

# The ANTI-MONEY LAUNDERING & COUNTERING FINANCING OF TERRORISM Bill 2009

-the law & economics of financial crime-

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# OVERVIEW

- What is money laundering?
- What is being done in NZ?
- The international context: timeline, and underlying drivers of the reform
- The main obligations
- The risk based approach
- Differences with Australian legislation
- AML implementation
- Enforcement issues
- Economic analysis of crime, and of AML



# What is money laundering?

- “**Money laundering** is the practice of engaging in financial transactions in order to conceal the identity, source, and/or destination of money” (source Wikipedia)
- In other words, turning dirty money into clean money.
- Three main stages of money laundering:
  - ❖ **Placement** (placing proceeds of crime into the financial system)
  - ❖ **Layering** (moving the funds to other accounts or FI’s)
  - ❖ **Integration** (reintegrating the funds to appear legitimate – purchasing assets etc)

# A simple, but real, example in NZ

- A Latvian shell bank (“XYZ Union Bank”) operating a bogus insurance and tax scheme in NZ

## Placement

- Victims placed funds into a NZ bank account with a slightly different name omitting the word “bank” (“XYZ Union Management Ltd”)

## Layering

- Funds were moved through a number of different accounts at different NZ banks

## Integration

- Moved offshore, used in NZ to pay fees including legal fees

# So how does terrorist financing work?

- In many cases in almost the same way to AML except there is generally a lack of a profit motive.
  - ❖ **Placement** (potentially legitimate assets such as from charities, are deposited with a financial institution )
  - ❖ **Layering** (funds moved to other FI's or accounts to obscure the link between origin & destination)
  - ❖ **Distribution** (Funds are distributed to finance terrorist activities)
- The amounts involved need not be large – the 9/11 attacks cost less than US\$500,000 with US\$300,000 being deposited into the hijackers' bank accounts by various means.

# What's being done in NZ?

- Key NZ legislation dealing with AML & CFT:
  - ❖ Crimes Act, Misuse of Drugs Act, Proceeds of Crime Act, Mutual Assistance in Criminal Matters Act, Terrorism Suppression Act, Financial Transactions Reporting Act, Criminal Proceeds (Recovery) Act
- NZ is one of the last OECD countries to implement enhanced legislation around AML/CFT
- Failure to implement to international (FATF) standards will adversely risk NZ's international reputation

# The international context: timeline

## The path to law reform (to date):

- FATF membership (and 40+9 recommendations)
- FATF country review in 2003 (critical of NZ, as FTRA not fully compliant)
- Ministry of Justice – 3x discussion papers, but overall 2003 – 2009, little has changed
- Oct 2008, consultation draft of legislation
- 2009, FATF visit New Zealand again, new Criminal Proceeds (Recovery) Act goes through Parliament
- June 2009, AML/CFT Bill introduced into House (tranche one)

# Time frame & implementation process

- August 2009, written submissions to Select Committee closed
- Select Committee has also heard days of oral submissions
- 15 September, Select Committee due to report back to Parliament
- Second & Third readings in Parliament during October (and FATF mutual evaluation report released)
- October 2009, likely enactment of tranche one legislation
- Late 2010, likely date for tranche two legislation to be introduced
- 2011, likely effective date for new regime for tranche one

# The international context (2): underlying drivers of the law reform

What are the real drivers demanding tougher regulation?

- ❖ International peer pressure (FATF mutual evaluation revisited NZ's compliance in 2009, report due October may not be pretty)
- ❖ By-product of globalisation and the seamless international financial system
- ❖ Desire not to be the weakest link in financial chain
- ❖ Growing awareness of Pacific issues (Vanuatu) and domestic issues (Methamphetamine proceeds)

NZ HAS to play legal 'catch-up' ...

BUT – try not to kill the industry with cost while doing so.

# Affected industries – scope of the Bill

1. Initial tranche of the legislation (financial institutions known as a “reporting entity”)
  - registered banks
  - non bank deposit takers (includes finance companies, building societies & credit unions)
  - life insurers
  - issuers of securities
  - futures dealers
  - funds managers
  - brokers
  - financial advisers
  - money changers and money and value transfer services
  - casinos
2. Subsequent tranches of the legislation
  - Racing Board (TABs), lawyers, conveyancers, accountants, real estate agents, jewellers

# The supervisors

The Bill proposes three regulators/supervisors:

## **Reserve Bank**

Banks

Life insurers

Non-bank deposit  
takers

## **Securities Commission**

Issuers of securities

Trustee companies

Futures dealers

Collective  
investment schemes

Brokers

Financial advisors

## **Dept. of Internal Affairs**

Casinos

Non-deposit-taking  
lenders

Money changers

Default supervisor

# The main obligations

- The main obligations under the Bill:
  - Implement an AML/CFT programme
  - customer due diligence (including PEPs)
  - Transaction monitoring and ongoing CDD
  - Record keeping for at least 5 years
  - Train & vet staff
  - Suspicious transaction reporting



