sharing?

See above.

6. Are the existing provisions that allow reporting entities to rely on third parties to meet their AML/CFT obligations sufficient and appropriate? If not, what changes should be made?

As part of Phase 2 the Ministry should consider the restriction on Designated Business Group formation being restricted to related parties. We observe the requirement was relaxed for money transfer agents to permit agents and sub agents to form a designated business group.[7] The new obligations impose significant compliance burden on a large number of reporting entities some of which may be operating in 'franchise' or 'network' model where reliance may be appropriate provided that associated ML/TF risks can be mitigated.

[7] Anti-Money Laundering and Countering Financing of Terrorism (Definitions) Regulations 2011 section 7.

7. Should the scope of the provision requiring persons providing trust and company services to comply with the AML/CFT Act be extended to activities carried out in the ordinary course of business, rather than just when they're the only or principal part of a business?

The inclusion of lawyers or accountants within the Phase 2, in particular the services proposed for both business sectors should largely address the issue.

8. Should the simplified customer due diligence provisions be extended to the types of low-risk institutions we've proposed? If not, why?

We support the CAANZ submission that simplified due diligence provisions be extended to state owned enterprises (SOEs) and majority-owned subsidiaries of publicly traded entities raised within the consultation paper.

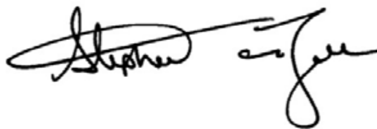
We have observed particular difficulties for global banks operating in NZ through subsidiary or branch structures to apply standard due diligence to majority-owned subsidiaries. The difficulty arises due to overseas practice in equivalent countries typically permitting simplified due diligence. FATF's position as your consultation notes is that simplified due diligence is appropriate.

9. Should we consider extending the provisions to any other institutions?

We have no further comments.

Thank you again for the opportunity to submit. Should you require any further information or assistance, please do not hesitate to contact the writer on +64 9 367 5834.

Yours sincerely



Stephen Bell
Partner

Appendix A: Overview of existing environment

KPMG NZ already operates in compliance with a range of policies, professional standards and regulatory requirements which are deigned to mitigate risk to the firm and the public. These include internal policies driven by global firm requirements and external, independent oversight of the firm's activities.

An overview of these policies procedures and controls are briefly outlined below in two parts:

- Internal standards and processes; and
- External standards and oversight.

Internal standards and processes

As a member firm of KPMG International, KPMG NZ is required to comply with a code of conduct and set of standards and values to ensure its staff act with integrity at all times. These set out how we engage with and deliver services to our clients.

Overarching governance policies

KPMG's has implemented and routinely reinforces its overarching ethical framework to help ensure a healthy and sustainable ethical culture. This framework includes:

- Code of Conduct;
- Risk & Ethics Disciplinary Policy;
- Gifts and Hospitality procedures;
- Conflicts of Interest procedures;
- KPMG Global Quality and Risk Management Manual;
- Independent reporting line ('Whistleblowing');
- Internal staff vetting procedures;
- Ethics and independence training and annual confirmations; and
- Acting with integrity training.

Prescribed client acceptance and continuance standards

The client acceptance evaluation provides the principal protection to KPMG from taking on inappropriate clients. The process involves evaluating risks associated with an entity or individual, documenting mitigating factors and the approval of the entity or individual as a potential client of KPMG. This involves checks to identify reputational risks and factors that could indicate issues with the integrity of the client. It also an assessment of threats to compliance with KPMG's fundamental ethical principles. Where the risks cannot be reduced to an acceptable level the prospective client is declined.

Client continuance is required to be performed for existing clients to assess the suitability of continuing the relationship with a client. This occurs periodically or driven by trigger events. Two factors within the assessment include:

- Information casting doubt on the perceived integrity of current management or principal owners; and
- Factors other than those listed above that may affect the risk profile of the client.

Transacting for or on behalf of a client

The firm is required to comply with guidelines where transacting for or on behalf of a client, including specific procedures regarding 'cash handling services' and handling of client monies. Relevant controls in this area include:

- Client and engagement evaluation for the provision of the service, including approval from the firms' National Risk Management Partner or delegate;
- Approval by National Risk Management Partner prior to opening new bank account for handling of client funds;
- Analysis to identify instances where services have been provided but not approved, including review of client or trust bank accounts;
- Identification and action for dormant balances; and
- Maintain records of bank accounts where deposits are held.

Compliance with the firm's internal policies and procedures is actively monitored by the KPMG international network.

External standards and oversight

KPMG NZ is an Approved Practice Entity under the rules of its local professional body (NZICA/CAANZ) and a registered audit firm subject to the requirements of the Auditor Regulation Act 2011. As a result, KPMG is subject to periodic inspection by both NZICA and the FMA. Those inspections specifically consider the firm-wide control environment.

The starting point for such inspections is a range of professional standards with which the firm, its partners and staff must comply. Those standards are set externally either by the External Reporting Board or the professional body. The firm's internal policies and procedures are designed to support these requirements.

Professional standards relevant in this context include engagement standards, which mandate the process by which client engagements may be accepted and retained, and specific standards regarding the handling of client funds (see NZICA standard: PS -2 Client Monies). For example, PS-2 directs the firm as follows: [8]

[8] A12, A13

The client's identity should be established at the time when the member or firm first establishes a professional relationship with the client, rather than when any client monies may first be received or when the member or firm's operation of any client bank account commences.

The member or firm should obtain an understanding of the nature of the client's business and/or other activities that give rise to client monies, sufficient to understand the source of client monies.

All members of CAANZ must comply with its Code of Ethics which underpins the professional standards and includes fundamental principles of integrity, objectivity and professional behavior. Compliance with professional standards and the Code of Ethics is monitored and enforced through NZICA's disciplinary procedures.

More broadly, entry into membership includes formal professional and ethical training and 'fit and proper' person requirements.