16 September 2016 **By email**

The AML/CFT consultation team
Ministry of Justice
SX10088
Wellington
New Zealand

Anti-Money Laundering and Countering Financing of Terrorism Act 2009 ('AML/CFT Act') - Submission on the Phase Two AML/CFT Act Consultation Paper

1 This is a submission by Kensington Swan relating to the Ministry of Justice ('MoJ') consultation paper on Improving New Zealand's ability to tackle money laundering and terrorist financing – Phase Two of the AML/CFT Act ('Consultation Paper').

2 Kensington Swan is one of New Zealand's premier law firms with a legal team comprising over 100 lawyers acting on government, commercial, and financial markets projects from our offices in Wellington and Auckland.

3 We have extensive experience in financial services law issues, with a specialist financial markets team acting for established major players as well as niche providers and new entrants to the market.

General comments

4 The Consultation Paper primarily focuses on Phase Two of New Zealand's anti-money laundering and terrorist financing ('AML/CFT') regime. Under this phase, it is proposed that the current AML/CFT regime would be extended to more businesses and professions, notably lawyers, accountants, real estate agents, conveyancers, high-value goods dealers and gambling service providers. In addition, the Consultation Paper also proposes some enhancements to the existing regime which, if adopted, would apply to all reporting entities (not just those covered by Phase Two).

5 We are generally supportive of the principles underpinning the proposals set out in the Consultation Paper.

6 This submission focuses on two aspects of New Zealand's future AML/CFT regime raised in the Consultation Paper which we consider to be of particular practical significance to our clients and the market more generally. These are:

a the proposal to expand reporting to the Police financial intelligence unit ('FIU') so that reports must be made of suspicious activities, and not just suspicious transactions

b the question raised as to whether the current third party reliance provisions are sufficient and appropriate, or whether they should be enhanced.

Proposal to require reporting entities to report suspicious activities

7 Currently, reporting entities are required by section 40 of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 ('AML/CFT Act') to report any suspicious transactions to the FIU.

8 The Consultation Paper notes that there are some situations when suspicious or unusual activities may not be reported because a transaction does not occur, even though it may provide valuable financial intelligence for detecting crime. Accordingly, the MoJ has proposed expanding the current reporting requirement to reporting suspicious activities.

9 The Consultation Paper does not contain any definition or guidance surrounding what activities will be considered suspicious for these purposes.

10 We agree in principle with the proposal to require reporting of suspicious activities. However, for this obligation to be workable in practice, reporting entities will need a high level of certainty around what types of activities would amount to suspicious activities for reporting purposes. We are concerned that this proposed extension of the regime will impose an unreasonable compliance burden and regulatory risk on reporting entities in the absence of an adequate level of certainty and guidance being provided as to what the new rules are intended to capture.

11 We submit that the best way to provide certainty to the market would be to include a definition of suspicious activities in the AML/CFT Act. We acknowledge that the definition would not be able to be exhaustive - given that those included in money laundering and terrorist financing activities are regularly adjusting and developing those activities to avoid detection and exploit new technologies. That said, having a clearly articulated principle and framework for this new aspect of the AML/CFT regime, coupled with a non-exhaustive list of the types of activities which should be considered suspicious for these purposes, would

a provide greater certainty to reporting entities about what activities they should definitely be reporting

b give reporting entities a better understanding of both the policy intent behind the change, and of the activities that are intended to be captured, which should in turn allow them to form better views on what other types of activities should be considered suspicious

c ensure reporting entities have sufficient statutory guidance to enable them to adjust their compliance programmes to make sure that appropriate processes are in place to identity and respond to relevant activities.

12 In the absence of such a definition in the AML/CFT Act, reporting entities will:

a need to form their own views on what constitutes suspicious activities - which has the potential to result in inconsistent processes being put in place and inconsistent reporting between entities, resulting in and under-reporting or over-reporting (depending on what parameters they choose to adopt)

b need to amend and develop their compliance processes in the absence of certain, clear requirements, which is likely to increase the investment of time and money required, given the broadness of the concept

c have greater difficulty in effectively managing the risk of non-compliance.

13 If the AML/CFT Act is not amended to insert a definition of suspicious transactions, then the next best approach would be for AML/CFT supervisors to provide unambiguous, pragmatic joint guidance on this issue.

14 A definition is preferable to guidance because:

a guidance does not have the same status as a legislative provision, and accordingly there is always a risk that complying with guidance may not actually result in compliance with the law

b reporting entities would need to wait for guidance to be issued - which could result in an unnecessary regulatory burden being imposed upon them in the meantime to consider what would constitute a suspicious activity and how their processes will need to be adjusted to capture such activities. This situation would obviously be exacerbated where any guidance provided:

i was not issued in a timely manner

ii was changed after being issued – whether before or after the proposal comes into effect

iii was not provided by the AML/CFT supervisors jointly – creating the potential for inconsistencies of approach which could impact on situations where suspicious activities arise and there are several reporting entities involved who are supervised by different AML/CFT supervisors.