# AML/CFT Programme

- Reporting entities must establish, implement, maintain and regularly audit (every 2 years) an AML/CFT programme incorporating policies, procedures & internal controls reasonable designed to assure compliance with the Bill.
- Appoint an AML officer
- Must undertake an assessment of the risk of money laundering in respect of their business prior to undertaking CDD and establishing an AML/CFT programme
- AML/CFT programme audit to be carried out by an independent party (can include internal audit) that is suitably qualified

# AML/CFT programme – cont.

- Must have an effective programme to vet:
  - Senior managers
  - AML compliance officer
  - Any employee engaged in AML related duties
- Must train the following on AML matters
  - Senior managers
  - AML compliance officer
  - Any employee engaged in AML related duties
- Must keep written findings relating to
  - Unusually large or complex transactions
  - Unusual patterns of transactions with no apparent economic purpose
  - Any other activity that may relate to ML
- And more....

# Customer Due Diligence

- Some prescription in the Bill around this
- Reporting entities must conduct CDD on
  - Customer
  - Any beneficial owner of a customer (what % constitutes a beneficial owner?)
  - Any person acting on behalf of a customer
- Types of CDD are
  - Standard CDD
  - Simplified CDD
  - Enhanced CDD

# Standard Customer Due Diligence

- When business relationship established with a new customer
- Customer seeks to conduct an occasional transaction
- If you suspect AML or CFT is involved
- If you reasonably suspect the customer is not who they say they are
- For existing customers:
  - Change in business relationship
  - Doubts raised as to original CCD documents or data
  - Suspect that the transaction involves AML or CFT
  - Believe that in relation to the level of risk, the entity has insufficient information on the customer
- Must have sufficient information on the nature & purpose of the proposed business relationship
- Have sufficient information to determine whether they need to be subject to enhanced CDD

# Standard Customer Due Diligence

What do you need?

- Full name
- DOB
- Person's relationship to customer (if not the customer)
- Address or registered office
- Company registration number
- Any information required by regulations
- Any other information, based on the risk, that could be reasonably obtained

# Simplified Customer Due Diligence

- Only require simplified CDD if the customer is:
  - A listed company
  - Govt. Dept.
  - Local govt. body
  - NZ Police
  - NZ SIS
  - Any other entity specified in the regulations
- If a person acts on behalf of an existing customer and CDD has already been undertaken on the customer

# Simplified Customer Due Diligence

What do you need? For a person acting on behalf of the customer:

- Full name
- DOB
- Person's relationship to customer (if not the customer)
- Any information required by regulations
- Any other information, based on the risk, that could be reasonably obtained

# Enhanced Customer Due Diligence

Enhanced CDD required when customer is:

- Trust or other vehicle for holding personal assets
- Non-resident customer from a country that has insufficient AML systems (how do we know what those countries are?)
- Company with nominee shareholders or shares in bearer form
- Unusually large or unusual pattern of transactions that have no apparent or visible economic or lawful purpose (transaction monitoring?)
- When reporting entity considers that level of risk is sufficient to apply enhanced due diligence
- PEPs – both domestic & foreign
- Involved with new or developing technologies and products that might favour anonymity
- Other requirements relating to wire transfers and correspondent banking

# Enhanced Customer Due Diligence

What do you need to do:

- Identify source of customer's funds, ensure that it is current & correct
- Take reasonable steps to verify beneficial owner's identity
- Verify identity of persons acting on behalf of customer
- Take all reasonable steps to verify source of wealth or funds of customer
- Anything else required by regulations

# If CDD is not carried out

- Must not establish a business relationship with customer
- Terminate any existing business relationship
- Not carry of any transactions for the customer
- Consider making a STR



# Suspicious Transaction Reporting

- No major change to current FTRA
  - Reasonable grounds to suspect that transaction may be relevant to a ML offence, relevant to the enforcing the Misuse of Drugs Act, relevant to Terrorism Suppression Act, relevant to Proceeds of Crime or Criminal Proceeds (Recovery) Acts.
  - Financial transactions (wholly or in part) are not legally privileged
- How do you identify those transactions?

