NEW ZEALAND BANKERS ASSOCIATION

Submission

to the

Ministry of Justice

on the

Consultation Paper: Improving New Zealand's ability to tackle money laundering and terrorist financing

16 September 2016

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About NZBA

1. NZBA works on behalf of the New Zealand banking industry in conjunction with its member banks. NZBA develops and promotes policy outcomes that contribute to a strong and stable banking system that benefits New Zealanders and the New Zealand economy.

2. The following fifteen registered banks in New Zealand are members of NZBA:
   - ANZ Bank New Zealand Limited
   - ASB Bank Limited
   - Bank of China (NZ) Limited
   - Bank of New Zealand
   - Bank of Tokyo-Mitsubishi, UFJ
   - Citibank, N.A.
   - The Co-operative Bank Limited
   - Heartland Bank Limited
   - The Hongkong and Shanghai Banking Corporation Limited
   - JPMorgan Chase Bank, N.A.
   - Kiwibank Limited
   - Rabobank New Zealand Limited
   - SBS Bank
   - TSB Bank Limited
   - Westpac New Zealand Limited.

Background

3. NZBA welcomes the opportunity to provide feedback to the Ministry of Justice (**MoJ**) on its Consultation Paper: Improving New Zealand's ability to tackle money laundering and terrorist financing (**Consultation Paper**), which proposes the implementation of Phase Two of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (**AML/CFT Act**).

4. If you would like to discuss any aspect of the submission further, please contact:

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Executive Summary

5. The following submission sets out NZBA's feedback on matters in the Consultation Paper on which there is general industry consensus. NZBA members will provide their responses to the specific questions posed in the Consultation Paper in their own individual submissions.

6. NZBA supports the proposals to extend the AML/CFT Act to include those additional business sectors set out in Part 3 of the Consultation Paper.

7. NZBA submits the model of supervision that would deliver the best outcomes for New Zealand is the single supervisor model.

8. With regard to the proposal to expand reporting to the Police Financial Intelligence Unit (**FIU**), NZBA submits that further clarity around "suspicious activities" is required.

9. NZBA is generally in favour of the increased information sharing proposals, however has some comments on the circumstances in which information should be shared and some concerns about practicalities. NZBA also submits information should be able to be shared between reporting entities in appropriate and defined circumstances.

10. NZBA considers that the existing provisions allowing reporting entities to rely on third parties are sufficient and appropriate.

11. NZBA supports the scope of services provided by trust and company service providers being expanded to an "ordinary course of business" test.

12. NZBA submits that the Consultation Paper's simplified customer due diligence (**CDD**) proposals are appropriate, but should also extend to regulated foreign financial institutions carrying on business in low risk jurisdictions.

13. NZBA also wishes to raise a number of additional matters not covered in the Consultation Paper, namely:

    a. NZBA submits that the Amended Identity Verification Code of Practice 2013 (**IDVCOP**) should be reviewed.

    b. NZBA submits that the AML/CFT regime would benefit from a centralised public register of all reporting entities.

    c. NZBA submits that an AML/CFT Act exemption for debt securities quoted on a regulated exchange should be progressed as part of the Phase Two reforms.

14. Please see our substantive submissions below.

Part 3: Sector-specific issues and questions

NZBA supports the proposals to extend the AML/CFT Act to include additional business sectors

15. NZBA supports the inclusion of lawyers, accountants, real estate agents, conveyancers, high value goods dealers and additional gambling service providers as reporting entities under the AML/CFT Act. In the view of NZBA and its members, these businesses and professions potentially present an inherently high risk of money laundering and accordingly NZBA submits that it is appropriate for them to be subject to the AML/CFT Act.

16. To ensure consistency of application, NZBA submits that all provisions of the AML/CFT Act be applied to the additional businesses and professions, subject to any

clearly defined and regulated exceptions or exemptions. NZBA submits that any exceptions or exemptions approved should be consistent with ensuring the AML/CFT Act's principles remain intact, and its objectives continue to be achieved.

17. Enhancing our AML/CFT regime in this respect in line with FATF Recommendations is an important part of building New Zealand's reputation as a jurisdiction with a strong commitment to combatting money laundering and terrorist financing.

Part 4: Supervision

NZBA submits the model of supervision that would deliver the best outcomes for New Zealand is the single supervisor model

Problems with the current model: multi-agency supervision

18. In NZBA's experience, the Reserve Bank of New Zealand (**RBNZ**) is well placed to supervise AML/CFT Act compliance in the banking sector. In addition to having a deep understanding of the operating models of banks, the AML/CFT expertise within the AML/CFT supervisory function of RBNZ is of a very high standard.