15 Given the increased globalisation of the financial services industry, we think it would be helpful for the definition (or guidance, in its absence) to draw upon and align itself with guidance that already exists offshore in respect of the meaning of suspicious activities. In particular we note that both AUSTRAC and HM Revenue & Customs have issued guidance on this question. If an approach was adopted which was inconsistent with such offshore guidance, additional compliance costs for reporting entities (who operate in those jurisdictions) would be incurred without a clear offsetting benefit to New Zealand.

Proposal to enhance current third party reliance provisions

16 Currently, there are a number of mechanisms under the AML/CFT Act and Anti-Money Laundering and Countering Financing of Terrorism (Class Exemptions) Notice 2014 ('Exemption Notice') by which reporting entities may rely on third parties to meet their AML/CFT obligations. These are:

a under the AML/CFT Act:

i reliance on a member of a designated business group

ii reliance on other reporting entities or persons in another country

iii reliance on agents

b under the Exemption Notice:

i reporting entities whose customers are licensed managing intermediaries

ii reporting entities whose customers are specified managing intermediaries.

17 The Consultation Paper seeks feedback as to whether the current third party reliance provisions are appropriate, or whether they should be enhanced.

18 We submit the current third party reliance provisions are enhanced to remove impediments to the efficacy of the application, and to ensure pragmatic options to comply with AML/CFT obligations are available where two reporting entities have a relationship in financial service providers with a mutual customer. We are aware of organisations that have observed consumer confidence in financial service providers being undermined, leading to an unwillingness to participate in financial markets due to the burdensome requirements of the current regime. Specifically, we recommend:

a the current third party reliance provisions in the AML/CFT Act are amended to enable reporting entities to be deemed to have discharged their own customer due diligence ('CDD') obligations where they have relied on CDD conducted by another reporting entity of good standing, unless they are on notice that the other reporting entity's processes and procedures are inadequate

b section 35 of the AML/CFT Act is deleted (which currently provides that information obtained by a third party for the purposes of conducting CDD may only be used for the purpose of complying with the AML/CFT Act and regulations), or at least revised to clarify that third party agents are able to use information gathered for legitimate commercial purposes

c the third party reliance provisions contained in the Exemption Notice are elevated to the AML/CFT Act, and streamlined for practical efficacy

d the licensed managing intermediaries exemption in the Exemption Notice is extended to apply to Australian licensed managing intermediaries.

Difficulties with existing provisions under the AML/CFT Act

19 Currently, a reporting entity that relies on section 33 of the AML/CFT Act (relating to reliance on other reporting entities or persons in another country) is exposed to any deficiencies in the third party's CDD procedures. A breach of the CDD requirements by the third party would automatically translate to a breach by the first reporting entity of those requirements, irrespective of any assurances obtained. In practice, our experience has been that a number of reporting entities have been unwilling to utilise section 33 due to the exposure to liability for a breach of the CDD requirements by the third party.

20 There are challenges under the provision in section 34 (relating to reliance on agents) where the agent and first reporting entity have different CDD processes. Agents are understandably reluctant to accept the burden of adopting the CDD processes of another reporting entity, which requires the first reporting entity to satisfy itself as to the adequacy of the agent's processes and procedures.

21 We also consider that the limit on the use of information obtained by a third party conducting CDD in section 35 is unduly restrictive. This provision limits the efficacy of section 34, and forces agents to potentially undertake two separate information-gathering processes – one to satisfy AML/CFT obligations, and one for all other purposes (for example maintaining their own customer relationship). Section 34 is accordingly of very limited application in practice. In our opinion, use of customer information should be a contractual matter between the parties concerned, without restrictions imposed by AML/CFT legislation.

Provisions under the Exemption Notice

22 We recommend the third party reliance provisions contained in the Exemption Notice are elevated to the AML/CFT Act. This would make the provisions more accessible and would future-proof the provisions, recognising that otherwise they expire mid-2018.

23 Currently, the licensed managing intermediaries exemption in the Exemption Notice does not necessarily apply to Trans-Tasman entities. We consider there should be an express statutory power to rely on Australian licensed managing intermediaries. This would facilitate Trans-Tasman business relationships, and align the provision with the specified managing intermediaries exemption, which currently extends to 'foreign financial institutions' (meaning a financial institution that has its principal place of business in an overseas jurisdiction with sufficient AML/CFT systems and measures in place, and is supervised for AML/CFT purposes).

24 Regardless, we recommend the mechanisms currently provided for under the Exemption Notice be streamlined, to minimise the extent of any practical impediments and conditions attached to the ability to rely upon the CDD processes of any financial intermediary who is also a reporting entity. The current restrictions, in our view, impose an excessive burden on both the financial institutions involved, and on their customers, with the degree of duplication of processes involved being inefficient and not necessary to achieve the AML/CFT regime's objectives.

Conclusion

25 We would be happy to discuss any aspect of our submission with you, if it would assist.

26 Thank you for the opportunity to submit.

Yours faithfully
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