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AML/CFT – supervision & other issues

1. This submission addresses the supervisory model and other discrete issues raised in the consultation document. It may be read with my earlier submission, also dated today. The submissions are separated for your convenience; if the suggestions contained in the earlier submission are disregarded, this submission may be too.

Supervision

2. The supervisory regime is potentially important, and the consultation document encapsulates well some of the 'pros and cons' associated with each model.

3. If New Zealand adopts a 'standard' implementation model for AML/CFT phase 2 – involving the proposed relatively mechanistic application of the form of FATF recommendations, possibly followed by an equally standard 'education/partnering' methodology – the model of supervision hardly matters. In relation to the ability materially and substantially to improve New Zealand's capacity to detect, prosecute and prevent serious crime, any model is likely to prove about as effective as currently evident in jurisdictions with a single supervisor model (as in Australia) as those with a multi-agency model (as in the UK). That is, not very.

4. If, however, New Zealand chooses to implement phase 2 with policy effectiveness its core, as outlined in my earlier submission, the single supervisor model is likely to best complement and enhance New Zealand's capacity to detect, prosecute and prevent serious crime.

5. In part, for the reasons expressed in the consultation document. Namely, a dedicated supervisor with a consistent, coordinated, holistic approach across sectors, and the capacity to focus resources on entities and activities with the greatest money laundering and terrorist financing risks, is inherently more likely to help achieve a policy objective of materially and substantially improving New Zealand's capacity to detect, prosecute and prevent serious crime. This goal will be further enhanced by avoiding duplication of effort and fragmentation of knowledge between supervisors, with an agency better able to work seamlessly with and between reporting entities and policy and enforcement agencies. Aside from establishment costs, a single supervisor should also be cheaper.[1]

6. Likewise, the consultation document acknowledges well the significant limitations of a multi-agency model, including overlap, inconsistencies, duplication and the obvious risk of conflict of interest (actual and perceived) of self-regulatory bodies.

7. In New Zealand, however, it may plausibly be argued that some of the conflict risks are manageable. Real estate agents already have separate supervisory and representative functions, removing one of the most significant areas of actual and perceived conflict of interest. Although the representative and regulatory functions remain fused for lawyers, the

[1] Even viewing costs in a limited accounting sense which ignores costs imposed on others, such as self-regulatory bodies, their members and other businesses, a single supervisor avoids the existing duplication of resources across multiple agencies. When assessing costs more realistically in an economic sense, a single supervisor model will almost inevitably be cheaper, with less complexity and an inherently more consistent focus than multi-agency supervision.

New Zealand Law Society's regulatory function has a strong tradition of extracting rotten apples, notwithstanding its representative function.

8. Yet, if AML/CFT policy effectiveness is a goal, that very strength illustrates another advantage of the single supervisor model. It is probably safe to assume that the Law Society is likely to prove as adept at punishing the most egregious AML/CFT breaches as it does for serious professional misconduct. It is necessary to root out the rotten apples in any profession, and the Law Society does this well. In AML/CFT parlance it might be expected to do likewise in relation to complicit professional facilitators, those knowingly enabling financial transactions involving criminal proceeds. There is still a conflict of interest for self-regulatory bodies performing this function, magnified when self-regulatory bodies also perform a representative function, but the Law Society, in my opinion, handles this task well.

9. However, the preliminary results of my research shows that New Zealand lawyers assessed as complicit in financial transactions involving criminal proceeds are a tiny minority, consistent with the international literature and experience. For policy effectiveness across an entire industry, as across all reporting entities, the literature and preliminary results from the New Zealand research on the phase 2 professions illustrates that policy success materially depends on the vast majority of professional facilitators who are innocent, unwitting and wilfully blind to their misuse by criminal actors. This is where the real (actual and perceived) conflict lies for any self-regulatory body, for these groups comprise 'regular, typical, just-like-me' professionals. Moreover, it appears that the 'awareness and education' model typically adopted by regulatory bodies to reach this vast majority of professionals is seldom more than marginally effective, at least in the short to medium term.

10. Accordingly, and provided that New Zealand elects to implement phase 2 with policy effectiveness its core (absent this, any model is pretty much as good as another), a single, independent supervisory body commends itself as complementary to policy initiatives seeking effectively to advance New Zealand's capacity materially, substantially and demonstrably to improve the detection and deterrence of serious crime.

11. **Disruption effect?** Nor, done well, aside from establishment issues, should a single supervisory model unduly disrupt phase one entities. To the contrary. It may help address one of the most significant concerns consistently expressed by reporting entities seldom aware of the outcomes of their activities, which frequently appear almost exclusively as cumbersome and costly compliance activities, sometimes expressed as 'compliance for the sake of compliance'. A new 'beyond compliance' approach that consciously, consistently and inexorably focuses on materially, substantially and demonstrably improving New Zealand's capacity to detect, prosecute and prevent serious crime might usefully help demonstrate the value of AML/CFT controls, where currently many phase one entities mostly see cost.

Other issues

Should transaction reporting be expanded to activity reporting?

12. Yes.

13. Put bluntly, this illustrates the "Swiss cheese" method of anti-money laundering controls, with a system full of obvious holes, some of which may be plugged from time to time, and which may prompt at least as much 'displacement' by criminals diverting their activities to remaining gaps as any incremental crime detection and prevention improvement.

14. Nonetheless, whether simply plugging another obvious hole in our Swiss cheese framework, or as part of a serious step-up designed expressly to materially advance New Zealand's

capacity to detect, prosecute and prevent serious crime, the self-evident anomaly that enables, authorises and tacitly encourages even actual knowledge of money-laundering activity *not* to be reported should be remedied in any event. As noted in relation to legal professionals in early 2014:

> "The FTRA requires lawyers only to report suspicious 'transactions' that have been conducted or sought to be conducted. It doesn't cover the full range of even the most obviously suspicious 'activities' proscribed in some other jurisdictions. The debate revealed that New Zealand's legislation seems mostly content for authorities to chase illusory shadows after the event – when the funds may already be lost through a dizzying jaunt through multiple jurisdictions sufficient to dissuade even the most assiduous pursuit – instead of seeking to prevent and deter money laundering (and its underlying associated criminality and multiplicity of victims) at the earliest stage" (Lawyers ethics plugs leaky legislation, Pol, LawTalk, 28 April 2014).

Should there be greater information sharing between government agencies?

15. Yes.

16. For the same reasons noted above. The perceived distinction, for example, between tax evasion and other crimes is artificial. Crime is crime. Safeguards are important, in relation to privacy, misuse of information, etc, and the legislation should preserve them accordingly, but siloed information that reduces the capacity to detect serious crime – in much the same way that the New Zealand research illustrates the use of multiple professional facilitators by criminals specifically to take advantage of information siloes to minimise detection risk – is counter-productive to policy effectiveness.

17. The subsidiary issue noted at page 35 – of government agency supervisors unable to share information between themselves about reporting entities – is equally artificial. It is a self-created problem, generated by the multi-agency supervision model itself. In addition to the obvious duplication costs occasioned by multiple supervisors, it also illustrates a policy effectiveness drain which benefits criminals and, when serious organised crime continues undetected, imposes ongoing societal harm and economic cost on New Zealand communities exposed to the crime enabled by the patchwork system itself. Single supervisor. No issue.

18. Likewise, static information-sharing limited to isolated suspicious transaction reports enabling reactive, after-the-event investigative responses, as against the potential capacity for real-time operational information-sharing allowing crime detection and prevention agencies to operate effectively in detecting, prosecuting and deterring serious crime? This, surely, is a question that answers itself.

Sincerely,

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