19. Notwithstanding this, NZBA considers that the existing multi-agency supervisor model presents some challenges.

20. The division of supervisory responsibilities across RBNZ, the Financial Markets Authority (**FMA**) and Department of Internal Affairs (**DIA**) means that the publication of regulatory guidance to the industry is very slow. Timely regulatory guidance is extremely important for reporting entities seeking to comply with a new and rapidly developing regime.

21. NZBA members have also observed (both when their business groups are subject to different supervisors, and with their customers who are themselves reporting entities) various inconsistencies in the approaches to supervision across the three supervisors.

Preference for Alternative 1: single supervisor

22. NZBA considers New Zealand would benefit from moving to a single supervisor model. A single supervisor model would:

    a. ensure consistency of supervisory activities across all sectors and a "level playing field" for all reporting entities;

    b. support New Zealand's implementation of global best practice (from a supervisory perspective);

    c. facilitate supervisory responsiveness in a constantly changing AML/CFT environment;

    d. engender reporting entity trust in the supervisory framework (and by default in other reporting entities); and

e. support timely communication and updating of supervisor guidelines (including responsiveness to reporting entity queries and requests for clarification).

23. Taking into account international models, NZBA submits a model similar to the Australian Transaction Reports and Analysis Centre (**AUSTRAC**)[1] and the Financial Transactions and Reports Analysis Centre of Canada (**FINTRAC**) should be adopted in New Zealand.

24. The single supervisor should be mandated to reduce systemic money laundering risks and promote integrity and confidence in the New Zealand financial system.

25. NZBA submits that the establishment of a new, well-resourced, single AML/CFT supervisor will require investment and an extended period to successfully implement.

26. NZBA appreciates that the creation of a single supervisor will have resourcing and cost challenges. However, the fundamental goal of legislative reform should be to enhance the current AML/CFT regime. It is therefore important to look beyond short term establishment costs and consider the longer term benefits to New Zealand, and ensure an effective, equitable and sustainable model.

27. Whilst NZBA supports the current approach where reporting entities are not charged directly for AML supervision, it is clear that this approach will require review in light of the increased number and variety of reporting entities following implementation of Phase Two proposals. NZBA recommends that MoJ request an appropriate allocation of funds for the financing of a single supervisor model from the Proceeds of Crime Fund (per the Criminal Proceeds (Recovery) Act 2009) as part of this review.

28. If it were necessary due to implementation timeframes, an interim solution might be to bring new reporting entities into the regime under the temporary supervision of an existing AML/CFT supervisor, for example the DIA, while the new single supervisor framework is being established.

Transparency International UK Report

29. In support of the above submissions, NZBA wishes to specifically draw the MoJ's attention to a Transparency International UK report of November 2015 entitled "Don't Look, Won't Find: Weaknesses in the supervision of the UK's Anti-Money Laundering Rules".[2]

[1] However, we note AUSTRAC is also responsible for operating a secondary arm as Australia's Financial Intelligence Unit. NZBA submits that the FIU should remain within the New Zealand Police and independent of a single supervisor. NZBA submits that the same agency should not operate as both a supervisory function and an intelligence gathering function, as this model could potentially result in issues around separation of duties.

[2] http://www.transparency.org.uk/publications/dont-look-wont-find-weaknesses-in-the-supervision-of-the-uks-anti-money-laundering-rules/

30. The report is critical of the UK's supervisory model, which sees 27 sector agencies responsible for AML/CFT supervision in the UK. The report analysed 22 of the 27 supervisors, and the following was included amongst its findings:

    a. Of the 22 supervisors across all sectors, none are providing a proportionate or credible deterrent to those who engage in complicit or wilful money laundering.

    b. 20 of the 22 supervisors fail to meet the standard of enforcement transparency.

    c. Only 7 out of the 22 supervisors adequately control conflicts of interest between their private sector lobbying role and their enforcement responsibilities.

    d. The mish-mash regulatory structure undermines effective implementation of legislation and leaves the UK open to the threat of money laundering. It also presents an inconsistent, unclear and unhelpful environment for businesses that are intending to abide by the rules.

    e. During a 12 month period, the entire real estate sector submitted a total of 179 Suspicious Activity Reports (**SAR**), or 0.05% of all SARs in the UK. This was deemed to be very low when considering allegations that billions of pounds of corrupt money is used to purchase property in the UK.

    f. It recommended that a "radical overhaul" of the supervisory system be considered, including consolidating the number of supervisors into a "super" supervisor – similar to AUSTRAC and FINTRAC.

31. We strongly suggest that New Zealand would benefit most from its own "radical overhaul" of the supervisory model, moving to a single supervisor.