# The 'risk based approach'

- Standard 'regulatory' theory – allow affected parties discretion to assess risk and act accordingly
- Can lead to uncertainty – need minimum level of prescription
- Does the Bill seriously dilute the 'risk based approach'?
  - “A reporting entity must, according to the level of risk involved, ...”  
*(Risk Based Approach)*
  - ... and according to “any other [information/circumstances/verification/requirements] of the Regulations or Codes of Practice”  
*(more prescriptive - when eventually set?)*
- Purpose statement (s3) and additional objective:  
To achieve all this at minimum cost via an AML/CFT framework that is appropriate to NZ's financial system, compatible with overseas frameworks (espec. Australia), and incorporates a risk based approach.  
*... easy, then?*

# Differences between Australian legislation & the NZ Bill

- Many similarities but also a number of differences
- Although largely risk-based, NZ's Bill has more prescription than our neighbours
- Expect to see far closer harmonisation in the final legislation (in line with current govt. policy push)
- In summary:

# Differences between Australian legislation & the NZ Bill

Australia	NZ
1 regulator	3 regulators
Designated services	Designated industries
Customer identification based on the level of AML/CFT risk	Largely prescribed (3 levels of CDD)
PEPs not defined	PEPs defined
Records kept for 7 years	Records kept for 5 years
Beneficial ownership defined (25%)	Beneficial ownership not yet defined
Re-identification linked to reporting of STRs	Broad requirements of when to re-identify existing customers

# Implementation issues

- Lack of expertise/knowledge
- Where do they start?
- Costs
- How do they manage their data requirements
- How do they engage with the regulator
- Do they understand that this is really a cultural and business process change issue?
- Don't wreck the brand both with the regulator and with their clients.

# 6 key messages for AML implementation

1. Implementation will cost more and take longer than they think
2. It is a regulatory cost of doing business, business benefits are negligible
3. The greatest return on expenditure is in effective training programmes
4. The quality of data is paramount and likely to be their biggest challenge
5. Don't over engineer – go for the Holden Barina approach (what you need to do not what you like to do)
6. Utilise & enhance existing processes as far as possible (i.e. “100 point check”).

# Enforcement and liability

- Mixture of civil & criminal liability
- Strict or absolute criminal liability
  - New criminal enforcement (at quite a low level)
  - Strict/absolute liability; few defences available
- Liability for senior managers
  - ‘senior managers’ now personally responsible
  - Broad reach of criminal liability, for what may be in truth an organisation or system failure

# Enforcement and new regulator issues

- Wide ranging, intrusive investigative powers to supply records, information, oral testimony
- Search and seizure powers, obtaining a warrant on reasonable belief there may be evidence of offence
- Can make 'on site' inspections and audits
- Can seek mandatory 'performance injunctions' and restraining injunctions
- Multi-supervisor model – how to ensure consistency across regulated sectors?
- Steep learning curve for regulators (e.g. Reserve Bank), as well as industry – could be a flood of initial STRs

# Extending the scope of 'reporting entities'?



## Investigators say meth ring used comic books to clean cash

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DENVER - Investigators believe two brothers bought collector comic books to launder money for a million-dollar drug ring.

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Investigators say they seized at least \$500,000 worth of comic books when they arrested 29-year-old Aaron Castro of Commerce City and 30-year-old Alfonzo Castro of Denver, according to Colorado Attorney General John Suthers.

Suthers says the two were part of a bust of a massive methamphetamine ring in which 41 suspects have been indicted. Only one is still at large and of those arrested, Suthers says 19 of them are suspected of violating the Colorado Organized Crime Act.

"The dismantling of this methamphetamine ring is a significant victory for the people of Colorado," Suthers said. "Methamphetamine fuels a great deal of crime in

Colorado, including roughly two-thirds of the identity thefts in the state."

Some of the comic books were first edition Superman and Batman publications encased in protective plastic covers, Adams County District Attorney Don Quick said.

"It was their intent to launder money, and their choice was collector comic books," Suthers said.

"It appeared as [though] they were working on a startup company for high-end comic books," Quick said.

One of the comic books was worth about \$3,500.

The ring imported and distributed as much as 100,000 doses of meth each month, collecting about \$500,000, Suthers said.

Women acting as "mules" would insert the drugs into their vaginal cavities to ferry the drugs to houses throughout the metro area where it would be sold, authorities said.

"It's a tawdry piece of information, but it's a big part of what this group was doing," Suthers said.

# Economic analysis of crime, and AML

- *Becker* (1968) – ‘Crime and punishment: an economic approach’
- An economic analysis of crime and of criminal sanctions: modelling the rational behaviour of a calculating, professional money launderer:
  - Raise expected costs of crime so as to exceed benefit/utility
  - Probability of detection/conviction; severity of punishment
- Modern literature – e.g. *Ferwerda* (2008) – international co-operation is most powerful policy influence on reducing crime
- AML law shifts the enforcement cost from central govt (the Police) to the financial community (detection agents)
  - Lower cost to enforce AML law against banks and FI’s for not detecting and reporting, than cost of detecting directly the drug dealers or underlying criminal activity

# Questions? Comments?

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