Least preferred option: Alternative 2: multiple agencies with self-regulatory bodies

32. NZBA submits that New Zealand would be setting itself up for a repeat of the UK experience if it adopted the second alternative model proposed in the Consultation Paper: multiple agencies with self-regulatory bodies.

33. Such a model would further contribute to the risk of inconsistent standards across industry sectors, reduce supervisor responsiveness to an ever changing AML/CFT environment, delay consultation processes and updates of regulatory guidelines, and promote the inefficient use of resources.

34. NZBA submits that industry professional bodies are not appropriate to take on supervisory roles due to inherent conflicts of interest, as well as material lack of experience in an AML/CFT regulatory environment. NZBA prefers visible independence and transparency.

Considerations should current model be retained

35. NZBA submits that, should the single supervisor model not be adopted, and the current model be retained, each company/group should be subject to a single

supervisor, even where their operations cross multiple areas. This will help to manage any overlaps or inconsistencies in supervisory approach.

Part 5: Implementation period & costs

Implementation timeframe

36. NZBA submits that businesses and professions under Phase Two should be allowed an implementation timeframe of two years.

37. NZBA submits that the implementation timeframe should commence once all relevant regulations have been gazetted.

38. NZBA submits that this approach is consistent with Phase One and will provide those businesses and professions under Phase Two with a reasonable timeframe to comply with the new requirements.

Part 6: Enhancing the AML/CFT Act

Proposal: expanded reporting to the Police FIU

Need for further clarity around "suspicious activities"

39. If the current requirement to report suspicious transactions is expanded to reporting suspicious activities, NZBA submits that:

    a. the words "suspicious" and "activities" should have clear definitions in the legislation;

    b. the legislation should clearly specify the type and amount of information reporting entities would be required to report to the FIU on customers under the suspicious activity definition;

    c. MoJ should engage with reporting entities to ascertain the practicalities of providing this additional information and potential system changes; and

    d. it will be necessary for the AML/CFT supervisor(s) to provide very clear guidance and examples/scenarios to assist reporting entities with the new requirement (including how a "suspicious activity" differs from a "proposed transaction" under section 40 of the AML/CFT Act, and what will and will not constitute "tipping off").

Proposal: information sharing

NZBA generally supports increased information sharing powers

40. NZBA is generally in favour of the increased information sharing proposals, however wishes to make the following comments about them:

a. Information sharing should only be permissible where it is reasonably necessary in order to meet the objectives of the AML/CFT Act, for example, to deter, detect or investigate money laundering.

b. In line with the above paragraph, NZBA does not support any proposal that would see AML/CFT supervisors being able to share AML/CFT related information with other government agencies that are not involved in the supervision, investigation or enforcement of AML/CFT related matters.

c. NZBA submits that, should information sharing powers be expanded, systems and/or processes should be implemented to ensure that reporting entities are not contacted by multiple different supervisors or government agencies, but rather are contacted by one centralised agency or supervisor only.

d. NZBA requests that MoJ clarifies what "real time operational information" means (on page 35 of the Consultation Paper).

Information about customers

41. NZBA submits the following in relation to the "Information about customers" proposals:

a. AML/CFT supervisors typically only receive very limited customer information from reporting entities in the course of carrying out their supervisory functions (for example, when sample customer files are provided in the course of examining a reporting entity's compliance with aspects of the AML/CFT Act). Rather, the larger beneficiary of customer information is the FIU (in the form of suspicious transaction reports). Accordingly, NZBA is unclear on the purpose of the proposal seeking to allow AML/CFT supervisors to share customer information with other government agencies. In this particular circumstance, NZBA submits that an AML/CFT supervisor should inform the reporting entity of their specific concerns, prior to any disclosure of any personal information to a government agency.

b. NZBA submits that appropriate safeguards must be in place to ensure the ability to share a person's personal information is not abused. NZBA submits there must be appropriate checks and balances implemented to ensure the 'reasonable grounds to suspect' test is met. NZBA submits that there should be specific legislation outlining the appropriate safeguards.

Information sharing between reporting entities

42. NZBA further submits that the AML/CFT regime would benefit significantly if reporting entities were able to share financial intelligence/customer information with other reporting entities (and indeed their own offshore counterparts) in appropriate and tightly defined circumstances. This would greatly enhance the ability of reporting entities to more accurately and effectively investigate suspicious activity where an activity or transaction that involves another reporting entity occurs.

43. In support of this submission, NZBA notes section 314(b) of the USA Patriot Act provides US financial institutions with the ability to share information with one another in order to better identify and report potential money laundering and terrorist

activities. Financial institutions must establish and maintain procedures to safeguard the security and confidentiality of shared information, and must only use shared information for strictly limited purposes.[3]

Proposal: reliance on third parties

44. NZBA considers that the existing provisions allowing reporting entities to rely on third parties (including agents, other reporting entities and other members of a designated business group) are sufficient and appropriate to assist a reporting entity in meeting AML/CFT Act obligations. Rather than any changes to the third party reliance provisions, NZBA recommends a change to the IDVCOP to allow greater flexibility when certifying documentation (please see paragraph 49.b below).

45. NZBA further submits that the current third party reliance provisions provide sufficient flexibility for reporting entities to meet various AML/CFT obligations. NZBA would be concerned if the current third party reliance provisions were extended to simply allow one reporting entity to rely upon another reporting entity in the absence of any written agreement or consent.

Proposal: trust and company service providers

46. In order to ensure a level playing field across all reporting entities, NZBA supports the scope of services provided by trust and company service providers being expanded to an "ordinary course of business" test rather than the existing "only or principal part of business" test.

Proposal: simplified customer due diligence

47. NZBA supports the proposal to extend simplified CDD to State Owned Enterprises (**SOEs**) and majority-owned subsidiaries of publicly traded entities in New Zealand and in low risk overseas jurisdictions. NZBA submits that low risk overseas jurisdictions should be all countries except for those listed by the FATF on its website as high-risk and non-cooperative jurisdictions.

48. NZBA submits that it would also be appropriate to extend simplified CDD to regulated foreign financial institutions operating in low risk overseas jurisdictions. Examples of these institutions are banks that are regulated for AML/CFT purposes in a low risk foreign jurisdiction but which are not publicly listed on an overseas exchange. There is typically a large amount of publicly available information that exists as to their management and ownership structures, and, from a money laundering perspective, these institutions are generally considered as having more effective policies, procedures and controls due to their regulated nature.

Additional submissions on other AML/CFT matters not covered in the Consultation Paper

[3] A useful factsheet relating to section 314(b) can be found at the following link: https://www.fincen.gov/statutes_regs/patriot/pdf/314bfactsheet.pdf

Review of Amended Identity Verification Code of Practice 2013

49. NZBA submits that the IDVCOP should be reviewed. Specifically:

    a. It would be helpful if the IDVCOP provided guidance on address verification. Address verification has proven problematic, and NZBA requests guidance to help ensure consistency of approach.

    b. Part 2 of the ICVCOP provides that the trusted referee must not be "a person involved in the transaction or business requiring the certification" (10(d)). NZBA submits this should be amended to allow internal lawyers (who hold practising certificates) within the business requiring the certification to certify documents. NZBA further submits that internal accountants should also be considered (while acknowledging this section was specifically changed between the 2011 and 2013 versions of the IDVCOP). If supervisors do not consider the suggested broad approach is appropriate, NZBA submits it could be limited to entities that qualify for simplified CDD.

    c. The IDVCOP provides a suggested best practice for conducting name and date of birth identity verification on customers (that are natural persons) who have been assessed to be low to medium risk. The rationale for limiting the process to low to medium risk customers is not stated. NZBA submits that it is the integrity of the identity verification process, rather than the risk rating of the customer, that is relevant. There is no reason therefore why the revised verification process could not be extended to include customers assessed to be high risk.

    d. When certification occurs overseas, the IDVCOP currently requires that copies of international identification provided by a customer resident overseas must be certified by a person authorised by law in that country to take statutory declarations or equivalent. NZBA submits that this requirement can be time-consuming, cumbersome and costly to the customer, who may be obliged to locate such an authorised person, arrange an appointment, travel to his/her offices and then pay a fee (which in some instances is not insignificant) for such certification services. There is however no assurance that such a process is superior in terms of integrity or authenticity than the use of "offshore certifiers" who are appropriately-trained staff of an international banking network. NZBA submits that the IDVCOP should recognise the global network available to international banks and the corresponding customer benefits, and be updated to include such offshore certification.

    e. Part 3 of the IDVCOP, which relates to Electronic Identity Verification, is dated and lacks detail. This has resulted in considerable inconsistencies in approach.

Register of reporting entities

50. NZBA considers that New Zealand's AML/CFT regime would benefit from a centralised public register of all reporting entities. This would benefit AML/CFT supervisors as well as reporting entities seeking to place reliance on each other for various aspects of the AML/CFT Act. The register should contain contact details of the AML/CFT Compliance Officer of each reporting entity.

Exemption for debt securities quoted on a regulated exchange

51. NZBA notes that some of its members have applied to MoJ for an exemption from the AML/CFT Act's requirements when they have issued regulatory capital debt securities to the public.

52. NZBA submits that a class exemption applying to any quoted debt securities should be progressed as part of the Phase Two reforms.